

**ISTISNĀ' FINANCING AS PRACTISED IN MALAYSIA AND
RELATED ISSUES**

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**DISSERTATION SUBMITTED IN FULFILLMENT OF THE
REQUIREMENTS FOR THE DEGREE OF
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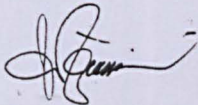
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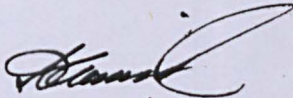
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ABSTRACT

Dedication to.....

*My mother Saudah Muhammad, my father Ilias Ismail, my
husband Azhan Ahmad
and my daughter Izzah Suffiah*

may Allah bless you for your everlasting support and understanding

ABSTRACT

At present, Islamic banking in Malaysia has become very significant in catering to the needs of Muslims in getting Sharī'ah-compliant financing. In the construction and manufacturing sectors, istiṣnā' contract is deemed the most appropriate. Nevertheless, its application has been altered to suit the modern financing requirements. In so doing, several original principles of this type of sale contract have also been modified resulting in differences of opinion among international Muslim scholars as to its validity. Hence, this dissertation intends to study the original principles of istiṣnā' contract, its current application in Malaysia and also relevant issues regarding its application especially in term of its conformity to Sharī'ah principles. The result of this research shows that istiṣnā' contract in Malaysia still requires further study by our local scholars.

ABSTRAK

Dewasa ini, perbankan Islam adalah amat penting untuk memenuhi kehendak orang Islam bagi mendapatkan pembiayaan yang menepati Syariah. Dalam sektor pembinaan dan pembuatan, kontrak istisnā' dianggap sebagai kontrak yang paling sesuai. Walaubagaimanapun, aplikasinya telah diubahsuai untuk disesuaikan dengan kehendak pembiayaan semasa. Proses ini menyebabkan beberapa prinsip asas kontrak ini diubahsuai dan ini membawa kepada berlakunya perselisihan pendapat di kalangan sarjana Islam antarabangsa tentang kesahihannya. Oleh yang demikian, disertasi ini bertujuan untuk mengkaji prinsip asal kontrak ini, aplikasinya pada masa sekarang dan juga beberapa isu yang berkaitan terutamanya dari segi pematuhan Syariah. Hasil kajian ini menunjukkan bahawa aplikasi kontrak ini di Malaysia masih memerlukan kajian yang lebih mendalam oleh sarjana tempatan.

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May Allah, The Exalted, reward us for our good efforts and may He guide us to the Straight Path, save us from the Hellfire and admit us by His mercy into Paradise.

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LIST OF RESOLUTIONS AND FATĀWA

Resolution of the Securities Commission Syariah Advisory Council during its 7th meeting held on 1st December 1995

Resolution of the Securities Commission Syariah Advisory Council during its 10th meeting on 16th-17th October 1997

Resolution of the Securities Commission Syariah Advisory Council during its 20th meeting on 14th July 1999

Resolution of the Securities Commission Syariah Advisory Council during its 20th meeting on 14th July 1999 and 30th meeting on 8th November 2000

Islamic Fiqh Academy Resolution No. 64 (7/2) made during its seventh session held on 7-12 Zulqa'īdah 1412H / 9th -14th May 1992

Islamic Fiqh Academy Resolution no. 65 (7/3) made during its sixth session held on 7-12 Zul qa'īdah 1412H / 9th -14th May 1992

Islamic Fiqh Academy Resolution No. 109 (12/3) made during its 12th session held on 25 Jamādīl Ākhīr – 1 Rejab 1421H / 23rd -28th September 2000

LIST OF CIRCULARS, GUIDELINES, STATUTES AND STANDARD

Bank Negara Malaysia circular dated 10th December 1998

Bank Negara Malaysia circular dated 13th January 2004

Banking and Financial Institutions Act 1989

Banking and Financial Institutions (Acquisition and Holding of Shares and Interests in Shares)(Licensed Bank, Licensed Finance Companies and Licensed Merchant Banks) Regulations 1991

Banking and Financial Institutions (Trading by Licensed Bank, Licensed Finance Companies and Licensed Merchant Banks) Order 1994

Capital Adequacy Standard for Institutions (Other Than Insurance Institutions) Offering Only Islamic Financial Services dated December 2005

Guidelines on Offering of Islamic Securities dated 26th July 2004

Housing Development (Control And Licensing) Act 1966

Housing Development (Control And Licensing) Regulations 1989 (Amended 2003)

Islamic Banking Act 1983

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LIST OF ACRONYMS

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
ALQ	Arab Law Quarterly
Art.	Article
Assoc. Prof.	Associate Professor
BAFIA	Banking and Financial Institutions Act 1989
BBA	<i>Bay' bithaman ājil</i>
Bhd.	Berhad
BNM	Bank Negara Malaysia
CERT	Centre for Research and Training
Co.	Company
Dr.	Doctor
edn.	Edition
etc.	Et cetera
H	Hijrah
HDA	Housing Development (Control And Licensing) Act 1966
HDR	Housing Development (Control And Licensing) Regulations 1989 (Amended 2003)
i.e.	That is
IBA	Islamic Banking Act 1983
ibid.	Ibidem
IIMM	Islamic Interbank Money Market
IIUMLJ	International Islamic University Malaysia Law Journal
INCEIF	International Centre for Education in Islamic Finance
IPA	<i>Istiṣnā'</i> Purchase Agreement
IPDS	Islamic Private Debt Securities
ISA	<i>Istiṣnā'</i> Sale Agreement

KLIBOR	Kuala Lumpur Interbank Offer Rate
MLJ	Malayan Law Journal
no.	Number
Op.cit	Opus citatum
p.	Page
pp.	Pages
r.a.	Raḍiyāllahu ‘anhu
RM	Ringgit Malaysia
S.	Section
s.a.w.	<i>Ṣallallāhu ‘alayhi wa sallam</i>
s.w.t.	<i>Subhānahu wa ta‘ālā</i>
SAC	<i>Sharī‘ah</i> Advisory Council
SC	Securities Commission
Sdn. Bhd.	Sendirian Berhad
ShC	<i>Sharī‘ah</i> Committee
SPV	Special Purpose Vehicle
Vol.	Volume

TRANSLITERATION GUIDE

<u>Arabic font</u>	<u>Transcription</u>	<u>Arabic font</u>	<u>Transcription</u>
ا, آ	: a, 'a	ط	: ṭ
ب	: b	ظ	: ḏ
ت	: t	ع	: 'a
ث	: th	غ	: gh
ج	: j	ف	: f
ح	: ḥ	ق	: q
خ	: kh	ك	: k
د	: d	ل	: l
ذ	: dh	م	: m
ر	: r	ن	: n
ز	: z	و	: w
س	: s	ه	: h
ش	: sh	ي	: y
ص	: ṣ	ة	: t
ض	: ḍ		

Short Vocal

َ	: a
ُ	: u
ِ	: i

Long Vocal

آ	: ā
و	: ū
ى	: ī

Diphthong

أو	: aw
أى	: ay
يَـ	: iy/ī
وِـ	: uww

CHAPTER 1

INTRODUCTION

1.1 RESEARCH BACKGROUND

One of the distinctive features of Islamic banking is that the underlying concept for financing offered to the customers is based on trading contract and not lending. At the outset of the establishment of Islamic banking in Malaysia, among the main reasons that motivated local financing institutions to form Islamic banks was the need to provide a banking facility for Muslims who are prohibited to deal in interest-based financial products. The purposes of the financing include home construction, personal financing, personal working capital and so on.

As the industry got on well to be competitive with the conventional banks, additional facilities are required such as sale of sukuk (Islamic bonds) and takaful (Islamic insurance) services. Financial institutions provide sukuk-based financing under a revolving structure. This is mainly because the former can continuously maintain a fixed flow of sukuk as financing for their need as business as well as to provide higher risk exposure. Since the sukuk is issued, it can be sold by the issuer at any time.

CHAPTER 1

INTRODUCTION

1.1 RESEARCH BACKGROUND

One of the distinctive features of Islamic banking is that the underlying contract for financing offered to the customers is based on trading contract and not lending. At the outset of the establishment of Islamic banking in Malaysia, among the well-known *Sharī'ah* contracts used in financing facilities are *bay' bithaman ājil* (hereinafter referred to as BBA), *bay' al-murābaḥah* (hereinafter referred to as *murābaḥah*) and *ijārah*. The purposes of the financing include home construction, project financing, personal, working capital and so on.

As the industries go on and to be competitive with its conventional counterpart, additional contracts are adopted such as *bay' al-istiṣnā'* (hereinafter referred to as *istiṣnā'*) and *bay' al-dayn*. Most Islamic financial institutions prefer sale-based financing rather equity-based financing. This is mainly because the former can contractually guarantee a fixed flow of income to them as compared to the latter which are perceived as having a higher risk exposure since the income as well as capital cannot be contractually guaranteed.

As far as home and project financings are concerned, the dominant type of contract is BBA. In summary, under the contract of BBA, one of the pillars to be fulfilled is that the asset must exist at the time of contract. In case of house under construction, at the time of applying the financing from the bank, the house is not yet in existence. At this stage, the customer is merely signing a sale and purchase agreement with the developer and this document is one of the requirements for applying financing from the bank. According to the current practice, what actually has been sold is the right arising from the beneficial ownership derived from the payment of 10% deposit to the developer. In case of house constructed by the customer on his own land, some banks will use the land as the underlying asset.

The mode of operation for BBA is that the bank will purchase the asset from the customer at a purchase price (cost price). Subsequently, the bank will sell it to the customer at a selling price which consists of cost and profit.

The above scenario for BBA applied in Malaysia is not acceptable by Middle Eastern scholars as it resembles *bay' al-'inah* which is considered as a trick to avoid *ribā*.¹ Furthermore, the subject-matter does not exist at the time of contract except the right arising from the beneficial ownership which recognition as a *māl* (property) is still questionable ?

¹ Usury, profit, or gain in excess of principal loan.

Such deficiency advocates Malaysian scholars to create a new product using a more appropriate contract i.e. *istiṣnāʿ*. Nevertheless, it is not a pure *istiṣnāʿ* as traditionally practised. It is called *istiṣnāʿ muwāzī* or parallel *istiṣnāʿ* whereby in brief, the bank enters into first *istiṣnāʿ* contract with a customer on the capacity as the supplier or contractor. Thereafter the bank will enter into a parallel *istiṣnāʿ* contract with the developer to construct the item which specifications are laid down by the ultimate purchaser or buyer under *istiṣnāʿ*.

Istiṣnāʿ can be aptly used as a financing tool in the area of house financing, project financing or manufacturing of aircraft, ships and so on so forth. The application of *istiṣnāʿ* is also extended to capital market instrument whereby it has been used as an underlying contract to create indebtedness prior to bond issuance.

Thus, this research aims at providing a detail discussion on the applicability of *istiṣnāʿ* contract as a financing mechanism in Malaysia and the arising issues as far as *Sharīʿah* compliance is concerned.

1.2 OBJECTIVES OF RESEARCH

This research aims at achieving the following objectives:-

1. To study the original concept of *istiṣnāʿ* contract as initially set up by the earlier leading jurists predominantly the Hanafis.
2. To study the evolvement of the application of *istiṣnāʿ* contract from a simple and basic transaction into a modern financing instrument.
3. To study different approaches adopted by Malaysian and other countries scholars in applying *istiṣnāʿ* as one of a new financing tool.
4. To study how the scholars have exercised *ijtihād* to create a new ruling to meet the present demand in establishing a *Sharīʿah* compliant financing device.
5. To study the application of *istiṣnāʿ* contract in various financing products in Malaysia.
6. To provide some recommendations in improving the current practice of *istiṣnāʿ* financing in Malaysia.

1.3 RESEARCH HYPOTHESES

The writer has made the following hypotheses:-

1. *Istiṣnāʿ* contract as elaborated in Islamic commercial transaction law is viable to be converted into a contemporary financing instrument to satisfy the market needs.
2. Some of the financing instruments structured based on *istiṣnāʿ* contract in Malaysia are *Shariʿah* compliant while the rest still require some modifications.

1.4 IMPORTANCE OF RESEARCH

This research is pertinent in view of the reasons mentioned below:-

1. This research significantly proves that *Shariʿah* is a complete code of law which does not merely confine its rules and disciplines to spiritual matters but also in the area of commercial transactions.
2. It evidently indicates that in the field of commercial transactions, *Shariʿah* is not rigid. On the other hand, it accepts changes and elastic so as to suit the present demand as long as the changes do not violate the fundamental *Shariʿah* principles.

3. House and project financing are two major areas requiring financing from banks and in great demand. Since they involve things which are not in existence at the time of contract, the application of *istiṣnāʿ* contract which complies with the *Sharīʿah* principles is inevitable to avoid from buying and selling things which do not exist based on normal sale contract.
4. This research will also assist those individuals who are directly involved in banking and financing industries to opt for a more appropriate contract in formulating the products and drafting legal documentations.
5. This research indirectly contributes towards enhancing local *istiṣnāʿ*-based products which consequently increase their value to be internationally acceptable.
6. Definitely, this dissertation will add to the number of researches and reading materials in respect of Islamic financing engineering especially which combines both the theoretical and practical aspects of *Sharīʿah* contract.

1.5 RESEARCH SCOPE

The research encompasses the study on the principles of *istiṣnāʿ* contract originally established by the traditional scholars consisting of the source of its legitimacy, pillars and conditions together with the differences of opinion among them in some aspects of *istiṣnāʿ* contract.

Next, the study continues with the application of this contract as a financing instrument in Malaysia not only pertaining to the *modus operandi* but also the salient terms of the contract. The research goes further by scrutinizing the application of *istiṣnāʿ* contract in Islamic private debt securities issue. After that, the writer has significantly compared the original mode of *istiṣnāʿ* and its application in Malaysia as well as some Middle Eastern countries. Lastly, the writer attempts to give some suggestions towards improving the applicability of this contract in Malaysia not only to ensure that it will be internationally recognised but more importantly valid in the eyes of *Shariʿah*.

1.6 LITERATURE REVIEW

It is positively difficult to find literatures which discuss about this type of contract as applied in Malaysian banking industry. This maybe attributable to the fact that other methods of financing such as BBA, *murābahah* and *muḍārabah* are prevailing and widely acceptable by industry players.

Muhammad al-Bashir Muhammad al-Amine considers the disputed legality of this type of contract by the early jurists as the probable reason why the application of this contract came rather late compared to other modes of investment.² According to him, academic discussion about this contract and its possible application into a modern mode of investment was initiated by Islamic *Fiqh* Academy in its seventh session where different papers were presented and important resolutions were adopted and similar discussion was held in Qatar in conjunction with the 22nd meeting of directors of investment in Islamic banks.³ He opines that *istiṣnāʿ* in its own right can play a leading role in Islamic banking system especially when major parts of the goods in commercial transaction are manufactured goods and due to flexibility of this contract and its secure aspect of investment.⁴

Engku Rabiah Adawiyah Engku Ali admits that the *istiṣnāʿ* arrangement practised in Malaysia is not the tripartite structure but rather the two-partite sale and buy-back arrangement which has been regarded by many jurists as amounting to *bayʿ al-ʿīnah*.⁵ According to her, it has been widely known that majority of classical and contemporary jurists forbade this kind of sale.⁶ With the inception of globalization and internationalization of the financial system, Islamic banking and finance will have to open up to the global market and

² Muhammad al-Bashir Muhammad al-Amine (2001), *Istiṣnāʿ (Manufacturing Contract) in Islamic Banking and Finance Law and Practice*, Kuala Lumpur : A.S Nordeen, p.1.

³ Ibid.

⁴ Ibid.

⁵ Engku Rabiah Adawiah bt Engku Ali, *Islamic Law Compliance Issues in Sale-Based Financing Structures as Practised in Malaysia*, [2003] 3 MLJ, p. lxx.

⁶ Ibid.

comply with the international *Sharī'ah* Standards for Islamic banking and financial practices.⁷ Her opinion that Malaysian market must consider reviewing their existing practice and choosing more acceptable practices is in agreement with the writer's view.

1.7 RESEARCH METHODOLOGY

The research was carried out via theoretical and fieldwork approaches mainly because the writer has to illuminate the original tenets of *istiṣnā'* contract and its practical adaptation in the modern financial systems in Malaysia.

1.7.1 Data Collection Method

a. Library research

This is one of the fundamental means adopted to gather various information and data relevant to this research. The sources include but not limited to *al-Qurān*, books on prophetic traditions, *fiqh*⁸ literatures based on diverse schools of law as well as the contemporary write-up on the *fiqh* and science of Islamic commercial transaction. The writer also accumulated the data from a range of *fiqh* resolutions whether locally such as resolutions of *Sharī'ah* Advisory Council (hereinafter referred to as SAC) of Securities Commission (hereinafter referred to

⁷ Ibid.

⁸ Generally refers to science of Islamic law

as SC), *Shari'ah* Committee (hereinafter referred to as ShC) of some local banks or internationally such as the one issued by Accounting and Auditing Organization for Islamic Financial Institutions (hereinafter referred to as AAOIFI) in the form of *Shari'ah* Standards and resolutions of Islamic *Fiqh* Academy.

The research has been carried out at these libraries:-

- 1) Law Library, University of Malaya.
- 2) Main Library, University of Malaya.
- 3) Islamic Study Academy, University of Malaya.
- 4) International Islamic University Malaysia Library.

b. Internet research

Other than that, the writer has also accessed to a number of websites to search for the related articles, statistics, newspaper archives, international *fiqh* resolutions and so on. Some of these websites are websites of several local banks, Bank Negara Malaysia (hereinafter referred to as BNM), Securities Commission, Islamic Finance, Islamic *Fiqh* Academy and so on.

c. Interview

Interview has been conducted mainly to know the actual implementation of *istiṣnāʿ* as one of the financing instrument in Malaysia whether it is completely similar to the original *istiṣnāʿ* or has been slightly modified and to what extent the contemporary jurists had innovatively transforming *istiṣnāʿ* into a practical financing mechanism. Some of the individuals who have been interviewed were:-

- 1) En. Hishamuddin Ab. Hamid,
Legal Executive, Company Secretarial and Legal Department,
Bank Muamalat Malaysia Berhad.
- 2) En. Ismail Nik,
Senior Executive, Islamic Banking and Takaful Department,
Bank Negara Malaysia.
- 3) Ustaz Azizi Che Seman,
Lecturer, Islamic Study Academy, University of Malaya.
- 4) En. Saifulzaman Ahmad,
Account Manager, Small Medium Entrepreneurship
Department, Bank Muamalat Malaysia Berhad.

1.7.2 Data Analysis Method

The data duly collected by way of library research, internet research and interview were meticulously scrutinized using the method of *istiqrā'*⁹ (inductive), *istinbāt*¹⁰ (deductive) and comparison. These three methods were repeatedly employed in the midst of writing and completing this research until the intended result was accomplished. Basically, these three techniques were utilized in elucidating the concept of *istiṣnā'* from traditional point of view, a present-day interpretation on this contract, its application as the underlying contract in financing products in Malaysia and a little bit of comparison points with its application in the Middle Eastern countries, issues arising therefrom as well as some suggestions for enhancement.

1.8 RESEARCH OUTLINE

Chapter One

The discussion will cover an introductory part relating to research background, research hypothesis, importance of research, research scope, literature review, research methodology and research outline.

⁹ This refers to a thorough scrutiny of a matter before a conclusive *ḥukm* (decision) is made on the matter. This method involves examining the application of general *dalīl* (evidence) on the related branches of the *ḥukm* and subsequently making exceptions, if any. See _____ (2002), *Resolutions of the Securities Commission Syariah Advisory Council*, Kuala Lumpur : Securities Commission, p.12.

¹⁰ This basically refers to a process of making a conclusion based on the preceding discussion.

Chapter Two

This chapter touches on the basic understanding on *istiṣnāʿ* contract as follows:-

- The definition of *istiṣnāʿ* by traditional and contemporary jurists
- Legitimacy of *istiṣnāʿ*
- Pillars of *istiṣnāʿ*
- Fixing date for delivery
- Nature of *istiṣnāʿ* contract
- The legal consequences of *istiṣnāʿ*
- Termination of *istiṣnāʿ* contract
- Differences of opinion between *Jumhūr* and the Ḥanafī vis-à-vis *istiṣnāʿ* contract
- *Istiṣnāʿ* in the *Majallah al-Aḥkām al-ʿAdliyyah* (hereinafter referred to as *Majallah*)
- *Istiṣnāʿ* according to Islamic *Fiqh* Academy
- Parallel *istiṣnāʿ* contract

Chapter Three

The writer will elaborate on *istiṣnāʿ* as a mode of financing in Malaysia with reference to banking products and also Islamic Private Debt Securities (hereinafter referred to as IPDS). The discussion will cover the areas of financing which suitably use this type of contract i.e. home financing and project financing including one with a revolving nature. In these three

categories, the writer has explained about their modus operandi and legal documentation involved. In the case of IPDS, the writer has an overview on IPDS in Malaysia, the process involved in bond issue in Malaysia and some examples of structures of bond issue based on *istiṣnāʿ* contract. Next, the writer gives some clarification on the newly introduced concept of *istiṣnāʿ* with floating rate mechanism.

Chapter Four

This chapter aims at analysing the compliance issues as far as the application of *istiṣnāʿ* contract as a financing instrument in Malaysia is concerned. The approach adopted is by contrasting the principles established by the earlier jurists and the resolutions made by scholars from other jurisdictions. Additionally, compliance with the current legislations will also be covered.

Chapter Five

The writer has listed down some suggestions to improve *istiṣnāʿ* financing as applied in Malaysia.

CHAPTER 2

CHAPTER 2

BASIC UNDERSTANDING ON *ISTIṢNĀ'* CONTRACT

2.1 INTRODUCTION

This part shall cover the essential explanation on *istiṣnā'* contract. This includes its definition, sources which support its legality, pillars composing the said contract together with the conditions which must be met to ensure its validity, its binding nature as well as the end result of this type of contract. The discussion also encompasses the juristic discourses concerning this type of contract particularly between the Hanafis and *Jumhūr* as well as *istiṣnā'* as laid down in the *Majallah* and Islamic *Fiqh* Academy resolutions.

2.2 DEFINITION OF *ISTIṢNĀ'*

Although there are a variety of ways in defining *istiṣnā'*, it carries some distinctive features which differentiate it from other types of contract. *Istiṣnā'* is derived from the word *ṣana'a* which means making, manufacturing or constructing something.¹¹ It occurs when someone invited, induced or caused another person to make or construct something.¹² The Ḥanafī jurists explain it as a contract with a manufacturer to make something or a contract

¹¹ Ibn Manẓūr, Muḥammad Ibn Mukarram (1955), *Lisān al-ʿArab*, vol. 8, Bayrūt : Dār Ṣādir, pp. 208-212.

¹² al -Zuḥaylī, Wahbah (1996), *al-Fiqh al-Islāmī wa Adillatuh*, vol.4, Damascus : Dār al-Fikr, p.631.

on a commodity on liability with a proviso of work.¹³ *Istiṣnāʿ* has been properly described as a sale transaction where a commodity is transacted prior to its existence.¹⁴ It is an order to a manufacturer to manufacture a specific commodity for the purchaser whereby the manufacturer uses his own material to manufacture the required goods.¹⁵ Another up-to-date definition elucidates *istiṣnāʿ* as a sale contract between *al-mustaṣniʿ* (the ultimate buyer) and *al-ṣāniʿ* (the seller), whereby *al-ṣāniʿ*, based on an order from *al-mustaṣniʿ*, undertakes to have manufactured or otherwise acquired *al-maṣnūʿ*¹⁶ (the subject-matter of the contract) according to specification and sells it to *al-mustaṣniʿ* for an agreed price and method of settlement whether that be in advance, by installments or deferred to a specific future time.¹⁷ It is a condition in *istiṣnāʿ* contract that *al-ṣāniʿ* should provide either the raw material or the labour or else it will become a contract of hire.¹⁸

To put it in a plain word, *istiṣnāʿ* is an exception to the general rule of non-permissibility of selling or buying goods which are not in existence. From the definition, we can conclude that *istiṣnāʿ* is basically a manufacturing or construction contract.

¹³ Ezzedine Mohd. Khodja and ‘Abdul Sattar Abū Ghuddah (2005), “Instrument of Islamic Investment : *Istiṣnāʿ* Sale” <http://www.albaraka.com/english/resource/instrument/chap1-4.html>, 5th January 2005.

¹⁴ _____ (2005), “Corporate-Structured Finance- *istiṣnāʿ*”, <http://www.meezanbank.com/en/ISTIṢNĀ.aspx>, 5th January 2005.

¹⁵ Ibid.

¹⁶ It can be commodity, service or both.

¹⁷ ‘Abdallah, Aḥmad ‘Alī, *The Juristic Rules of the Contract of Istiṣnāʿ and Parallel Istiṣnāʿ*, Accounting and Auditing Organization for Islamic Financial Institutions, , pp 2-8 as quoted in _____ (1424-1425H / 2003-2004), *Accounting, Auditing and Governance Standards for Islamic Financial Institutions*, Baḥrayn : Accounting and Auditing Organization for Islamic Financial Institutions, p. 316.

¹⁸ al-Zuḥaylī, (1996), *op.cit.*, p.631.

2.3 LEGITIMACY OF *ISTIṢNĀ'*

In Islamic law, something is not acceptable unless supported with substantial evidence whether from primary or secondary sources. *Istiṣnā'*, following the stringent requirement of sale contract is void because the subject-matter does not exist at the time of contract. This can be seen when the Prophet s.a.w. said to the effect that do not sell what you own not.¹⁹

Majority of jurists regard the legitimacy of *istiṣnā'* is on *bay' al-salam* (hereinafter referred to as *salam*)²⁰ and also on the basis of '*urf*' (custom) which was prevailing during the Prophet s.a.w. time.²¹ Therefore, it is subsumed under the definition of *salam* except the Hanafīs which treat *istiṣnā'* as an independent and distinct contract.²² Thus, it is well-accepted that this contract has been popularly promoted by the Hanafīs to the extent that it has been said to be the result of jurisprudential engineering of the Ḥanafī school as presented in the *Majallah* and the resolutions of the Islamic *Fiqh* Academy.²³

¹⁹ _____ (2006), Sunan al-Tirmizī, al-Buyū' 'an Rasūlillah, mā Jā'a fī Karāhiyyah Bay' mā Laisa 'Indaka, <http://hadith.al-islam.com/Display/Display.asp?Doc=2&Rec=2021>, 10th March 2006.

²⁰ *Salam* is a contract of sale of specific goods to be delivered later but the price is paid at the time the contract is entered.

²¹ Joni Tomkin Borhan, *Istiṣnā' in Islamic Banking: Concept and Application*, presented at 8th Annual Seminar on *Shari'ah* and Legal Aspects of Islamic Banking and Practice, 5th-6th November 2001, Crown Princess Hotel, Kuala Lumpur.

²² *opcit.*, <http://www.albaraka.com/res1c1d.htm>.

²³ _____ (1424-1425H / 2003-2004), *Accounting, Auditing and Governance Standards for Islamic Financial Institutions*, Baḥrayn : Accounting and Auditing Organization for Islamic Financial Institutions, p. 316.

As a matter of fact, the sources of validity of this contract can be traced from several reliable *aḥadīth* of the Prophet s.a.w. One of which is when the Prophet s.a.w. requested someone to manufacture a pulpit for preaching whereby it was narrated by Sahl r.a. to the effect that the Prophet s.a.w. sent someone to a woman telling her to order her slave, a carpenter to prepare a wooden pulpit for him to sit on.²⁴ Another occasion is in the case of finger ring whereby it was narrated by Anas bin Mālik r.a. that once the Prophet s.a.w. wrote a letter or had an idea of writing a letter. The Prophet s.a.w. was told that they (rulers) would not read letters unless they were sealed. So the Prophet s.a.w. got a silver ring made with "Muḥammad Allah's Apostle" engraved on it. As if I were just observing its white glitter in the hand of the Prophet s.a.w.²⁵

The Hanafis have endorsed *istiṣnāʿ* contract on the basis of *istiḥsān* (equity).²⁶ There are several reasons to support their view. Firstly, *istiṣnāʿ* has been widely practiced by people without denunciation and this consequently establishes a case of *ijmāʿ*.²⁷ They relied on the *ḥadīth* of the Prophet s.a.w. to the effect that what is seen good by Muslim, is considered good by Allah.²⁸

²⁴ Bukhārī, Muḥammad Ibn Ismāʿīl, (1980), *Ṣaḥīḥ al-Bukhārī : The Translation of Ṣaḥīḥ al-Bukhārī Arabic-English Version*, vol. 1, Bayrūt : Dār al-Fikr, *kitāb al-ṣolāt*, *ḥadīth* no. 439, p. 262.

²⁵ _____ (2005), "Translation of *Ṣaḥīḥ Bukhārī*, Book 92, vol. 9, no. 401", <http://www.usc.edu/dept/MSA/fundamentals/hadithsunnah/bukhari/003.sbt.html#001.003.065.>, 22nd January 2005.

²⁶ *Istiḥsān* means to ignore a ruling that has *dalīl* over a matter and substituting it with another *dalīl* which is better based on *Syaraʿ*.

²⁷ It means consensus agreement among the scholars of the Muslim community on *Sharīʿah* rulings enforced during a particular period of time after the demise of the Prophet s.a.w.

²⁸ The *ḥadīth* is not genuine. It is just the saying of Ibn Masʿūd reported by Aḥmad, a-Bazzār and al-Ṭabrānī. See al -Zuḥaylī (1996), *op.cit.*, p.632.

Secondly, the validity of *istiṣnāʿ* is strongly supported by the fact that people are undeniably in need of this kind of contract. Indeed, people always require goods which are not available in market which suit their specification and thus they have to enter into this contract to have those goods manufactured for them.²⁹ *Istiṣnāʿ* is also valid corresponding to the general rule of permissibility of contracts as long as this does not contravene any text or rule of *Sharīʿah*.³⁰ Furthermore, there is a legal maxim to support this view that is in matter relating to transactions, the original state of things is permissibility.³¹

Some contemporary *fuqahaʿ* are of the view that *istiṣnāʿ* is valid on the basis of *qiyās*³² and the general rules of *Sharīʿah*. The argument is that although the subject-matter in this contract does not exist at the time of contract, it is compensated for by its preponderant existence at the time of delivery in the future. Then, it is a legal contract and any contract which is free from excessive risk or *gharar*³³ is a contract in accordance with *qiyās*.³⁴

²⁹ al-Sarakhsī, Muḥammad Ibn Aḥmad (2001), *al-Mabsūṭ*, vol. 11-12, Bayrūt : Dār al-Kitāb al-ʿIlmiyyah, pp. 165-166.

³⁰ ʿAbdallāh, Aḥmad ʿAlī, *op.cit.*, pp. 17-27 as quoted in *Accounting, Auditing and Governance Standards for Islamic Financial Institutions*, *op.cit.*, p. 317.

³¹ *Majallah*, Art.5.

³² It refers to equating an original *ḥukm* (rule) having explicit legal text with a new matter having no *naṣ* (evidence) but possessing the same *ʿillah* (cause).

³³ Literally it covers several negative elements such as deceit, fraud, uncertainty, danger, risk etc. that might lead to destruction and loss.

³⁴ al-Ḍarīr, Ṣiddīq Muḥammad al-ʿĀmīn (1995), *al-Gharar wa Atharuhu fī al-ʿUqūd fī al-Fiqh al-Islāmī: Dirāsah Muqāranah*, Jeddah : Majmūʿat Dāllah al-Barakah, Idāratal Taḥwīr wa al-Buḥuth, p.466.

2.4 PILLARS OF *ISTIṢNĀ'*

To be valid and enforceable, all pillars of *istiṣnā'* contract must exist and the prerequisite for each pillar must be satisfied with. The pillars follow those of ordinary sale contract ³⁵ with some exceptions especially in respect of the subject-matter.³⁶ The pillars of *istiṣnā'* contract are as follows:-

- *Ījāb wa qabūl* (offer and acceptance)
- *Al-muta'āqidāni* (parties to the contract)

The parties consist of the *al-ṣāni'* (manufacturer) and the purchaser (*al- mustaṣni'*)

- *Al-mustaṣni'* *'alaih* (subject-matter). For *istiṣnā'* contract, the requirement of existence of subject-matter at the time of contract is waived but there are certain conditions attached to it which must be fulfilled.
- *Al-thaman* (price)

2.4.1 OFFER AND ACCEPTANCE

Both offer and acceptance can be expressed either orally, in writing or by conduct. The parties are free to use whatever modes of expression

³⁵ Also known as *Bay' al-Muṭlāq*.

³⁶ This explains why the discussion pertaining the first two pillars of *istiṣnā'* contract is more or less similar to those of ordinary outright sale.

duly recognized by custom.³⁷ As far as the nature of statement to be used, Islamic law does not confine certain specific statement but the parties are free to use whatever statements as long as they are indicative of mutual consent of the parties to the contract. This is attributed to the fact that the core principle in the contract is consent.³⁸ However, it is wise to put the offer and acceptance as well as other terms and conditions in writing if the contracts involve a huge amount of money to avoid future dispute.

In Islamic commercial law, there is a requirement known as *majlis al-‘aqad* (session of contract) whereby both the offer and acceptance are to be jointly linked in one single session without any gap whether in time or place. To meet this condition, the parties must ensure that the session occurs in any place where the parties convene for the purpose of establishing the contract. The session illustrates the unity of the time and place which is essential to demonstrate the twofold intention and consent.

The above issue has been agreed upon by all schools of law. This will consequently means that certain disruption during the session such as stopping to pray, or discussing other subjects, changing positions or attitudes, or even falling asleep are held to terminate the session and

³⁷ *Majallah*, Art.173 and Art.174.

³⁸ As mentioned in *Sūrah al-Nisā’* (4:29) which states to the effect “O you who believe! Eat not up your property among yourselves unjustly (*bil bāṭil* i.e by falsehood and deception) except it be trade amongst you, by mutual consent.”

therefore the offer. This will also indicate that the acceptance should be immediate. Nevertheless, before the offeree accepts the offer, the offeror may withdraw his offer. This brings us to another principle of Islamic commercial law i.e. the notion of *khiyār al-majlis*. This means the right to revoke the concluded offer and acceptance, provided both the parties are still available in the session of the contract. If both of them left the session, the right to do so ceases to exit. However, the jurists are varied among themselves as what constitutes the session. Hence, it is submitted that it is more appeal to customary practice of any society to decide on the separation from the session of contract.³⁹

Classical Islamic law seemed to insist on the notion of contracts inter presenters in the sense that the contracting parties should hear other's declaration which is, it is respectfully submitted, devoid of legal relevance.⁴⁰ This is because, the contracts inter absentees by means of representatives or modern communication systems such as the telephone, telex, fax, e-mail, letter are equally valid provided they are performed in one single session of contract.⁴¹

³⁹ Mohd. Daud Bakar (_____), *Contracts in Islamic Commercial and Their Application in Modern Islamic Financial System*, International Islamic University Malaysia, p.3.

⁴⁰ Ibid.

⁴¹ Ibid.

2.4.2 PARTIES TO THE CONTRACT

It is crucial to ensure that the parties to a contract are legally competent to enter into a contract. The competence to transact in Islamic law is measured mainly by two aspects, namely prudence and puberty. In this respect, Allah said to the effect “Prove orphans till they reach the marriageable age; then if you find them with sound judgment, deliver over unto them their fortune.”⁴²

Capability of the parties to enter into a contract is a core ingredient to ensure its validity. According to Islamic law, no person can legally conclude a transaction without first having attained physical and intellectual maturity. A person is recognized to enjoy full capacity, once he reaches physical *bulūgh* (puberty) and possesses sound judgment in financial matters also known as *rushd* (prudence). Another additional condition for majority according to the Shafī’is school of law is sound judgment in the matters of religion.

There are few signs in determining puberty though there are some juristic differences in this regard. For boys and girls, the signs are firstly, the appearance of coarse hair around the sexual part of the body although this sign is not significant by the Hanafis; secondly, voluntary or involuntary emission of the seminal fluid or thirdly the attainment of a given age except for Imām Mālik himself, who does

⁴² *Sūrah al-Mā'idah* (5:4).

not consider age as indicative of puberty. Other signs of puberty particularly for girls are menstruation and pregnancy.

However, there is a period called *sinn al-tamyīz* (age of discernment or age of reason) between infancy and majority usually six or seven years old. The Hanafis and Malikis attach a weight to some transaction performed by a discerning minor i.e. to conclude contracts which is fully beneficial to him without his guardian's authorization such as acceptance of gifts or bequests. A minor however is forbidden to enter into fully detrimental contracts such as granting loans or guarantees.

In a case of contracts which may result either beneficial or detrimental, it would depend on guardian's ratification. Based on the Ḥanbalī school of law, a minor, whether discerning or not, cannot enter into any kind of financial transactions but the contracts are valid with the approval of the guardian. The Shafi'is however totally disapproves the contracts of a minor.

In addition to the above discussion on legal capacity of a party to enter into any kind of contract, it is perhaps pertinent to note that Islamic law of contract does impose certain legal interdictions with a view to safeguard the interest of third parties. The third party may confirm or cancel the disposition of a person who is interdicted from disposing of his property. Hence, it follows that *al-muflis* (insolvent) is interdicted from disposing off his property by the judge to protect the interest of

his creditors. Similarly, an ill person with death sickness is interdicted in the interests of his heirs or creditors.

2.4.3 SUBJECT-MATTER

As mentioned earlier, since the subject-matter of *istiṣnā'* does not exist at the time of conclusion of contract, it must conform to several conditions.

Firstly, the essential ingredient of subject-matter of *istiṣnā'* or *al-maṣnū'* is that its subject-matter must be known and precise to the extent of removing any lack of knowledge with regards to its kind, types, quality and quantity. This is relatively significant since the subject-matter does not exist at the time the contract is concluded and it can avoid future dispute between the contracting parties. For example in the construction of 100 units of double storey house with the specifications agreed by the parties.

It is also an imperative condition that the subject-matter should be something which can be converted from the state of raw materials into a new product via manufacturing or construction process. Thus, a person cannot sell foods, stocks, fruits, animals or ready made items based on *istiṣnā'* contract since they are not within the term of *istiṣnā'* which means a sale of materials on condition that they are

capable of being transformed via manufacturing or construction process. This differentiates it from *salam* contract whereby *salam* contract involves a sale of specific identified goods.

2.4.4 PRICE

In this regard, the Hanafis argued that the subject-matter of *istiṣnāʿ* contract must be something which is normally dealt with by the people in the market. According to them, this feature is vital since the permissibility of *istiṣnāʿ* is based on the customary practices of people. Nevertheless, since the legitimacy of *istiṣnāʿ* is also based on *qiyās*, general rules of *Sharīʿah*, permissibility of whatever has not been considered illegitimate and *maṣlaḥah* (public interest), it is therefore considered a permissible contract to be used whenever the need arises regardless of whether the subject-matter has been commonly practiced by people.⁴³ Thus, subject-matter of *istiṣnāʿ* may vary depending on the customary practices which usually changes with the change of time and place.

Additionally, the subject-matter of *istiṣnāʿ* must be lawful in the eyes of Islamic law. Lawfulness here necessitates that the object must be lawful, that is something which is allowed to be transacted. It must be of legal value i.e. its subject-matter and *sabab* (underlying cause) must be lawful and not prohibited by Islamic law or a nuisance to public

⁴³ *Accounting, Auditing and Governance Standards for Islamic Financial Institutions, op.cit.*, p. 317.

order or morality, for example the constructions of casino, entertainment premises and factory for producing liquor.

2.4.4 PRICE

As for the consideration of price, it is not necessarily in the form of money but it may be in the form of another commodity depending on the agreement of the parties. The prohibition against *gharar* requires that the price must be fixed and exist at the time of the contract and cannot be determined at a later date whether with reference to the market price or subject to determination by other third parties. It should be known by the parties to the extent of eliminating lack of knowledge. It cannot be increased or decreased due to increase or decrease in commodity prices or cost of labour or other reasons. However, is it not a condition that the price should be paid in advance.⁴⁴

2.5 FIXING A DATE FOR DELIVERY

2.5.1 As far as this issue is concerned, there are three opinions among the Ḥanafī jurists concerning this matter:-

⁴⁴ This feature distinguishes it from *salam* contract which requires the price to be paid immediately after the formation of contract.

- i) Imām Abū Ḥanīfah disallows fixing date for delivery of the subject-matter. According to him, this will change *istiṣnāʿ* into a *salam* contract because this is a feature of a binding contract such as *salam*.
- ii) Abū Yūsuf and Muḥammad bin al-Ḥassan al-Shaybānī, the students of Abū Ḥanīfah agree with fixing a specific future delivery date since people have been practising *istiṣnāʿ* in this manner.
- iii) However, all of them have concurred that an *istiṣnāʿ* contract would turn into a *salam* contract if *istiṣnāʿ* contract is not in line with what is commonly practiced and the date of delivery is fixed.

2.5.2 It is submitted that the second opinion is favorable due to these reasons:-

- i) Fixing a delivery date is a requisite in order to remove *gharar*.
- ii) In fact, the delivery date is fixed based on mutual agreement between the two parties or depending on the time required by manufacturer to finish the goods and or to obtain it from other parties according to the contract.

- iii) This permissibility to fix a delivery date should not be distinguished whether or not it is commonly practiced by people as long as the need and necessity arises.

2.6 NATURE OF *ISTIṢNĀ'* CONTRACT

The discussion on the nature of *istiṣnā'* contract can be divided into 3 scenarios. Firstly, it is prior to manufacturing process taking place. At this stage, the Hanafis unanimously do not consider *istiṣnā'* as a binding contract. Thus, each party has the option to withdraw the contract before it is implemented. The manufacturer has the right to stop manufacturing the goods while the person making an order has the right to cancel the purchase of the goods ordered.

Secondly, if the subject-matter has been manufactured but the purchaser has yet seen it, the contract is also not treated as binding. Thus, the manufacturer is not obliged to deliver it to the purchaser. In this situation, he has the option to do away with it in the manner he deems suitable. The basis for this is because the contract is not for the manufactured goods themselves but for a particular and specific subject-matter already agreed and determined earlier.

Thirdly, where the subject-matter has been completely manufactured in accordance with the specification and the manufacturer delivers it to the purchaser.

The prevailing view is attributed to three scholars that the contract becomes binding on the manufacturer who waived his option by delivering the subject-matter. Nevertheless, the purchaser still has the right to exercise the option. This is the view of Abū Ḥanīfah, Abū Yūsuf and Muḥammad.

Nonetheless, it has been reported that Abū Ḥanīfah has said that even at this stage, the manufacturer equally enjoys the option. There is a second opinion expressed by Abū Yūsuf that in this situation, the contract becomes binding. The preponderant opinion in the Hanafīs school is that at this stage, *istiṣnāʿ* contract is binding once it has been constituted.⁴⁵ A number of jurists have concurred with this opinion.⁴⁶

The *Majallah*'s commentator clarifies that *istiṣnāʿ* is a contract of sale and not a mere promise. Once it is constituted, no party according to Abū Yūsuf's point of view has the right to withdraw unless the consent of the other party is secured.⁴⁷ According to Abū Yūsuf, this is due to the fact that the manufacturer has spent money in order to manufacture and deliver according to the specification. If the purchaser has a right to refuse the manufactured

⁴⁵ al-Sarakhsī (1987), *op.cit.*, p.167.

⁴⁶ *Accounting, Auditing and Governance Standards for Islamic Financial Institutions*, *op.cit.*, p.319.

⁴⁷ *Majallah*, Art. 375.

goods, then the manufacturer will incur losses because he will face difficulty to find another buyer and the market risks exposure in terms of price depreciation. Accordingly, the manufacturer has to deliver the goods.⁴⁸

Wahbah al-Zuhaylī also gives the same opinion whereby according to him, it is implausible for *istiṣnāʿ* contract not to be binding particularly in modern time where most contracts involve manufacturing high cost project or goods.⁴⁹

In light of the above, all civil legislation based on *Sharīʿah* has treated *istiṣnāʿ* as a binding contract. These are the Jordanian, Yemeni and Sudanese laws of civil transactions as well as the Unified Arab Law proposed by the League of Arab Countries.⁵⁰

2.7 THE LEGAL CONSEQUENCES OF *ISTIṢNĀʿ*

The Hanafis collectively agree that a valid *istiṣnāʿ* has the effect of equal transfer of the title ownership between the manufacturer and the party making the order and to establish the entitlement of the manufacturer towards the agreed amount of contract. This view has been generally adopted by recent civil Islamic legislation and modern transactions whereby both the transfer of

⁴⁸ ‘Ali Ḥaydar (1991), *Durar al-Ḥukkām Sharḥ Majallat al-Aḥkām*, vol.1, Bayrūt : Dār al-Jīl, p. 424

⁴⁹ al-Zuhaylī (1996), *op.cit.*, p. 634.

⁵⁰ *Accounting, Auditing and Governance Standards for Islamic Financial Institutions*, *op.cit.*, p. 319.

ownership is automatic and unconditional and the manufacturer is entitled to the agreed price once the contract is constituted.⁵¹

2.8 TERMINATION OF *ISTIṢNĀ'* CONTRACT

Istiṣnā' contract may be terminated in the following circumstances:-

- 2.8.1 Both parties have fulfilled their obligation according to the terms of the contract.
- 2.8.2 Mutual consent of both parties.
- 2.8.3 Judicial rescission of the contract when a reasonable cause arises to prevent the execution of the contract or its completion and each party may sue for its rescission.⁵²

2.9 DIFFERENCES OF OPINION BETWEEN *JUMHŪR* AND THE ḤANAFĪ JURISTS VIS-À-VIS *ISTIṢNĀ'* CONTRACT

2.9.1 Treatment of Contract

The Hanafīs consider *istiṣnā'* as an independent contract whilst *Jumhūr* (majority scholars) treat it as a species of *salam* contract.

⁵¹ ‘Abdallah, Aḥmad ‘Alī, *op.cit.* p.59 as quoted in *Accounting, Auditing and Governance Standards For Islamic Financial Institutions*, *op.cit.*, p. 320.

⁵² Ibid.

2.9.2 Method of Payment

The Hanafis does not oblige the purchaser to release the payment at the point of *'aqad*. *Jumhūr* on the other hand make it a condition that the price should be paid at the time the contract is executed.

2.9.3 Stipulating the Date of Delivery

Abū Ḥanīfah disallows the fixing of the delivery date whilst the other two companions do not prohibit the same. According to *Jumhūr*, fixing a delivery date is a must since it is part of *salam* contract.

2.9.4 Nature of *Istiṣnā'*

Before the manufacturing process occurs, the Hanafis regard *istiṣnā'* as a non-binding contract. The effect is similar after the subject-matter has been manufactured but the purchaser does not see it yet. In a case when the subject-matter has been manufactured according to the specification and the manufacturer delivers it to the purchaser, majority holds that the manufacturer has waived its option and therefore the contract becomes binding on him and not on the purchaser. Abū Ḥanīfah according to another opinion, views that both of them still can exercise the option while Abū Yūsuf opines that

the contract is binding on both of them. Conversely, *Jumhūr* regard *istiṣnāʿ* as a binding contract from the beginning.

2.10 *ISTIṢNĀʿ IN MAJALLAH AL-AḤKĀM AL – ‘ADLIYYAH*

There are several articles in the *Majallah* which spell out about *istiṣnāʿ* contract. Art. 124 defines *istiṣnāʿ* as to make a contract with a skilled person to make something. The person who makes the thing is called *ṣāniʿ*, the person who causes it to be made *mustaṣnāʿ* and the thing made *maṣnuʿ*. Art. 388 describes how *istiṣnāʿ* contract occurs. It states that, “if someone say make a thing of this sort for so many piastres for me” to one of the skilled persons who makes those things and he accepts, the sale by *istiṣnāʿ* is a concluded contract. According to this article, *istiṣnāʿ* is considered as a concluded contract which binds the parties from the beginning and not a mere promise.

This fact is further stressed by Art. 92 which states to the effect that after *istiṣnāʿ* is concluded by agreement, the parties cannot go back from the bargain. However, if the thing made does not match with the description, the person who gives the order has an option.

Based on Art. 389, the subject-matter of *istiṣnāʿ* must be something which is customary and regularly used and known by the people and the time for

delivery should not be fixed. However, if the subject-matter is not the one prevailing in the society, the contract is still regarded as *istiṣnāʿ* provided that the time for delivery is not fixed. It further explains that if the items manufactured are not within the existing custom and the time for delivery is fixed, then the contract change to *salam* and all conditions of *salam* must be adhered to.

Art. 390 stipulates the condition for the subject-matter whereby it must be properly described by the party making the order. Art. 391 mentions that the payment in *istiṣnāʿ* contract should not necessarily be made in advance.

2.11 *ISTIṢNĀʿ* ACCORDING TO ISLAMIC *FIQH* ACADEMY

Islamic *Fiqh* Academy has decreed that the contract of *istiṣnāʿ* is binding on its parties provided that certain conditions are fulfilled.⁵³ Those conditions are as follows:-

- 2.11.1 Description as to the nature, amount and specification of the product required by the party.
- 2.11.2 Date for the delivery of the subject-matter should be fixed.
- 2.11.3 It is permissible for the payment of price to be deferred or paid in staggered within the agreed period.

⁵³ Resolution No. 65(7/3) made during its seventh session held on 7-12 Zulqāʿidah 1412H / 9th -14th May 1992.

- 2.11.4 It is permissible for the parties to put a condition regarding penalty clauses mutually agreed by both of them subject to the case of intervening contingencies.

2.12 PARALLEL *ISTIṢNĀ'* CONTRACT

Since the pioneer in developing this new version of *istiṣnā'* is Middle Eastern countries, the conditions regarding this parallel *istiṣnā'* shall be based on their decisions.⁵⁴ Parallel *istiṣnā'* occurs when the customer does not stipulate in the contract that the bank should manufacture the subject-matter by itself. This will allow the bank to enter into a second *istiṣnā'* contract for the purpose of fulfilling its contractual obligations in the earlier contract. The second contract is known as parallel *istiṣnā'* which is in reality a subcontract whereby the obligations of the manufacturer in the first contract are carried out. The rationales for permissibility of parallel *istiṣnā'* are as follows:-⁵⁵

- i) In such a case there are two separate deals of *istiṣnā'*. There is no link between the two contracts; hence this is not an instance of two sales in one deal, which is prohibited.

⁵⁴ For example, Islamic *Fiqh* Academy has discussed about this contract in the sixth session held in Jeddah, Saudi Arabia from 7 to 12 Zulqā'idah 1412H / 9th -14th May 1992 while *Sharī'ah* Board of AAOIFI has decided to give priority to the preparation of the *Sharī'ah* rules for *istiṣnā'* and parallel *istiṣnā'* in its meeting no.5 held in Makkah al-Mukarramah on 8-12 Ramaḍān 1421H (4th - 8th December 2000).

⁵⁵ (2002/2003), *Shari'a Standards*, Baḥrayn : Accounting and Auditing Organization for Islamic Financial Institutions, , p.194.

- ii) The separation of the two contracts also has the effect of making the transaction a type of non- *ribā* based financing.

To further elaborate, parallel *Istiṣnāʿ* must comply with these conditions:- ⁵⁶

- i) The bank as a manufacturer in the first contract will remain solely responsible for the execution of his obligations as if the parallel contract does not exist.
- ii) The manufacturer in the parallel contract is accountable to the bank in the way and manner by which he performs his obligations. He has no direct legal relationship with the bank in the first contract. The second *Istiṣnāʿ* is a parallel contract and not a contingent transaction on the first contract. Legally speaking, there are different contracts with respect to rights and obligations.
- iii) The bank acting as a contractor is liable to the customer as far as any of the subcontractor and any guarantees arising therefrom. It is this very liability that justifies the validity of the parallel *Istiṣnāʿ* which also justifies the charging of profit by the bank, if any.

⁵⁶ *Accounting, Auditing and Governance Standards for Islamic Financial Institutions, op.cit., p.321.*

CHAPTER 3

APPLICATION OF ISTISNA' CONTRACT IN MALAYSIA

3.1 AREA OF FINANCING

As stated in previous chapters, *istisna'* is a major type of contract in finance for Islamic banks which are not in existence at the time of conclusion of contract in particular to finance the construction of Islamic commercial buildings, power plant, infrastructure etc. Furthermore, it involves construction and maintenance of infrastructure for subject-matter of *istisna'* contract.³⁷ This fact has been admitted by BNM itself when Islamic Banking and Takaful Department has initiated a review of Islamic financing³⁸ on 29th July 2006. One of the reasons which urged the said department to review the current practice of Islamic finance financing is to explore the possibility of structuring a more comprehensive Islamic bank financing by applying new principles of *istisna'* and *ijarah*. However, prior to this initiative, several local banks have already taken an adaptive step to modify this product by introducing *istisna'* as the underlying contract for *ijarah* for Islamic bank asset-based financing.³⁹

However, since the financing products available to the Malaysian market remain restricted to the underlying contract of *ijarah* and *murabahah*,

³⁷ *Al-Farooq*, supra note 1, at 100-101.

³⁸ *Islamic Finance* is the tag line of the review which is an initiative of Islamic Banking and Takaful Department.

³⁹ For example, the Bank Islam Malaysia has started applying *istisna'* as the underlying contract.

CHAPTER 3

APPLICATION OF *ISTIṢNĀ'* CONTRACT IN MALAYSIA

3.1 AREA OF FINANCING

As stated in previous chapters, *istiṣnā'* is a proper type of contract to finance the assets which are not in existence at the time of execution of contract in particular to finance the construction of house, commercial buildings, power plant, infrastructures etc. Furthermore, it involves construction and manufacturing processes which is in line with the requirement for subject-matter of *istiṣnā'* contract. This fact has been admitted by BNM itself when Islamic Banking and Takaful Department has initiated a review of home financing-*i*⁵⁷ on 29th July 2004. One of the reasons which urged the said department to review the current practice of Islamic home financing is to explore the possibility of structuring a more universally accepted Islamic home financing by applying new principles one of which is *istiṣnā'*. However, prior to this initiative, some local banks have already taken an advance steps to modify this product by introducing *istiṣnā'* as the underlying contract not only for home but also project financing.⁵⁸

Below are some of the financing products available in the Malaysian market using *istiṣnā'* as the underlying contract :-

⁵⁷ To put a letter "i" at the end of the product name is to indicate a generic name for Islamic product.

⁵⁸ For example Bank Muamalat Malaysia Berhad and Bank Islam Malaysia Berhad.

3.1.1 Home financing

3.1.2 Project financing

3.1.3 Revolving facility

3.2 HOME FINANCING

3.2.1 MODUS OPERANDI

a) Parties involved

- i) Bank
- ii) Customer cum House Owner
- iii) Contractor

b) Structure

The structure can be illustrated by the diagram below:

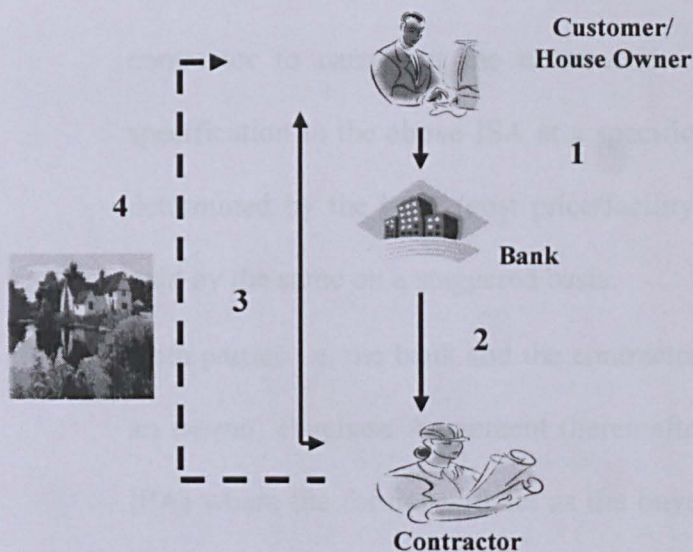


DIAGRAM 3.1
***Istışnâ'* Home Financing Facility Structure**

The details of each transaction above are described below:-

Transaction 1

- Customer cum house owner will request the bank to construct his/her house according to a specified approved architecture design at a specific selling price determined by the bank (cost plus profit margin) to be paid by the customer on an agreed deferred term.
- *Istiṣnā'* Sale Agreement (hereinafter referred to as ISA) will be entered into by both parties i.e. the customer and the bank, where the former will act as the buyer and the latter as the seller.

Transaction 2

- The bank thereafter will request another party i.e. contractor to carry out the construction with the same specification in the above ISA at a specific purchase price determined by the bank (cost price/facility amount) to be paid by the same on a staggered basis.
- Both parties i.e. the bank and the contractor will enter into an *Istiṣnā'* Purchase Agreement (hereinafter referred to as IPA) where the former will act as the buyer and the latter as the seller.

Transaction 3

- During the construction period, the customer will monitor the progress of the project on behalf of the bank as stipulated in the Supervision of Contract Agreement.

Transaction 4

- Upon completion of the construction, the contractor as the seller in the IPA will handover the completed house to the bank as the buyer and subsequently the bank as the seller in the ISA will handover the said house to the customer as the buyer; or
- The contractor directly handover the completed house to the original buyer i.e. the customer with an authorisation from the bank.

3.2.2 LEGAL DOCUMENTATION

a) Documentation involved :-

- i) *Istiṣnāʿ* Facility Agreement
- ii) *Istiṣnāʿ* Sale Agreement-Annexure 1
- iii) *Istiṣnāʿ* Purchase Agreement-Annexure 2
- iv) Supervision of Construction Agreement

- v) Security documents such as first party charge or third party charge

b) Illustration

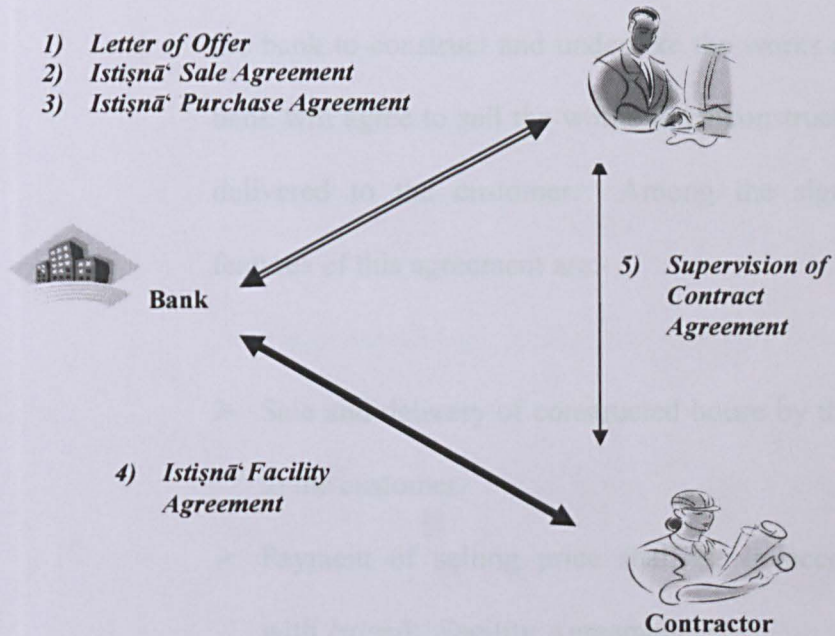


DIAGRAM 3.2
Sequence of documentation for *Istiṣnā'* Home Financing Facility

c) Sequence of Documentation

i) Letter of Offer

It indicates an offer by the bank to the customer as to the *Istiṣnā'* Home Financing Facility. It summarises the general terms and conditions of this facility.

ii) *Istiṣnā'* Sale Agreement

Simultaneously with the execution of the *Istiṣnā'* Facility Agreement, the bank and the customer shall also execute the ISA. The customer will request the bank to construct and undertake the works and the bank will agree to sell the works to be constructed and delivered to the customer. Among the significant features of this agreement are:-

- Sale and delivery of constructed house by the bank to the customer.
- Payment of selling price shall be in accordance with *Istiṣnā'* Facility Agreement.
- In the event the bank is unable to deliver to the customer a completed house within specified period, the customer agrees to accept the uncompleted house at its existing state and pay the bank all amounts disbursed together with profit margin, premium and other charges.⁵⁹

⁵⁹ However, the bank may exercise its discretion to grant *Ibra'* to ease the burden on the part of the customer.

iii) *Istiṣnāʿ* Purchase Agreement

Subsequent to the execution of ISA, the bank will enter into IPA with the contractor for the construction of house as per the construction documents and will release progressive payments of the purchase price to contractor on completion of each stage of the work. Among the salient features of this agreement are:-

- Construction and delivery of completed house to the customer.
- Payment of purchase price by the bank to the contractor.
- In the event the contractor fails to complete the construction within the stipulated period, the bank will stop any further disbursement of the purchase price and customer may exercise the right to seek alternative arrangement with any other third party to complete the work.
- The customer has direct recourse against the contractor for any damages suffered due to delay or failure to complete.

iv) *Istiṣnā'* Facility Agreement

The purpose of facility is for home construction. It is available to land owners who are desirous of constructing a house on their land.⁶⁰ According to this agreement, the customer will approach a contractor for construction of a house and agree on the terms including the cost and specification of works. After that, the customer approaches the bank to finance the construction. Upon approval of the application, the bank will enter into an *Istiṣnā'* Facility Agreement with the customer and the terms therein will have to be acknowledged by the contractor appointed by the customer. Some of the salient features of this agreement are:-

- Compliance with conditions precedent by the customer.
- Representation and warranties by the customer.
- Covenants, undertakings and guarantee to be fulfilled by the customer.
- Payment of purchase price to contractor.
- Payment of selling price by the customer.

⁶⁰ This means, the product is inapplicable if the land is owned by third party.

- Securities to be given by the customer to the bank.
- Occurrence of events of default.
- Acknowledgement by the contractor to be bound by the terms of this agreement.

v) **Supervision of Construction Agreement**

Following IPA, the bank will authorize the customer to enter into a supervision of construction agreement with the contractor wherein the customer will supervise and oversee the construction of the house on behalf of the bank. This agreement is basically meant to mitigate the risk of non-completion and is not a prerequisite for *istiṣnāʾ* contract. Among the salient features of this agreement are:-

- The contractor's responsibility to carry out and complete the construction of the house within stipulated period.
- The customer has right to issue instruction to the contractor which does not result in variation of the purchase price.

- The contractor to ensure issuance of certificate of fitness and delivery of vacant possession.
- Payment or disbursement notice to be verified by the customer prior to disbursement by the bank.
- Construction must be done in conformity with description of works already agreed.
- Contractor to be accountable for any defect discovered during defect liability period.

3.3 PROJECT FINANCING

3.3.1 MODUS OPERANDI

a) Parties involved

- i) Awarder
- ii) Bank
- iii) Customer
- iv) Contractor⁶¹

⁶¹ It is to be noted that customer and contractor are in fact the same person but acting in different capacities. There is also situation where awarding party is absent i.e. when the project belongs to the customer himself for example a housing developer.

- b) Structure (it can be either involving awarding party or vice versa)

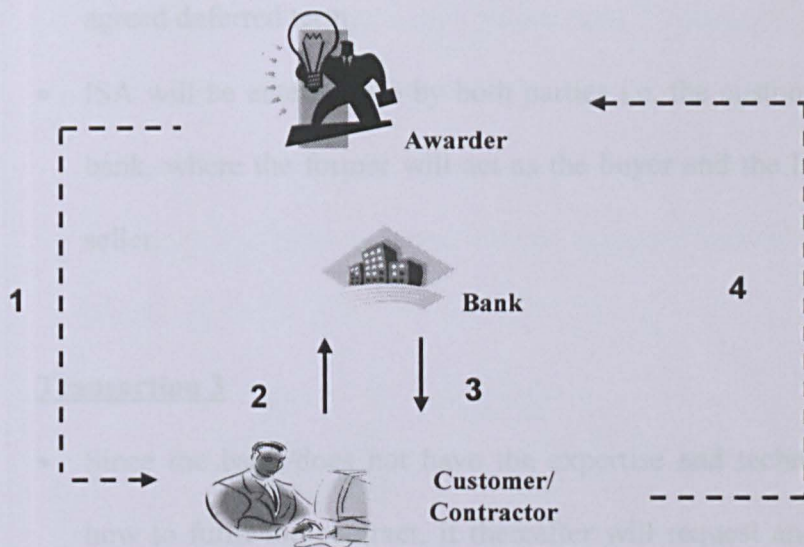


DIAGRAM 3.3

***Istisnā'* Project Financing Facility Structure (Involving awarding party)**

The details of each transaction above are described below:-

Transaction 1

- Contract/Tender/Letter of Award granted by the awarding party such as government bodies to carry out the project as per specified in the said documents, for example to build a hospital.

Transaction 2

- With the contract in hand and the need for financing, the customer will request the bank to build the hospital according to a specified approved architecture design at a specific selling price determined

by the bank (cost plus profit margin) to be paid by customer on an agreed deferred term.

- ISA will be entered into by both parties i.e. the customer and the bank, where the former will act as the buyer and the latter as the seller.

Transaction 3

- Since the bank does not have the expertise and technical-know-how to fulfil the contract, it thereafter will request another party i.e. contractor to carry out the construction with the same specification in the above ISA at a specific purchase price determined by the bank (cost price/facility amount) to be paid by the same on a staggered basis. The contractor is actually the customer who acts in different capacity.⁶²
- Both parties i.e. the bank and the contractor will enter into IPA where the former will act as the buyer and the latter as the seller.

Transaction 4

- Upon completion of the construction, the contractor as the seller in the IPA will handover the completed hospital to the bank as the buyer and subsequently the bank as the seller in the ISA will handover the said house to the customer as the buyer; or

⁶² The reason for this is because the contract awarded is not transferable to another party.

- The contractor directly handover the completed hospital to the awarding party with an authorisation from the bank.
- The bank and the contractor as the buyers in the IPA and ISA respectively will have a right to ensure that the construction work has been done in accordance with the demanded specification.

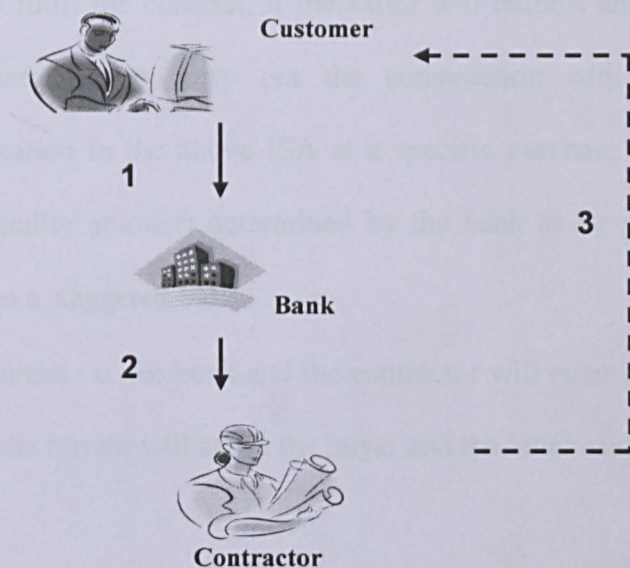


DIAGRAM 3.4

***Istiṣnā'* Project Financing Facility Structure (Not involving awarding party)**

The details of each transaction above are described below:-

Transaction 1

- The customer will request the bank to develop the project; for example a housing project according to a specified approved architecture design at a specific selling price (cost plus profit margin) determined by the bank to be paid by the customer on an agreed deferred term.

- An ISA will be entered into by both parties i.e. the customer and the bank, where the former will act as the buyer and the latter as the seller.

Transaction 2

- Since the bank does not have the expertise and technical-know-how to fulfil the contract, it thereafter will request another party i.e. contractor to carry out the construction with the same specification in the above ISA at a specific purchase price (cost price/facility amount) determined by the bank to be paid by the same on a staggered basis.
- Both parties i.e. the bank and the contractor will enter into an IPA where the former will act as the buyer and the latter as the seller.

Transaction 3

- Upon completion of the construction, the contractor as the seller in the IPA will handover the completed houses to the bank as the buyer and subsequently the bank as the seller in the ISA will handover the said house to the customer as the buyer.
- The bank and the customer as the buyers in the IPA and ISA respectively will have a right to ensure that the construction work has been done in accordance with the demanded specification.

3.3.2 LEGAL DOCUMENTATION

a) **Documentation involved :-**

- i) Letter of Offer
- ii) *Istiṣnā'* Sale Agreement
- iii) *Istiṣnā'* Purchase Agreement
- iv) Security documents

b) **Illustration**

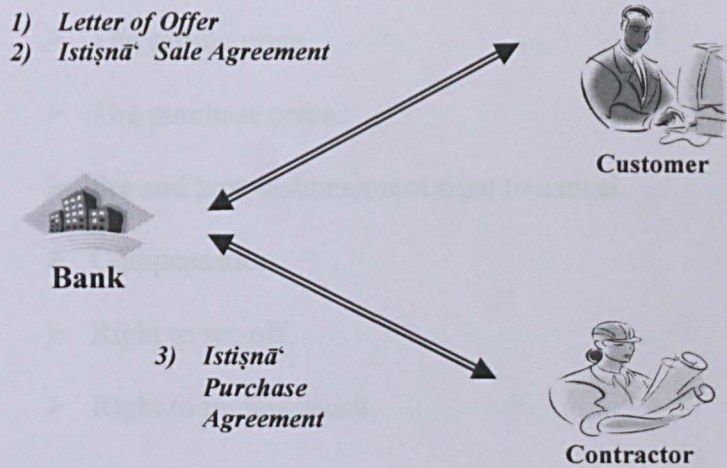


DIAGRAM 3.5
Sequence of documentation for *Istiṣnā'* Project Financing Facility

c) Sequence of Documentation

i) Letter of Offer

The purpose of this Letter of Offer is to indicate the offer by the bank to the customer to accept the financing facility that is *Istiṣnā'* Project Financing. It summarizes the principal terms and conditions of the offer such as:-

- The facility amount.
- The selling price.
- The purchase price.
- Pre and post disbursement right to cancel.
- Compensation.
- Right to set-off.
- Right to review/recall.

Since there is no Facility Agreement for this type of financing, the provisions regarding the payment of the sale price is incorporated in the Letter of Offer.

ii) *Istiṣnā'* Sale Agreement

After the execution of the Letter of Offer, the bank and the customer shall execute the ISA. It refers to an agreement entered into between the contractor and the bank whereby the bank agrees to sell and the contractor agrees to purchase the project to be constructed and delivered by the bank.

Among the significant features of this agreement are:-

- Sale and delivery of the constructed house by the bank to the customer.
- Payment of selling price shall be in accordance with ISA.
- In the event that the bank is unable to deliver to the customer a completed house within specified period, the customer agrees to accept the uncompleted house at its existing state and pay the bank all amounts disbursed together with profit margin, premium and other charges.

iii) *Istiṣnāʿ* Purchase Agreement

Pursuant to the execution of ISA, the bank will enter into IPA with the contractor for the construction of the project similar to the specification under ISA. The bank will release progressive payments of the purchase price to contractor on completion of each stage of the work.

Among the salient features of this agreement are:-

- Construction and delivery of completed house to the customer.
- Payment of purchase price by the bank to the contractor in accordance with the terms stipulated in IPA.
- In the event the contractor fails to complete the construction within the stipulated period or the project does not comply with specification, the bank agrees to accept the project at its existing state at the price equivalent to the sum already paid by the bank to the contractor under the agreement.

3.4 REVOLVING FACILITY

3.4.1 MODUS OPERANDI

- a) Parties involved
 - i) Bank
 - ii) Customer
 - iii) Contractor

b) Structure

The structure can be illustrated by the diagram below:

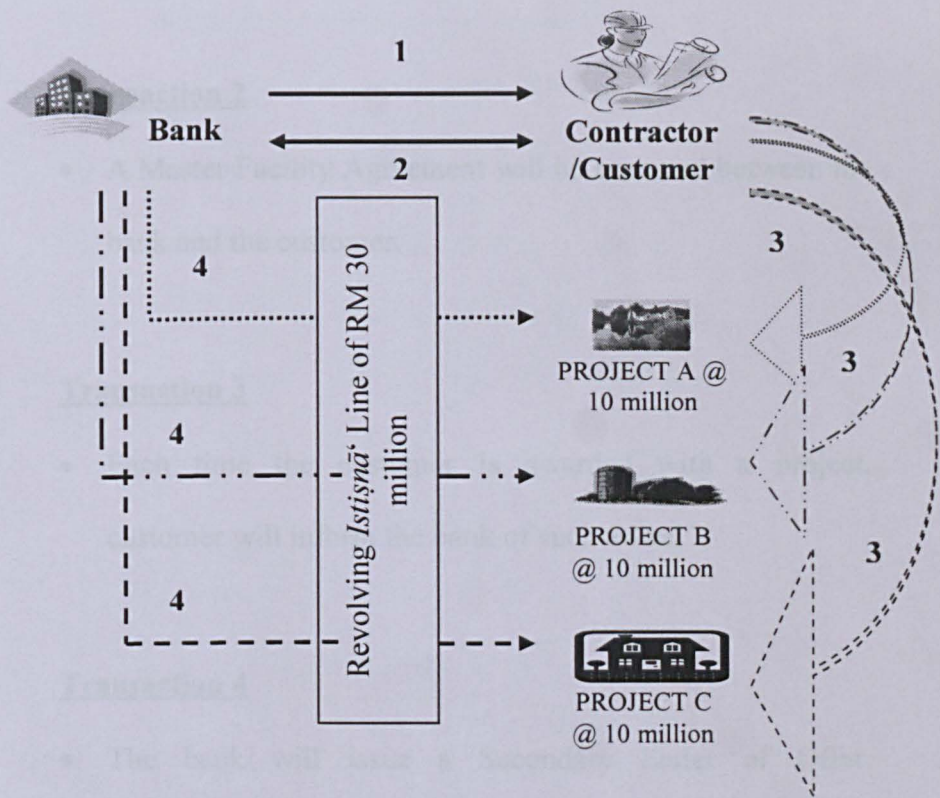


DIAGRAM 3.6
Structure for Istisnā' Revolving Financing Facility

Istishnā' Revolving Facility is basically a project financing however granted to a selected customer only and revolving in nature. It will enable a customer to enjoy a financing facility for several projects without a need to reapply the financing for each separate project.

The details of each transaction above are described below:-

Transaction 1

- The bank will offer to customer a maximum facility amount say RM 30 million to undertake various projects.

Transaction 2

- A Master Facility Agreement will be executed between the bank and the customer.

Transaction 3

- Each time the customer is awarded with a project, customer will inform the bank of such award

Transaction 4

- The bank will issue a Secondary Letter of Offer. Subsequently, the parties will enter into the ISA and IPA

separately. The selling price and purchase price will be determined in accordance with an individual project.

- Being revolving in nature, once customer pays up the existing facility, the *istiṣnāʿ* line will be available and the customer may utilize whatever balance for future projects.

3.4.2 LEGAL DOCUMENTATION

a) Documentation involved :-

- i) Letter of Offer
- ii) Revolving *Istiṣnāʿ* Master Facility Agreement
- iii) Notification of Receipt of Award
- v) Secondary Letter of Offer
- vi) *Istiṣnāʿ* Sale Agreement
- vii) *Istiṣnāʿ* Purchase Agreement
- viii) Payment / Disbursement Notice

b) **Illustration**

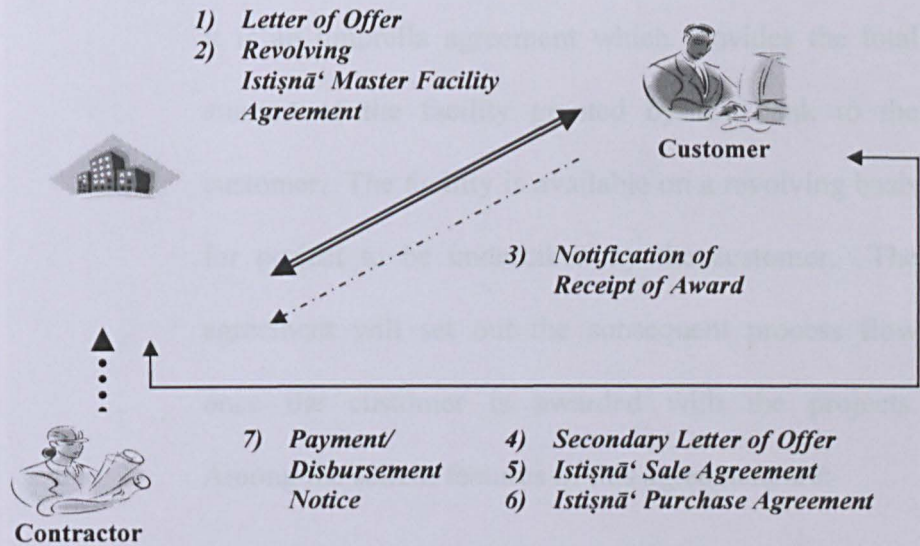


Diagram 3.7
Sequence of documentation for *Istiṣnā'* Revolving Facility

c) **Sequence of Documentation**

i) **Letter of Offer**

It is issued by the bank to be accepted by the customer. In general, it states the total amount of financing approved to the customer. It also specifies the salient features to be incorporated in the Revolving *Istiṣnā'* Master Facility Agreement.

ii) Revolving *Istiṣnāʿ* Master Facility Agreement.

It is an umbrella agreement which provides the total amount of the facility granted by the bank to the customer. The facility is available on a revolving basis for project to be undertaken by the customer. The agreement will set out the subsequent process flow once the customer is awarded with the projects. Among the salient features of this agreement are:-

- Compliance with conditions precedent by the customer.
- Representation and warranties by the customer.
- Covenants, undertakings and guarantee to be fulfilled by the customer.
- Securities to be given by the customer to the bank.
- Occurrence of events of default.
- Schedules setting out the forms of the following :-
 - a) Secondary Letter of Offer.
 - b) *Istiṣnāʿ* Sale Agreement.
 - c) *Istiṣnāʿ* Purchase Agreement.
 - d) Payment / Disbursement Notice.

iii) Notification of Receipt of Award

The notice is issued by the customer notifying the bank of the following:-

- receipt of the letter of award from the awarder and;
- intention to utilize the financing amount in order to undertake the works pursuant to the said notice.

Additionally, the customer also confirms the following:-

- The conditions precedent of the Master Agreement have been fulfilled.
- The representations and warranties in the Master Agreement are true and accurate.
- No event of default has occurred.
- All covenants and undertakings in the Master Agreement have been complied with.

iv) Secondary Letter of Offer

It is issued by the bank pursuant to the Notification of Receipt of Award and will be duly accepted by the

customer. This Secondary Letter of Offer specifies the following:-

- Purchase price of the specific project to be undertaken by the customer.
- Selling price of the specific project to be undertaken by the customer.
- The securities to be provided by the customer.
- The particulars of project document(s) between the customer and the awarding party.

v) ***Istiṣnāʾ* Sale Agreement**

Following the acceptance of the Secondary Letter of Offer, the bank and the customer shall execute the ISA. The customer will request the bank to construct and undertake the project and the bank will agree to sell the project to be constructed and deliver to the customer. Among the salient features of this agreement are:-

- Sale and delivery of constructed project by the bank to the customer.

- Amount and method of payment of selling price shall be in accordance with the schedule attached thereto.
- In the event the bank is unable to deliver to the customer the completed project within the specified period, the customer agrees to accept the uncompleted project at its existing state and pay the bank all amounts disbursed together with profit margin, premium and other charges.

vii) *Istiṣnāʿ* Purchase Agreement

The bank will pursuant to the ISA enter into an IPA with the contractor for the construction of the project as per the Project Document (s) and will release progressive payments of the purchase price to the contractor on completion of each stage of the project. Some of the salient features of this agreement are:-

- Construction and delivery of the completed project by the contractor.
- Amount and method of payment of purchase price shall be in accordance with schedule attached thereto.

- In the event that the contractor is unable to deliver to the bank a completed project within the specified period, the bank agrees to accept the uncompleted project at its existing state at the price equivalent to the sum already disbursed to the contractor.

viii) Payment/Disbursement Notice

The notice is issued by the contractor to the bank after the customer has accepted the Secondary Letter of Offer and has executed the ISA and IPA with the bank.

The notice states:-

- The particulars of account where the purchase price shall be disbursed into; or
- The particulars of the supplier authorised to receive the purchase price.

The notice also specifies the percentage of completion of the project done by the contractor supported by documentary evidence reflecting the completion of the project.

3.5 ISLAMIC PRIVATE DEBT SECURITIES ISSUANCE BASED ON *ISTIṢNĀ*⁶³

3.5.1 OVERVIEW ON ISLAMIC PRIVATE DEBT SECURITIES

IPDS issuance is the process of raising funds from the Islamic capital markets through the issuance of negotiable instruments which evidences an unconditional debt obligation of the issuer. IPDS are negotiable instruments which are issued with a defined life and final maturity. The investors who subscribed IPDS are entitled to an agreed income.

Unlike conventional loans from the bank market, IPDS enables the process of disintermediation, allowing funds to be tapped directly from end-investors in the capital market such as discount houses, pension or provident funds, Employees Provident Fund, insurance companies, prescribed corporations and government bodies.

SC, the governing bodies for Islamic capital market in Malaysia has listed down additional requirements for IPDS issuance over the existing requirements for conventional Private Debt Securities issuance:-⁶³

⁶³ The requirements are embodied in Guidelines on Offering of Islamic Securities dated 26th July 2004.

- i) Independent *Sharī'ah* Advisor(s) approved by SC.
- ii) The *Sharī'ah* Committee of an Islamic bank; or
- iii) A licensed institution approved by BNM to carry out Islamic Banking Scheme.
- iv) Approval by *Sharī'ah* Committee must be obtained for any principle or concept used before submission to SC.
- v) Islamic principle used must be stated.
- vi) The assets are to be identified.
- vii) The purchase and selling price or rental where applicable is to be stated.
- viii) The details of the primary and secondary notes are to be stated.

3.5.2 ISLAMIC PRIVATE DEBT SECURITIES ISSUANCE BASED ON *ISTIṢNĀ'*

Islamic securities based on *istiṣnā'* has been structured particularly to finance projects which will be constructed sometimes in future. Some of the common instances are construction of power plant, highways, hospitals etc.

Issuance of IPDS is another mode of raising capital and funding sources. It basically involves three main stages i.e. the creation of underlying asset, issuance of Islamic debt

certificate and trading of debt certificates in the secondary market using the contract of *bay' al- dayn* .⁶⁴ The detailed explanations of these three stages are as follows:-

i) The creation of indebtedness.

Indebtedness is created via the same chain of transaction as elucidated in the discussion regarding one layer *istiṣnā'* financing in earlier section. For the sake of discussion here, the process is explained once again. ABC Co. requests the bank to construct a highway and agrees to pay RM 15 million. The bank will enter into a parallel *istiṣnā'* contract requesting another party, say XYZ Co. to perform the task. The bank shall pay the cost of the project to XYZ Co. say RM 10 million. ABC Co. is now indebted to the bank for the sum of RM 15 million which should be paid in 10 years.

⁶⁴ Saiful Azhar Rosly and Mahmood M. Sanusi, *The Application of Bay' al-Ṣinah and Bay' al-Dayn in Malaysian Islamic Bonds: An Islamic Analysis*, International Journal of Islamic Financial Services, vol.1, no.2, p. 2.

ii) Securitization via issuance of Islamic debt certificates.

Afterwards, this indebtedness will be securitized through the issuance of Islamic bonds. Asset securitization⁶⁵ is the essence of Islamic bonds issues as a bond must assume the role of *māl* to qualify as an object of sale.⁶⁶ When a bond certificate is supported by an asset as evidenced via securitization process, it is transformed into an object of value and therefore qualifies to become an object of trade whereby it can be purchased and sold in both primary and secondary market. In an example given, to evidence this indebtedness, ABC Co. acting as the issuer, issues Islamic bonds to the bank. The face value of the bonds should be equivalent to the indebtedness amount and in this hypothetical case, RM 15 million.

⁶⁵ Asset securitization generally refers to the process of issuing securities by selling financial assets identified as an underlying asset to third party. Its purpose is to liquidate financial assets for cash or as an instrument to obtain new funds at more attractive cost, compared to obtaining funds through direct borrowing from financial institutions. Specifically, financial assets which have future cash flow will be sold by a company that needs liquidity or as a new fund to a third party known as a Special Purpose Vehicle (SPV) for cash. To enable the payment for the purchase of the assets, the SPV will issue asset-backed debt securities to investors based on future cash flow of the assets. Investors will then gain returns through a future cash flow managed by the SPV. SAC of SC allowed asset securitization during its meeting held on 1st December 1995. See *Resolution of the Securities Commission Syariah Advisory Council, op.cit.* p.47

⁶⁶ Ibid. p.3

iii) Trading of debt certificates

For liquidity purposes, the bank will then sell the bonds to other interested parties at the secondary market⁶⁷ by cash at a discounted price. Proceeds from the sale of the bonds are used to pay off the ABC Co.'s selling price. The tenor of the bond will be similar to the financing period i.e. 10 years.

In Malaysia, *istiṣnā'* contract has been applied in several bond issuances such as:-

- i) Prai Power Sdn. Bhd. in 2002
- ii) SKS Sdn. Bhd. Power in 2003
- iv) Jimah Energy Ventures Sdn. Bhd. in 2005

⁶⁷ Islamic Interbank Money Market (IIMM)

Below are several models of structures used in the bond issuance in Malaysia.⁶⁸

a) ISSUANCE OF *ISTISNĀ'* FIXED RATE SERIAL BONDS WITH NOMINAL VALUE (PRIMARY BONDS) OF RM 780.0 MILLION BY PRAI POWER SDN.BHD

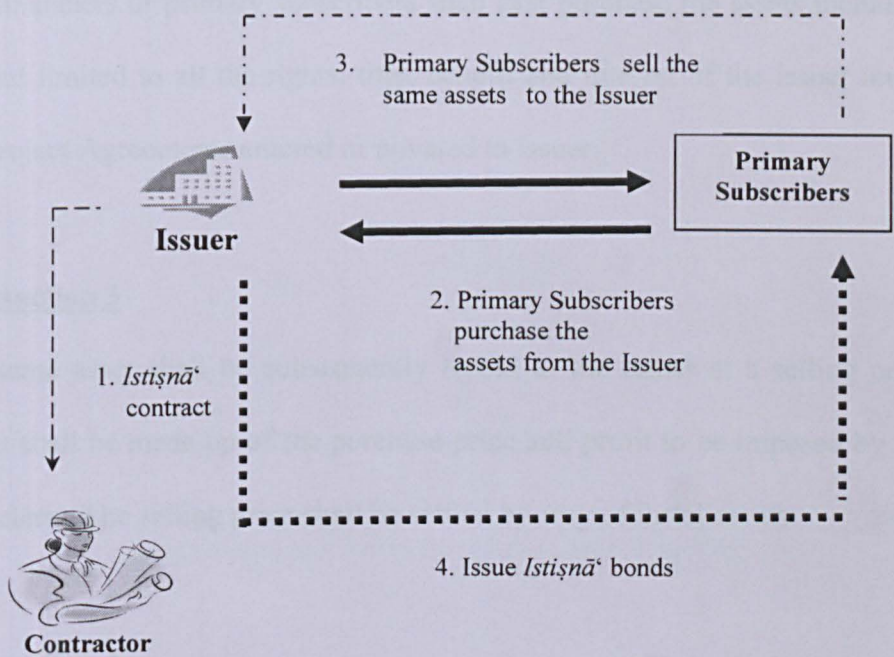


DIAGRAM 3.8

Issuance of *Istisnā'* Fixed Rate Serial Bonds with Nominal Value (Primary Bonds) of RM 780.0 Million by Prai Power Sdn. Bhd.⁶⁹

⁶⁸ The information has been adapted with some modification from <http://www.sc.com.my>.

⁶⁹ This structure resembles BBA or *bay' al-'inah* due to the fact that the indebtedness did not arise from manufacturing contract but from deferred payment sale.

A step by step explanation on the above structure is as follows:-

Transaction 1

Issuer secures all the rights, title, benefit and interest under the Project Agreement.

Transaction 2

The financiers or primary subscribers shall first purchase the assets including but not limited to all the rights, title, benefit and interest of the issuer under the Project Agreements entered or novated to issuer.

Transaction 3

The same asset shall be subsequently resold to the issuer at a selling price which shall be made up of the purchase price and profit to be imposed by the financiers. The selling price shall be settled by way of installments.

Transaction 4

The issuer issues bonds to evidence the indebtedness.

b) ISLAMIC MEDIUM TERM NOTES (“ISLAMIC MTNs”) ISSUANCE
FOR UP TO RM5,600 MILLION NOMINAL VALUE BY SKS POWER
SDN. BHD.

Transaction 1

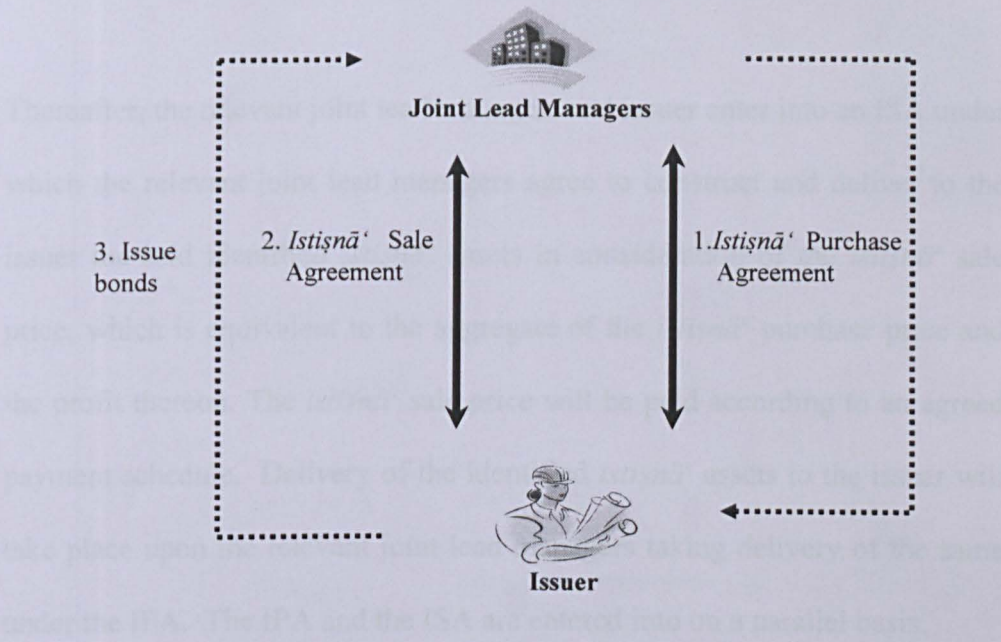


DIAGRAM 3.9

Islamic Medium Term Notes (“Islamic MTNs”) Issuance For Up To RM 5,600 Million Nominal Value by SKS Power Sdn. Bhd.

Following is the detailed explanations on the above structure:-

Transaction 1

The issuer and the relevant joint lead managers execute an IPA under which the issuer agrees to construct and deliver to the relevant joint lead managers

the identified *istiṣnāʿ* assets in consideration of the IPA. The *istiṣnāʿ* purchase price shall be disbursed to the issuer in one lump sum.

Transaction 2

Thereafter, the relevant joint lead managers and issuer enter into an ISA under which the relevant joint lead managers agree to construct and deliver to the issuer the said identified *istiṣnāʿ* assets in consideration of the *istiṣnāʿ* sale price, which is equivalent to the aggregate of the *istiṣnāʿ* purchase price and the profit thereon. The *istiṣnāʿ* sale price will be paid according to an agreed payment schedule. Delivery of the identified *istiṣnāʿ* assets to the issuer will take place upon the relevant joint lead managers taking delivery of the same under the IPA. The IPA and the ISA are entered into on a parallel basis.

Transaction 3

The Islamic MTNs issued by the issuer is the evidence of the *istiṣnāʿ* sale price payable by the issuer under the relevant ISA. Each issuance of the Islamic MTNs under the Islamic MTNs Programme shall involve a separate set of IPA and ISA

c) ISSUANCE OF RM4,847 MILLION SENIOR ISLAMIC MEDIUM TERM NOTES FACILITY BY JIMAH ENERGY VENTURES SDN. BHD.

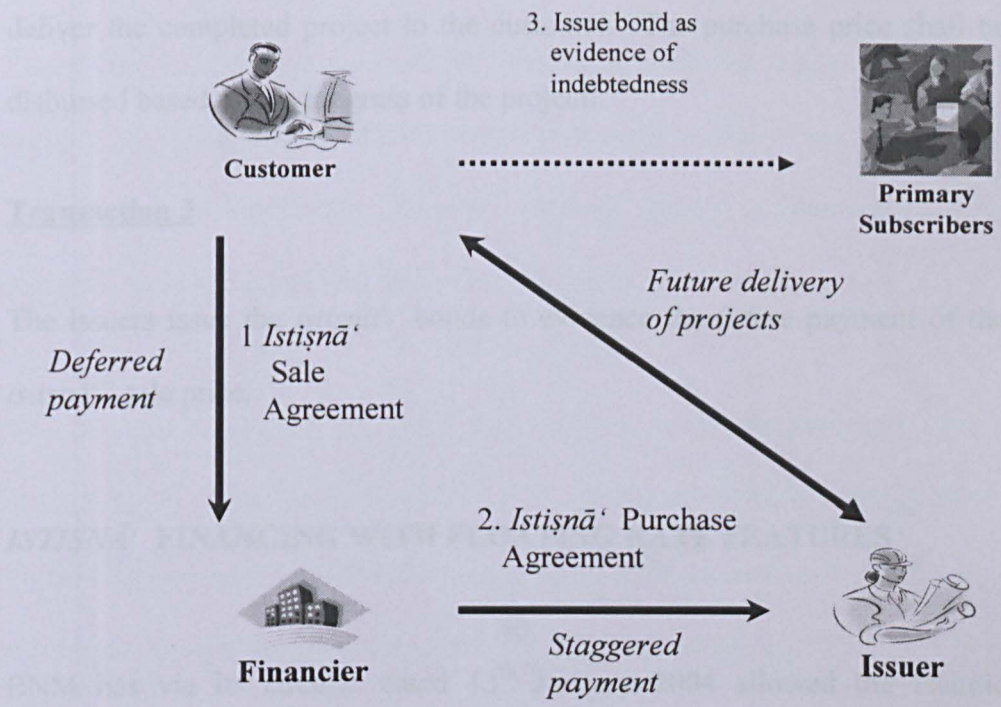


DIAGRAM 3.10

Issuance of RM 4,847 Million Senior Islamic Medium Term Notes Facility By Jimah Energy Ventures Sdn. Bhd.

Explained below is a step-by-step transaction for the above structure:-

Transaction 1

The customers cum issuers and financiers will execute an ISA pursuant which the former shall request the latter to undertake the project and the latter have agreed to undertake the project and thereafter sell the project at the selling price on deferred payment basis to the former.

Transaction 2

The financiers shall have the right to request another party which may be the customer, pursuant to IPA to undertake the project at the purchase price and deliver the completed project to the customer. The purchase price shall be disbursed based on the progress of the project.

Transaction 3

The issuers issue the *istiṣnāʿ* bonds to evidence the future payment of the *istiṣnāʿ* sale price.

3.6 *ISTIṢNĀʿ* FINANCING WITH FLOATING RATE FEATURES

BNM has via its circular dated 13th January 2004 allowed the Islamic financial institutions to introduce a financing based on BBA and *Murābahah* contract with floating rate features. Some banks have extended the application of this feature to financing based on *istiṣnāʿ* and *bayʿ al ʿīnah* contract.

The core feature of this mechanism is the fixing of selling price at a ceiling price based on the capped profit rate. This is to avoid uncertainty as far as the price is concerned. Nevertheless, the monthly installment payable by the customer will be based on the effective profit rate. This means, the whole installments payable do not necessarily based on that ceiling price because it

will be fixed according to the effective profit rate which can be lower or higher depending on the prevailing market rate⁷⁰ but should not exceed the selling price.

To achieve this purpose, the bank will have to provide two types of rebate i.e. compulsory rebate and optional rebate. The former type of rebate refers to the rebate granted if there is any difference between the selling price and the total monthly installment payable at the end of the financing tenure.

The optional rebate on the other hand refers to the discretionary rebate granted by the bank in the case of early settlement of the financing. This mechanism will allow the Islamic banks to introduce a more competitive and profitable product yet within the ambit of *Sharī'ah* principles.

For better understanding, it is perhaps useful to provide a simulation of this floating rate features:-

Purchase price	:	RM100,000-00
Selling price	:	(RM100,000-00 x 10% x 10 years) + RM100,000-00 = RM200,000-00
Initial profit rate	:	10%
Installment based on initial profit rate	:	(RM200,000-00 / 120 months) = RM 1666-00

⁷⁰ For instance based on Kuala Lumpur Interbank Offer Rate (KLIBOR)

Say for example, during the first month, the effective rate is 6%, so the monthly installment payable is RM 1333-00 based on the following calculation formula:-

$$\begin{aligned} \text{Monthly installment based on } 6\% &= (RM100,000-00 \times 6\% \times 10) + RM100,000-00 / 120 \\ &= RM1333-00 \end{aligned}$$

$$\begin{aligned} \text{Thus, the compulsory rebate is } &RM1666-00 - RM1333-00 \\ &= RM333-00 \end{aligned}$$

CHAPTER 4

In case of bond issue, Jimah Energy Ventures has adopted floating mechanism for its *istiṣnā'* bond.

CHAPTER 4

CHAPTER 4

***ISTIṢNĀ'* FINANCING IN MALAYSIA: COMPLIANCE ISSUES**

The discussion in previous chapter reveals an apparent transformation of *istiṣnā'* contract laid down by the former classical scholars. This chapter aims at analysing *istiṣnā'* financing as practiced in Malaysia and related issues especially in terms of their compliance with original Islamic law requirements. The discussion will also encompass the compliance issues in respect of some existing laws in force in Malaysia.

4.1 DEFINITION OF *ISTIṢNĀ'*

In most agreements, *istiṣnā'* has been appropriately defined as *Sharī'ah* principle that concerns with the order and delivery of a specified item to be manufactured or constructed, asset or property at a future date. However, it is submitted that a better term to replace the word principle is contract since *istiṣnā'* is one category of sale contract in *fiqh mu'āmalāt*.

4.2 PILLARS OF *ISTIṢNĀ'*

There are two separate documents to reflect parallel *istiṣnā'*. These documents are ISA and IPA. Both documents represent an '*aqad* document

which spell out the essential pillars of *istiṣnāʿ* contract i.e offer and acceptance, parties to the contract, price and specification of subject-matter.

ISA shall be executed first between the customer and the bank. Subsequently thereafter, the parties shall enter into IPA together with contractor.

Under the first agreement, the bank agrees to sell and the customer agrees to purchase the building or asset to be constructed and delivered by the bank subject to and in accordance with the terms and conditions of this agreement.

Under the second agreement, the contractor agrees to construct the building for the bank upon which the bank agrees to purchase the building to be constructed and delivered by the contractor subject to and in accordance with the terms and conditions of this agreement. The agreement also requires the party i.e the customer to fill in the description and specification about the building or asset to be constructed. Purchase price refers to the financing amount required by the customer payable by the bank while selling price referred to the financing amount plus profit payable by the customer to the bank.

Thus, it is not a straightforward *istiṣnāʿ* between the buyer and manufacturer but it involves three parties whereby the bank plays a dual roles, i.e. a manufacturer on one side and the buyer on the other side.

Nevertheless, all requirements as to the pillars of this contract have been fulfilled.

4.3 METHOD OF PAYMENT

In general, mode of payment has been declared in the agreement whether single bullet payment or on staggered basis. As far as the customer is concerned, payment of selling price shall be either by way of monthly installment in accordance with the agreed schedule of payment or by way of single bullet payment.

In case of purchase price, the bank will disburse progressively upon fulfillment several conditions precedent, inter alia:-

- i) All representations and warranties shall have been complied with in all respects;
- ii) The contractor has complied with all its obligations under this agreement; and
- iii) The contractor has produced documentary evidence (including but not limited to progressive payment claims and/or architect's certificate) acceptable to the bank evidencing the construction cost of the building.

In this respect, modern *istiṣnāʿ* financing is in conformity with traditional *istiṣnāʿ* whereby in *istiṣnāʿ* contract, the price should be clearly fixed to avoid *gharar*. In case of parallel *istiṣnāʿ*, the price payable by the bank to the contractor is usually called purchase price i.e. financing amount required to complete the project. The price to be paid by the customer to the bank is termed as selling price and it comprises of financing amount plus profit to the bank. Additionally, it is also not a condition that the price should be paid in advance.

4.4 FIXING DATE OF DELIVERY

For proper monitoring and risk control, the date of delivery has been fixed in the agreement. This is in line with Abū Yūsuf and Moḥammad bin al-Ḥassan al-Shaybānī's opinion.

4.5 BINDING NATURE OF *ISTIṢNĀʿ* CONTRACT

Once the parties have executed the agreement, they are bound by the terms and conditions of the contract.⁷¹ The contract becomes binding on both parties whereby they have agreed upfront that in the event the building or asset constructed does not comply or meet with the specifications as contained in the original agreement (between customer and contract awarder)

⁷¹ However the disbursement is *mawqūf* (conditional) and subject to fulfillment of conditions precedent by the customer or contractor, as the case may be.

the bank shall accept the same at its existing state at the price equivalent to the sum already paid by the bank to the contractor under the agreement.⁷²

Furthermore, the parties also agree that in the event the contractor fails to complete and deliver the building to the bank within the time period as stipulated in the original agreement, the bank shall accept the uncompleted building from the contractor at the purchase price equivalent to the sum already paid by the bank to the contractor under this agreement.⁷³

The same terms also appear in ISA whereby the customer is obliged to accept the building at its existing state even though it does not comply with the fixed specification and also agrees to pay the selling price. Similarly, the customer is also required to agree that in the event the bank or the contractor appointed by the bank to undertake the building for the bank under the IPA fails to complete and deliver the building within the time period as stipulated in the original agreement which results in the failure of the bank to deliver the building to the customer under this agreement, the customer shall accept the uncompleted building from the bank at its existing state at the selling price. In this situation, the bank shall have the absolute discretion to reduce the selling price.

⁷² *Istiṣnāʾ* Purchase Agreement.

⁷³ This also refers to *Istiṣnāʾ* Purchase Agreement.

Pertaining to this issue, the approach of treating *istiṣnāʿ* contract as binding corresponds with the view of Abū Yūsuf as well as the provision in *Majallah* with one point of difference i.e. Abū Yūsuf and the *Majallah* give the customer an option to refuse or to accept if the subject-matter does not match the agreed prescription whilst under the Malaysian practice is not so.

In this respect, a question arises as to whether the term on the acceptance of the building at its existing state regardless of its completion in accordance with the specification is permissible from *Sharīʿah* point of view ? It seems that the agreement tries to exclude the application of *khiyār al-ʿayb* (option of defect) and *khiyār fawāt al-waṣf al-marghūb* (option of desired description).⁷⁴

Arguably, it is worth to explain about these two kinds of option since it will assist towards understanding the final conclusion made later. *Khiyār al-ʿayb* is the right of buyer to cancel or to confirm the contract if he discovers a defect in the object which diminishes its value.⁷⁵ It is a legal right whereby there is no need for the contracting parties to stipulate a special clause at the time of the contract.⁷⁶ *Khiyār fawāt al-waṣf al-marghūb* on the other hand refers to the right to rescind the contract due to the absence or violation of the desired description stipulated by the contracting parties in the subject-matter

⁷⁴ These two options are more or less similar and their legality also lies on the same basis.

⁷⁵ Wafā, Muḥammad (1987), *Buyūʿ al-Taghrīr wa al-Tadlīs : Bayʿ al-Maʿayb fī al-Fiqh al-Islāmi wa al-Qānūn al-Waḍʿīʿ al-Miṣrī*, Cairo : Dār al-Ṭibāʿah al-Muḥammadiyyah, p. 15

⁷⁶ Rayner S.E. (1991), *The Theory of Contracts in Islamic Law*, London : Graham & Totham, pp.327-328

of the contract.⁷⁷ As opposed to option of defect, this type of option must be explicitly stipulated in the contract. This stipulation should be viewed under the general theory of contracts and conditions.⁷⁸ Another difference is that defective goods will affect the value of the object in the market whilst violation of the desired description will not be regarded as defect in all cases since it does not necessarily reduce the value of the said goods.

The causal reason for the option of defect is to uphold justice among the contracting parties. Allah s.w.t. has prohibited the taking of other's money illegally and thus allows the victimized party to rescind the contract in the presence of defect. This can be seen in *Sūrah al-Nisā'* (4:29). Additionally, there are several *aḥadīth* of the Prophet s.a.w. which legalize the exercise of this option. The *aḥadīth* are as follows:-

- a) A Muslim is brother to another Muslim. It is unlawful for a Muslim to sell to his brother a defective good unless he makes it clear to him.⁷⁹
- b) It is also reported that the Prophet s.a.w. passed by someone selling foodstuff. He put his hand in it and found it wet. He then said, "Who cheats us is not from us."⁸⁰

⁷⁷ Abū Ghuddah, 'Abdul Sattar (1985), *al-Khiyār wa Atharuhu fī al- 'Uqūd*, Jeddah: Majmū'at Dāllat al-Barakah Idārat al-Taṭwīr wa al-Buhūth, p. 719

⁷⁸ It is allowed because it is beneficial to the parties as in the case of charge and guarantee.

⁷⁹ Ibn Mājah, Muḥammad bin Yazīd (1980), *Sunan Ibn Mājah*, vol. 2, Beirut : Maktabah 'Ilmiyyah, *kitāb al-tijārāt*, ḥadīth no. 2246, p.749.

⁸⁰ Ibid. *Kitāb al- tijārāt*, ḥadīth no. 2224, p.755.

There are however several conditions which must be fulfilled before one can exercise the option of defect in an ordinary sale. These conditions are:-⁸¹

- a) The defect has existed in the subject-matter prior to the time of sale or it occurs before the delivery and while it is still in the hands of the seller.⁸²
- b) The defect must continue to exist when the buyer has taken possession of the object as well as when the buyer wants to annul the contract. If the defect disappears before the cancellation, then the right ceases to exist.
- c) The buyer must be unaware of the defect at the time of the contract and takes the possession of the subject-matter. Otherwise he is considered as impliedly consent to it.⁸³
- d) The defect decreases the value of the subject-matter or renders it unfit for the purpose it is lawfully destined.⁸⁴
- e) The defect is major, material and not easily removed.
- f) The contract must not have been subject to an agreement excluding guarantee. However, if the buyer has exonerated the seller from his responsibility for defect, he has no option.
- g) The seller did not stipulate that he is not liable for any defect.⁸⁵

However, there are juristic discourses in regard to this condition. The

⁸¹ al-Zuhaylī, (1996), *op.cit.*, pp.559-560.

⁸² See also *Majallah*, Art. 340. It is submitted that this condition is inapplicable in the case *istiṣnāʾ* since the subject-matter is not in existence yet at the time of contract.

⁸³ See also al-Sanhūrī, ‘Abd. al-Razzāq Aḥmad (1983) *Maṣādir al-Haqq fī al-Fiqh al-Islāmī*, vol. 4, al-Qāhirah : Dār al-Nahdah al-‘Arabiyyah, p.274.

⁸⁴ See also *Majallah*, Art. 336.

⁸⁵ See also *Majallah*, Art. 342.

Hanafīs observes that the seller has a right to exclude himself from any liability for any defect in the commodity as long as the condition is mutually agreed between the contracting parties.⁸⁶ On the contrary, majority scholars do not recognize such exclusion and held that the seller is still liable despite his stipulation to waive himself from the responsibility unless the defect is invisible.⁸⁷ This reason is attributed to the fact that waiver to all types of defect will protect fraud, dishonesty and corruption. Nevertheless, all jurists unanimously agree that if the seller is acting in *mala fide*, the clause is void and his liability is maintained.⁸⁸

Option of desired description must conform to these conditions:-⁸⁹

- a) It must be an attribute.
- b) The desired description must be legal by itself.
- c) It must be clear and unambiguous.
- d) It must be stipulated.

If the option of desired description exists, the buyer has an option whether to return the asset or to take them at the full price without any compensation for

⁸⁶ al-Zuhaylī, (1996), *op.cit.*, pp.572-575.

⁸⁷ Ibid.

⁸⁸ Ibid.

⁸⁹ Abū Ghuddah, ‘Abdul Sattar, *op.cit.*, p. 724-726.

such contravention.⁹⁰ In case of option of defect, if the defect has been discovered and fulfills all conditions, the law has guaranteed the buyer's right to call off or confirm the contract with the full price based on the Hanafis and the Shafi'is's view. The Malikis only allow if the defect is major. The Hanbalis opine that he can opt whether to cancel or to confirm it with commensurate damages to the defect. The Malikis also give the same view but only if the defect is major.

Next is it permissible to stipulate the exclusion of this two types of options in *istiṣnā'* contract? Pertaining to the option of desired description, if we refer to Abū Yūsuf's opinion, although *istiṣnā'* contract binds the parties from the beginning, the buyer still has an option to accept or to reject if it mismatches the description. However, throughout the research done, ruling out an option of defect in *istiṣnā'* contract was never discussed by the classical jurists including the Hanafis.

Nevertheless, a modern scholar, al-Zarqā' is of the opinion that among the point of difference between the ordinary sale and *istiṣnā'* which must be adopted is that any clause intended to waive the responsibility of the seller from any defect in the commodity should be treated as absolutely void

⁹⁰ Ibid., p. 730

regardless of the divergence opinions about its validity among the classical scholars in the ordinary sale.⁹¹

The argument is sensible especially when nowadays, *istiṣnāʿ* instrument has been used as a tool to finance a classy articles and high-level projects whereby any defect would obviously lead to a massive financial loss. This leeway will create an opportunity for some corporations to rely on this clause as escapism from their legal liability.

Obviously, the principle of bearing responsibility for any defective manufactured goods is an essential part of the *istiṣnāʿ* contract and Islamic banks should not see it as a hindrance but rather as one of the distinguishing element between *ribāwī* and Islamic investment.⁹²

Shariʿa Standards (hereinafter referred to as the Standards) is in line with this approach whereby it states to the effect that if the subject-matter does not conform to the specification agreed upon, the customer has the option to accept or refuse the subject-matter.⁹³ It also does not permit the manufacturer to stipulate in the contract that he is not liable for defect.⁹⁴ It also spells out that in parallel *istiṣnāʿ*, the bank is not allowed to transfer the risk arising

⁹¹ al-Zarqāʾ, Muṣṭapha Aḥmad (1995), *ʿAqad al-Istiṣnāʿ wa Mada Ahammiyyatuhu fi al-Istithmārāt al-Islāmiyyah al-Muʿāṣirah*, (Lectures Series of Renowned Scholars No.12), Jeddah : Islamic Development Bank, pp.37-49 as quoted by Muhammad al-Bashir Muhammad al-Amine (2001), *op.cit.*, p.47

⁹² Ibid.

⁹³ *Shariʿa* Standards (2002-2003), *op.cit.*, p. 179

⁹⁴ Ibid., p. 180

from its obligation towards customer.⁹⁵ The justification for this impermissibility is because *istiṣnāʿ* is a sale of a specified goods to be delivered in the future and exclusion of liability as to defect is valid only in sales of particular identified goods.⁹⁶ This prohibition of excluding defect liability in *istiṣnāʿ* is one feature that makes it different from an ordinary sale.⁹⁷

Exclusion of ownership liability is also indicative of non-compliance with the established principle of *al-ghunmu bil ghurmi* (no profit without risk) and *al-kharāj bil ḍamān* (in any benefit lies a liability) which is the cornerstone of Islamic theory of profit. The banks are not interested to bear the risks associated with the *istiṣnāʿ* contract such as non-completion or defective construction of the project undertaken. The absence of *ʿiwaḍ* (equal counter value) in the sale contract puts the risk of implicating *ribā* in the profit created from the *istiṣnāʿ* financing.

Hence, it is vividly clear that the treatment concerning the binding principle of *istiṣnāʿ* as practised in Malaysia does not tally with classical⁹⁸ as well as AAOIFI Standards.

⁹⁵ Ibid., p. 187

⁹⁶ Ibid., p. 191

⁹⁷ Ibid.

⁹⁸ Abū Yūsuf's opinion and also provision in the *Majallah*.

4.6 THE LEGAL CONSEQUENCES OF *ISTIṢNĀ'*

The transfer of ownership of the *istiṣnā'* asset from the contractor to the bank and from the bank to the customer and the entitlement of the *istiṣnā'* price whether purchase price or selling price is subject to the fulfillment of a list of condition precedents by the customer and the contractor respectively. Thus, it differs from the original view stated by Muslim scholars who considered the transfer of ownership is automatic and unconditional and the manufacturer is entitled to the agreed price once the contract is constituted.

It is worth to discuss about the judicial treatment on *istiṣnā'* financing in Malaysia as far as its legal consequence is concerned.

In the case of *Tahan Steel Corporation Sdn Bhd v. Bank Islam Malaysia Bhd* [2004] 6 CLJ 25 and [2004] 6 CLJ 131, the plaintiff secured *istiṣnā'* financing facility from the defendant to develop and construct a Steckel Hot Strip Mill Plant to produce Hot Rolled Coils (hereinafter referred to as the project). The defendant purchased the project from the plaintiff for a purchase price of RM 97 million which is disbursed immediately into a financing payable account. From such account, the monies are paid out to the plaintiff upon the latter meeting all conditions stipulated in the *istiṣnā'* purchase agreement. Subsequently, the defendant sold back the said project to the plaintiff by way

of *istiṣnā'* sale agreement for an agreed price comprising the purchase price together with profit margin.

The disbursement of purchase price is however subject to fulfillment of a list of conditions precedent one of which is to secure the EXIM loan from foreign EXIM banks due to sound commercial basis. There is no evidence indicating that the plaintiff has complied with the said condition. Despite the non-fulfillment of the said condition, the defendant had released two tranches of the facility but refused to release the third tranche of the facility.

The plaintiff claimed that the defendant had fundamentally breached the facility agreements by its wrongful suspension of the drawdown of the RM 97 million and had also wrongfully conducted itself in unilaterally purporting to re-write the terms of the facility agreements, and that by reason of these fundamental breaches, the defendant was not entitled to enforce the security documents against the plaintiff.

It was held that the plaintiff was not entitled to depart from the requirement of the EXIM loan condition without the written and signed consent of the defendant and on the facts, there is no evidence to show that the defendant had agreed in writing to vary the contract. The defendant was well within its right to refuse to allow the disbursal of the third tranche of the facility since the plaintiff had by its own admission failed to secure the EXIM loan. There

was no legal duty on the part of the defendant to release any portion of the purchase price. In short, the plaintiff had failed to perform the contract.

Therefore, the learned judge has dismissed the plaintiff's application for an injunction to restrain the defendant from enforcing its securities to recover the monies owed to it.

It is submitted that the learned judge has carefully analysed the said case and came to the right conclusion. The decision however did not reveal the amount which the defendant was entitled to claim whether the total selling price or the selling price recalculated based on the disbursed amount or the exact amount disbursed. It is submitted that since the contract is treated as *mawqūf* (conditional) subject to fulfillment of certain conditions, neither parties were entitled to the claim the price (whether purchase price or selling price respectively). Nevertheless, since the defendant has already disbursed certain amount to the customer, the writer is of the opinion that the defendant is entitled to claim the disbursed amount only without any profit. In this situation, the defendant is deemed to make certain advancement of money but not arising from sale contract. Otherwise, the defendant is considered as has agreed to waive the condition precedent in respect of securing the EXIM loan and consequently it must disburse the whole amount of selling price.⁹⁹

⁹⁹ It is perhaps pertinent to look into the Malaysian courts stance in other decided cases as far as the issue on selling price is concerned. Firstly, the landmark case of *Affin Bank Bhd v. Zulkifli Abdullah* [2006] 1 CLJ 438. The main issue is whether the bank offering Islamic financing facility based on BBA is entitled to claim the whole amount of selling price from the customer in

4.7 TERMINATION OF *ISTIṢNĀ'* CONTRACT

It has been agreed, though not specifically stated, that the agreement comes to an end when both parties has fulfilled their obligation according to the terms of the contract. Nonetheless, the agreement may also be terminated regardless of whether the terms of the agreement have been satisfactorily fulfilled for example when the contractor fails to construct the building according to the specification as discussed before. Most of the agreements do not also stipulate the right of both parties to mutually terminate the contract although from *Sharī'ah* point of view they are entitled to do so under the principle of *iqālah* (mutual consent to call off the contract).¹⁰⁰ On the contrary, there is a clause which grants a right to the bank recall or terminate the facility at any time without assigning any reason thereto by giving written notice of the same to the customer. The effect of such recall or termination is that any amount so recalled or terminated shall become immediately due and payable within certain period of time.

the event of default (although the financing tenure does not expire yet). The judge has radically compared the facility offered based on conventional loan operation with BBA contract. The judge argued that the profit margin that continues to be charged on the unexpired tenure cannot be actual profit and if the profit has not been earned, it is not a profit and cannot be claimed under the facility. The similar issue arises in the case of *Malayan Banking Bhd v. Marilyn Ho Siok Lin* [2006] 3 CLJ 796. The judge has concurred with the judgment made in *Affin Bank* case and held that it was an authority for the proposition that it would not be equitable to allow the bank to recover the sale price as defined when the tenure of the facility was terminated prematurely. With due respect, it is submitted that, the judgments have ignored the legal consequences of sale contract based on *Sharī'ah* interpretation. The judgments also failed to acknowledge the right of the seller (bank) to the full price (though paid by way of installments) and also the right to grant *ibrā'* as a mechanism to reduce the burden on the part of the buyer (customer) to pay the debt.

¹⁰⁰ It is however submitted that such term is impractical to be included in the agreement.

There are also a number of events which can lead to the termination of the agreement. This clause seems to be acceptable because it intends to secure the right of the bank and occurs due to the default of the customer. These events of defaults include but not limited to the followings:-

- (a) Breach of the terms of contract by the parties.
- (b) Failure by customer to pay any sums due to whether on demand being made by the bank or not.
- (c) Bankruptcy petition shall be presented or an order is made for bankruptcy or other analogous proceedings are instituted against the customer.

Upon the occurrence of any of the abovementioned, the whole outstanding sum and any other monies due and outstanding under this agreement and the security documents shall become due and immediately payable on demand. The obligation of the bank to perform during the continuance of default shall be immediately suspended. If the customer fails to pay the outstanding sum after a demand for payment of the same has been made by the bank, the agreement will be terminated and the bank shall be entitled to enforce any or all of the remedies available to the bank under this agreement and/or the security documents.¹⁰¹

¹⁰¹ Several documents which constitute securities to the bank including letter of offer, charge annexure etc.

There is another clause which renders the contract to be terminated i.e. illegality. Based on this clause, if by reason of any change in any applicable law, regulation or regulatory requirement by any governmental or any authority whereby it shall become unlawful for the bank to comply with its obligations under the contract, the bank shall promptly inform the customer of the relevant circumstances whereupon:

- (a) Any outstanding obligations of the bank shall be terminated and cancelled; and
- (b) The customer shall upon demand refund to the bank all monies covenanted to be paid by the customer under the contract.

As far as the death of either party is concerned, it should be noted that this condition should be applicable only if the parties are individuals. In case of company, its juristic will continue as long as the corporation is in existence regardless of the death of its members. However, the contract may be terminated if the company is wound-up. It is also normal for the bank to undergo merger process, amalgamation or reconstruction and if such thing happens, it does not in any way affect the obligation of the bank created in the contract.

4.8 PARALLEL *ISTIṢNĀ'*

The core issue surrounds the application of *istiṣnā'* contract as practised by most banks in Malaysia is that it does not in actual fact a tripartite arrangement involving three different parties. Although it seems to be tripartite whereby the first arrangement is between the customer and the bank and the second arrangement is between the bank and the contractor, the customer and the contractor is referring to the same party.

This attracts non-compliance issue as far as the Middle Eastern approach is concerned as embodied in the Standards issued by AAOIFI in the chapter relating to *istiṣnā'* and parallel *istiṣnā'*. The Standards states to the effect that it is not permitted to conclude *istiṣnā'* contracts or processes of *istiṣnā'* in a manner that makes it a legal device for mere interest based financing.¹⁰² One of the instances mentioned is where the party ordering the subject-matter to be produced is the manufacturer himself.¹⁰³ This, according to the Standards would make the deal an interest-based financing deal in which the subject-matter never genuinely changes hands even if the deal is won through competitive bidding.¹⁰⁴

Apparently, the second issue would follow since the structure accepted is two-partite structure consists of the sale and buy-back element between the

¹⁰² *Shari'a Standards, op.cit.* p. 180

¹⁰³ *Ibid.*

¹⁰⁴ *Ibid.*

customer and the bank. This buy-back arrangement has been regarded by majority jurists as tantamount to sale of cash or *bay' al-'īnah* which is disallowed by most classical as well as contemporary jurists.

For the sake of this discussion, it is perhaps sufficient to concisely elaborate here the views of the distinguished scholars representing the main schools of Islamic law on *bay' al-'īnah*. Firstly, the Malikis and Hanbalis indisputably ruled that *bay' al-'īnah* is void and impermissible to prevent a legal trick to circumvent the prohibition of *ribā* based on the principle of *sadd al-zarī'ah*.¹⁰⁵ Additionally, they also relied on the narration whereby 'Aishah has disapproved *bay' al-'īnah* as practised by Zayd bin Arqām which reads as follows:-

'Āliyah bin Awfa said: I entered 'Aishah's place with Umm Walad Zayd bin Arqam and his wife. Then, Umm Walad Zayd bin Arqam said: "I had sold a slave to Zayd bin Arqam for 800 dirhams on deferred payment. Then I bought him back from Zayd for 600 dirhams cash". 'Aīshah replied, "Very bad is what you sold and bought. Convey to Zayd that he had nullified his struggle with the Prophet s.a.w. unless he repented."¹⁰⁶

The Hanafis also shared the similar stance in prohibiting the sale and buy back arrangement and considered the contract as *fāsid* (bad). Nonetheless,

¹⁰⁵ It basically means to close the way which can lead to prohibited things.

¹⁰⁶ al-Zuhaylī (1996), *op.cit.* vol. 4, pp. 466-467.

they ruled that if the contract involved three parties where a third party intermediated between the original seller and buyer, it is valid.¹⁰⁷

According to the Shafi'is and Zahiris, it is acceptable since the contract fulfilled all the requirements of a valid sale and cannot be nullified by sheer supposition of the existence of an illicit ulterior intention to get around the prohibition of *ribā*. They further argued that legal judgment can only be given based on the manifest intention and not otherwise which is left to the God's judgment.

Malaysian scholars have relied on the opinion attributed to the Shafi'is and the Zahiris in allowing *bay' al- 'inah* although majority of contemporary scholars prone towards disapproving this kind of sale. One of the underlying reasons to support the adoption of this view is public interest consideration i.e. to overcome the problem of liquidity in the country without resorting to the conventional *ribā*-based lending.¹⁰⁸

Other than the issue of *bay' al- 'inah*, Malaysian version of parallel *istiṣnā'* also does not fulfill the required conditions as per specified by the Standards.¹⁰⁹ To reiterate, these conditions are firstly, the responsibility of the bank towards the ultimate buyer irrespective of the fulfillment of the

¹⁰⁷ As seen in the *tawarruq* contract practised in the United Arab Emirates countries.

¹⁰⁸ Engku Rabiah Adawiah Engku Ali (2003), *op.cit.* p. lxxi.

¹⁰⁹ See also Capital Adequacy Standard for Institutions (Other Than Insurance Institutions) Offering Only Islamic Financial Services issued by Islamic Financial Services Board, December 2005, p. 28.

obligations of the manufacturer in parallel *istiṣnāʿ* and secondly, the institution must also assume liability for ownership risk and maintenance and insurance expenses prior to delivering the subject-matter to the ultimate buyer.

Looking at the existing scenario for project financing in Malaysia whereby the parties in need of financing have usually entered into a legal relation with the awarder before they seek financing from the banks, it seems difficult if not impossible for tripartite arrangement to materialize. Similar issue arises in the case of house financing whereby the customer has usually entered into a sale and purchase agreement with the developer prior to obtaining financing from the bank. Non-existent of this earlier legal relationship would lead to uncertainty in the extent of the parties' commitment which would be impractical for the customer to approach the bank to secure the financing and also for the bank to offer the same.

4.9 OTHER TERMS AND CONDITIONS

Below are a list of clauses embodied in the *istiṣnāʿ* contract whereby most of these conditions are not directly discussed by the classical scholars.

4.9.1 Compensation for late payment

The agreement also provides a compensation clause which allows the bank to impose on the customer to pay a certain amount of compensation on overdue installments and payments of selling price on the due date as follows:¹¹⁰

- (a) For failure to pay any installments of the selling price from the date of the first disbursement until the due date; the compensation rate that shall be applied shall be one per centum (1%) per annum on the overdue amount or any other method approved by BNM;
- (b) For failure to pay any installments/ payments and which failure continues beyond the due date; the compensation rate that shall be applied shall be the bank's current Islamic Money Market rate on the principal balance or any other method approved by BNM;
- (c) The amount of such compensation shall not be compounded on the principal amount.

¹¹⁰ BNM circular dated 10th December 1998.

This is in line with the resolution made by SAC of BNM as well as SC.¹¹¹ The permissibility is backed by some of the following arguments:-

- a) *Ḥadīth* of the Prophet s.a.w. stated that he admonished those who delay in the payment of debt. He said to the effect that procrastination (delay) in repaying debts by a wealthy person is injustice.¹¹²
- b) By way of *qiyās*, the act of delay in settling the debt is equal to *ghasb* (usurpation) of valuable property. The *'illah* is similar that is depriving the use of property and exploiting it in an oppressive way.¹¹³ The Shafi'is and Hanbalis school view that the usurper is obligated to pay compensation to the owner because he has gained benefit out of using the latter's property.¹¹⁴ Likewise, the creditor should also be compensated since the debtor has used the former's money to the extent of denying him from utilizing it for his own benefit.¹¹⁵

¹¹¹ During its 20th meeting on 14th July 1999 and 30th meeting on 8th November 2000, see *Resolutions of the Securities Commission Syariah Advisory Council*, *op.cit.* p. 102.

¹¹² Bukhārī, Muḥammad Ibn Ismā'il, (1977), *The Translation of the Meanings of Ṣaḥīḥ al-Bukhārī*, vol. 3, Chicago : Kazi Publications, *kitāb fī al-Istiqrāḍ wa Ada' al-Duyūn wa al-Ḥijr wa al-Taflīs*, *ḥadīth* no.588, p. 345

¹¹³ *Resolutions of the Securities Commission Syariah Advisory Council*, *op.cit.* p. 103

¹¹⁴ Ibid. pp. 103-104.

¹¹⁵ Ibid.

c) Resolution of Qāḍī Shurayḥ as in a case narrated by Bukhārī from Ibn Sirīn:-

A potential customer said to the owner of some animals for hire, "Prepare for me one of your animals. Should I not hire it on such a date, I will pay you 10 dirham."

Apparently the customer did not proceed with his deal and so according to Qāḍī Shurayḥ, "Whoever imposes a condition upon himself voluntarily, then that condition is binding."¹¹⁶

The payment is for opportunity loss borne by the creditor. Muṣṭafa al-Zarqā' sums it up by saying that compensation is for loss (borne by parties involved in a business transaction) as a result of waiting and disrupting transaction.¹¹⁷

Islamic *Fiqh* Academy has issued a resolution concerning this issue whereby it is lawful to insert liquidated damages and penalty clause in *istiṣnā'* contract.¹¹⁸

¹¹⁶ Ibn Ḥajar al-ʿAsqalānī (1959), *Fath al-Bārī*, vol.5, Bayrūt: Dār al-Maʿrifah, p.707.

¹¹⁷ Al-Zarqā', Muṣṭafa Aḥmad (1998), *al-Madkhal al-Fiqhī*, vol.1, Dimashq : Dār al-Qalam, p.496.

¹¹⁸ Resolution No. 65(7/3) made during its seventh session held on 7-12 Zulqāʿidah 1412H / 9th -14th May 1992. See also Resolution No. 109(12/3) made during its 12th session held on 25 Jamādīl Ākhīr – 1 Rejab 1421H / 23rd -28th September 2000.

Under the Standards, this clause is known as penalty clause. However, it is applicable in a different way whereby this penalty clause should be stipulated against the ultimate purchaser for default on payment but against the manufacturer to compensate the ultimate purchaser due to late delivery by the former. Such compensation is permissible only if the delay is not attributed to intervening contingencies.¹¹⁹

The compensation will be treated as an income to the bank. In some other jurisdiction, the compensation amount will be donated for charitable purposes. However, it is submitted that based on the argument forwarded above, compensation can be part of the bank's income since the delay has caused hardship to the bank.

4.9.2 Force Majeure

It refers to dominant unforeseen event such as action or inaction of any governmental or local authority or any strike, boycott, blockade, act of God, civil disturbance or cause beyond the control of the contracting parties which affect their abilities to perform their respective obligations under the contract. In this regard, the bank has stipulated that it will not be liable for any failure to perform any

¹¹⁹ *Shari'a Standards* (2002-2003), *op.cit.*, p. 186.

obligation resulting directly or indirectly from the occurrence of the aforesaid reasons.¹²⁰

In modern Arab contract law, intervening contingencies is known as *Naẓariyyāt al-Ẓurūf al-Istithnai'yyah* or *al-Ẓurūf al-Qāhiraḥ*. As a matter of fact, this principle can be traced back to the Islamic law theory of *al-Ḍarūrah al-Shar'īyyah* (legal necessity) or specifically the doctrine of *al-'Udhr* and *al-Jāi'ḥah*.¹²¹ This theory will be briefly discussed here.

Al-'udhr was popularly established by Ḥanafī school of law. It can be invoked in case of contingency which renders continuing performance of a contract harmful for one of the contacting parties.¹²² The concept of *al-Jāi'ḥah* was recognised mainly by Mālikī and Ḥanbalī school. According to the former, it refers to an irresistible occurrence such as cold, drought, plant disease and locust swarms which reduces or destroys the value of sold crops or fruits before they have been harvested.¹²³ The latter describes it as an epidemic beyond human control such as high winds, drought and other acts of God.¹²⁴

¹²⁰ Another clause which would result in the frustration of contract is the illegality clause as discussed earlier. Please refer Termination of *Istiṣnā'* Contract at para. 4.7 p. 89.

¹²¹ According to Ḥanafī school.

¹²² Adnan Amkhan, *The Effect of Change in Circumstances in Arab Contract Law*, (1994) 9 ALQ, p. 259

¹²³ Ibid. p. 260

¹²⁴ Ibid.

The legitimacy of this doctrine can be traced from these Quranic verses:-

Allah says to the effect:-

“God commands justice and fair dealing”¹²⁵

“O ye who believe! Eat not up your property among yourselves in vanities”¹²⁶

The following legal maxims are also relevant to support the validity of this doctrine:-

- 1) No harm may either be inflicted or reciprocated.¹²⁷
- 2) Necessities allow actions which would otherwise be prohibited.¹²⁸
- 3) Harm must be eliminated to an end.¹²⁹
- 4) A major harm may be replaced by a lesser harm.¹³⁰

Some ‘Arab countries have laid down certain conditions before the parties could entitle to resort to this doctrine:-¹³¹

- a) The event should be exceptional.
- b) The event should be unforeseeable.

¹²⁵ *Sūrah al-Nahl* (16:90).

¹²⁶ *Sūrah al-Nisā* (4:29)

¹²⁷ *Majallah* Art. 19.

¹²⁸ *Majallah* Art. 21.

¹²⁹ *Majallah* Art. 22.

¹³⁰ *Majallah* Art. 29.

¹³¹ Adnan Amkhan (1994), *op.cit.*, pp. 263-269.

- c) The event should be general in character affecting a wide spectrum of people.
- d) The event should occur during the performance and not before.
- e) The supervening event causes the performance of the contract by the parties highly onerous.

If the above conditions have been fulfilled, the court may ask the parties to renegotiate. If unsuccessful, the court will usually reduce the aggrieved party's burdensome obligation or increase the counter obligation.¹³²

This doctrine recognises the fact that the performance of the obligation by the parties in a contract can be frustrated due to occurrence of certain events beyond their control. Consequently, it is impossible for the parties to carry out their obligation which has been agreed at the outset.

From the above discussion, it appears that the bank has absolutely absolved itself from any liability if the intervening event happens thus lead to a question of fairness of this clause. Again, this clause is indicative of the fact that the parallel *istiṣnā'* is inter conditional with the first *istiṣnā'* contract. This is also another distinction with the

¹³² Ibid., p. 269. Compare with Art. 443 of *Majallah* which provides that if any event happens whereby the reason for the conclusion of the contract disappears, so that the contract cannot be performed, such contract is terminated.

Standards which requires the bank to make good the contract such as by appointing another contractor to perform the remaining uncompleted work.

4.9.3 Variation of Terms

The parties to the contract is allowed to vary the terms of the contract by mutual consent reflected through mutual exchange of letters or supplemental agreements or other means agreed upon by the parties. The variation made shall subject to the *Sharī'ah* principles. For example, the parties cannot increase the *istiṣnā'* price in consideration of extension of period of payment. In addition to that, variation to the works is allowed subject to prior consent of the bank if the variation is substantial. This condition is in line with the Standards.

4.9.4 Guarantee/ Security

One of the risk mitigating factors adopted by the Islamic banks is to ask the customer to provide security for the payment of the price. The security can be in the form of pledge, security deposit, assignment of contract proceed¹³³ or personal guarantee.

¹³³ This kind of security is required for example in the case of project financing involving project awarder.

The taking of security in *istiṣnā'* contract does not contravene the general principles of Islamic commercial contract because the purpose is to secure the interest of the bank in the event of default.

4.9.5 *Ibrā'* / rebate for early settlement¹³⁴

The bank may give rebate to the customer in case of early settlement at its sole discretion. This view has been in agreement with a resolution issued by Islamic *Fiqh* Academy¹³⁵ as well as the Standards.¹³⁶

Locally, SAC of SC has issued a *fatwa* (ruling) allowing the granting of rebate for early settlement relying on the principle of *ḍa' wa ta'ajjal*.¹³⁷ This principle refers to the act of creditor in reducing part of the debt when the debtor makes an early settlement. This principle is supported by a *ḥadīth* narrated by Ibn 'Abbas whereby the Prophet s.a.w. has said to *Banī Naḍīr* (when they were ordered to evacuate from Madīnah) to give discount and hasten the payment upon their claim of debt towards some people in the city.¹³⁸ Ibn 'Abbas also

¹³⁴ Detail discussions on juristic views on this issue will be discussed under the sub-topic of *Istiṣnā'* With Floating Rate Features.

¹³⁵ Resolution No. 64 (7/2) made during its seventh session held on 7-12 Zulqā'idah 1412H / 9th - 14th May 1992.

¹³⁶ *Shari'a Standards* (2002-2003), *op.cit.* p. 193.

¹³⁷ During its 10th meeting on 16-17th October 1997.

¹³⁸ Ibn Rushd, Muḥammad Ibn Aḥmad (1981), *Bidāyat al-Mujtahid*, vol.2, Egypt: Maṭba'at al-Bāb al-Ḥalabī, pp.143-144.

opines that this principle is allowable because it concerns with claiming part of one's right and relinquishing another.¹³⁹

Thus, the approach adopted by Malaysian banks is in line with the opinion of Ibn 'Abbas, Ibrāhīm al-Nakha'ī as well as Ibn Taymiyyah and Ibn Qayyim as opposed to Hanafis, Malikis, Shafi'is and majority of the Hanbalis. The latter group considers it as an illegal transaction arguing that the transaction is equivalent to the act of asking the debtor to pay more money in exchange of relaxation of time to pay.¹⁴⁰

They relied on the *ḥadīth* of the Prophet s.a.w who said to Miqdād al-Aswad that he has eaten *ribā* when he requested a debtor to give him 90 dinars before the due date of payment instead of 100 dinars.¹⁴¹ Ibn Qayyim has refuted this argument by drawing a distinction between *ribā* and the principle of *ḍa' wa ta'ajjal* whereby *ribā* is either you increase the payment due to late payment or settle the debt in time while *ḍa' wa ta'ajjal* is to pay the debt earlier and the amount of debt will be lessened. Furthermore, there is no explicit *naṣ*, *ijmā'* and validated *qiyās* to prohibit this principle.

In conclusion, although the parties can stipulate whatever conditions in the contract by virtue of the doctrine of *ḥurriyyah al-syurūṭ* or

¹³⁹ Ibn Qudāmah, Muwāfaq al-Dīn 'Abdallāh Ibn Aḥmad (1994), *al-Mughnī*, vol. 4, Bayrūt : Dār al-Fikr, p.189.

¹⁴⁰ Ibn Rushd (1981), *op.cit.*, pp 236-237.

¹⁴¹ al-Bayhaqī, Aḥmad bin al-Ḥusīn (1980), *al-Sunan al-Kubra*, vol.6, Bayrūt : Dār al-Fikr p.28.

freedom to stipulate conditions, the drafters of the agreement must also remember that the freedom is not absolute. Firstly, the condition must comply with the *ḥadīth* of the Prophet s.a.w. to the effect that Muslim are bound by their conditions unless condition which changes *ḥarām* (unlawful) into *ḥalāl* (lawful) or vice versa.¹⁴² Secondly, the principle of justice and fairness whereby it must not be one sided agreement against the interest of weaker bargaining power.

4.10 FLOATING RATE *ISTIṢNĀ'*

This kind of instrument is first ever introduced in Islamic banking systems. The issue is whether compulsory rebate is allowed by classical jurists as well as scholars in other jurisdictions. One may argue that this is another trick to play around with the rise of interest rate and also the fixing of tremendously high selling price which is oppressive to the customer.

As discussed before, the party to the contract is allowed to grant rebate but it must not be stipulated as a condition rather it should be at a discretion of the party.

¹⁴² al-Bayhaqī, Aḥmad bin al-Ḥusīn et. al Muḥammad 'Abdul Qādir 'Aṭa' (1994), *al-Sunan al-Bayhaqī al-Kubra*, vol. 6, Makkah al-Mukarramah: Maktabah Dār al-Bāz, *ḥadīth* no. 11211 p.79.

Islamic *Fiqh* Academy has concurred with the second opinion. The Academy resolved that a rebate for early payment whether it is requested by the creditor or out of debtor's willingness is legal and not a kind of *ribā* provided it is not the result of prior agreement between the parties and the deal involves only two parties.¹⁴³

It is clear from the above that Malaysian scholars have departed from the opinion of Middle Eastern scholars.

4.11 *ISTIṢNĀ'* BONDS¹⁴⁴

The fundamental issue lingering in the Malaysian capital market in particular regarding IPDS issuance is the practice of debt trading at a discount which is absolutely unacceptable by the Middle Eastern scholars. In Malaysia, the permissibility of such practice is primarily based on two principles. Firstly, asset securitization process which has transformed the nature of debt as a monetary receivables to an independent asset which is non-monetary and consequently not bound by the rules for exchange of *ribāwī* goods. Secondly, the principle of *ḍa' wa ta'ajjal* as discussed before which allows the debtor to pay the debt at a lesser amount than the original since he accelerates the payment.

⁴³ If third party is involved, it is illegal because it will lead to bill discounting. Resolution No. 64 (7/2) made during its seventh session held on 7-12 Zulqā'īdah 1412H / 9th -14th May 1992.

⁴⁴ This section will focus on the stage where the securitized debt is sold at the secondary market.

To have a clear picture on this issue, the discussion will touch on the background of *bay' al-dayn* ranging from the definition of debt and various juristic opinions pertaining to this kind of sale.

Debt or *dayn* in Arabic term is capable to be defined as a constructive asset in the obligation of the debtor.¹⁴⁵ In general, it can be referred to as the right to receivables resulting from various transaction whether loan or exchange contracts such as *murābahah*, BBA, *ijārah*, *istiṣnā'* and so on. From this definition, it is clear that debt is a form of *māl* (asset), even if *hukmiy* (constructive) and *'aynī / māddī* (not real).¹⁴⁶ In conclusion, debt is a form of asset or at least *haq mālī* (financial right).¹⁴⁷

It is then confirmed that debt is recognized as an asset or financial right. Next question is whether it can be bought or sold. The jurists have given different views concerning this. As far as the trading occurs between the debtor and creditor, most jurists including the Hanafis, Malikis, Shafi'is and the dominant view of Hanbalis are of the opinion that it is allowable.¹⁴⁸ The differences of opinion are apparent in case of sale of debt between creditors and a third party.

¹⁴⁵ *Majallah*, Art. 158.

¹⁴⁶ Engku Rabiah Adawiah Engku Ali (2003), *op.cit.*, p. lxxv.

¹⁴⁷ Ibid. *Haq mālī* are rights on assets with financial values such as *haq dayn* (debt right) and *haq tamalluk* (ownership right). Another type of rights recognized by Islamic jurisprudence are rights not related to asset with financial values such as custodian right.

¹⁴⁸ Al-Zuḥaylī (1996), *op.cit.*, p. 433. The decision is attributed to the fact that it removes the risk of *gharar* in the contract.

The Hanafis and Hanbalis disallow *bay' al-dayn* because of the risk or uncertainty faced by the buyer in respect of delivery of the subject-matter of the contract i.e. debt.¹⁴⁹ Some of the Shafi'is permit this sale while the rest prohibit it on similar reasoning with the previous two schools. The group which allows *bay' al-dayn* attaches some conditions to it:¹⁵⁰

- a) The debt must be an established debt (*mustaqir*).
- b) The debt is sold in exchange of goods that must be delivered immediately.
- c) When the debt is sold, it must be paid in cash or tangible asset as agreed.

The Malikis have laid down eight conditions to be fulfilled for a sale of debt to be valid. In summary, the conditions are as follows:-¹⁵¹

- a) Payment of the purchase price is spot at the time of contract.¹⁵²
- b) The debtor is present at the place of contract.
- c) The debtor acknowledges the debt.
- d) Legally, the debtor must be bound to pay the debt.

¹⁴⁹ Ibn Qudāmah (1994), *op.cit.*, p. 225.

¹⁵⁰ Resolutions of the Securities Commission Syariah Advisory Council (2002), *op.cit.* p. 18.

¹⁵¹ Ibid., pp. 17-18.

¹⁵² This condition aims at preventing *bay' al-kālī bil kālī*.

- e) The price should not be of the same type with the debt. If it is so, then the price should be at the same value to avoid *ribā* i.e. *ribā al-faḍl*.¹⁵³
- f) The original sale and purchase is not between the gold and silver. If not, it will cause a deferred currency exchange leading the occurrence of *ribā al-nasīʾah*.¹⁵⁴
- g) The debt should be capable of being sold even prior to taking possession. Hence, the debt cannot be in the form of food items because they cannot be sold before taking possession.
- h) There should be no hostility between buyer and seller which can create hardship or harm to the original debtor.

The abovementioned rules aim at protecting the interest of the buyer and to avoid *ribā* as well as the sale of debt before taking possession occurs.

Ibn Qayyim tends to permit *bayʿ al-dayn* on the basis that there is no general *naṣ* or *ijmāʿ* which said to the contrary. According to him, what was prohibited is the prohibition of *bayʿ al-kālī bil kālī*.¹⁵⁵

¹⁵³ A type of *ribā* arising from the exchange of *ribāwi* items if the prescribed rules are not complied with.

¹⁵⁴ A type of *ribā* which occurs when the creditor allows the debtor to defer the payment subject to the increment in the original capital value of loan.

¹⁵⁵ al-Jawziyyah, Ibn Qayyim (____), *Iʿlām al-Muwaqqiʿīn*, vol.1, Bayrūt : Dār al-Fikr, p. 388 as quoted in *Resolutions of the Securities Commission Syariah Advisory Council*, op.cit., p.18. Briefly, *bayʿ al-kālī bil kālī* means a debt sale is paid by debt.

Contemporary scholars have a propensity to follow the opinion of the Shafi‘is and Malikis in permitting *bay‘ al-dayn* such as Şiddīq al-Ḍarīr, ‘Alī al-Quraḥ Daghi and Nazīh Ḥammād provided it is not tainted with any element of *gharar* and *ribā*.¹⁵⁶

Additionally, Islamic *Fiqh* Academy has also adopted a decision in favour of allowing *bay‘ al-dayn* provided always that the transaction is free from *ribā* and *gharar*.

If the debt trading is allowed, then why the Malaysian practice of debt trading is not recognised by Middle East countries?

It is submitted that the distinguishing point is the treatment on the nature of the debt. The classical juristic opinions incline towards regarding the status of the debt to be dependable on its receivables.¹⁵⁷ If the debt has receivables in the monetary forms, then it is considered as similar to money and the rules in exchange of money will apply.¹⁵⁸ If the debt has receivables in the forms of other goods that are non-*ribā* bearing such as non-*ribāwī* goods in a *salam* contract, it is regarded as a non-monetary financial right in the obligation of debtor and the rules in the exchange of money or *ribāwī* commodities will not apply.¹⁵⁹

¹⁵⁶ See paper by Suhaimi Mohd Yusof entitled, *Bay‘ al-Dayn : Keputusan Majlis Penasihat Syariah Suruhanjaya Sekuriti*”, presented at Muzakarah *Bay‘ al-Dayn* , organised by Bank Negara Malaysia, 4th July 2002, Kuala Lumpur at p. 12.

¹⁵⁷ Engku Rabiah Adawiah Engku Ali (2003), *op.cit.*, p. lxxvii.

¹⁵⁸ Ibid. It comprises of two conditions i.e. equality and spot transaction.

¹⁵⁹ Ibid. For example when the receivables is in the form of essential food items enumerated in the *ḥadīth* on six commodities.

Hence, it follows that since all the debts traded in the Malaysian capital market have monetary receivables, the rules pertaining to currency exchange is validly related and applicable. To interpret the resolution passed by the Islamic *Fiqh* Academy, the following rules must be observed:-¹⁶⁰

- 1) The price for the debt is not in the form of money. Otherwise the following conditions must be fulfilled:-
 - a) If the price is of the same denomination with the debt, the exchange must be at equal value payable in cash; and
 - b) If the price is of different denomination with the debt, then it must be based on the exchange rate of the trading day payable in cash.
- 2) The payment must be spot to avoid *bay' al- kālī' bil kālī'*.

In conclusion, the practice of *bay' al-dayn* in Malaysia does not comply with the above requirements since it involves monetary receivables while the price is paid by money at a discounted amount ignoring the parity rule in exchange of money for money.¹⁶¹

Nevertheless, SAC of SC allows the practice of sale of debt to a third party at a discounted price relying on different arguments as to the nature of the debt.

¹⁶⁰ Ibid.
¹⁶¹ Ibid.

The ruling states to the effect that since the debt is securitized, the characteristic of securities differentiates it from currency and thus it is not bound by the conditions for exchange of *ribāwī* items, in particular money for money. The securitized right to receive debt payment which is a financial right is regarded as an independent asset capable of being sold at whatever price agreed by the parties.¹⁶² Consequently, the practice of debt discounting is allowed but it still requires the payment to be made in cash to avoid *bay' al- kālī' bil kālī*.

As mentioned earlier, debt discounting is also legitimised based on the *da' wa ta'ajjal* principle which has already been elaborated in detail before this. Again, the resolution of SAC of SC differs from that of Islamic *Fiqh* Academy because the latter only allows the principle to be applied between creditor and debtor only and not extendable to third parties whilst the former allows it.

In conclusion, this is another instance of differences of opinion between Malaysian scholars and Middle Eastern scholars.

¹⁶² It has been similarly treated with other asset-backed financial rights such as shares, copyright, patent, trademark etc.

4.12 COMPLIANCE VIS-À-VIS EXISTING LAWS

Housing development particularly for residential purposes is governed by Housing Development (Control And Licensing) Act, 1966 (hereinafter referred to as HDA) and Housing Development (Control And Licensing) Regulations 1989 (Amended 2003) (hereinafter referred to as the HDR).¹⁶³ HDA defines housing developer as any person, body of persons, company, firm or society (by whatever name described), who or which engages in or carries out or undertakes or causes to be undertaken a housing development.¹⁶⁴ According to HDA, housing development project must comply with these two laws if it relates to the construction of more than four units of housing accommodation.¹⁶⁵ This means, if the number of the houses is less than four units or if the development is for commercial purposes, then HDA is inapplicable. HDA further states that no housing development shall be engaged in, carried out, undertaken or caused to be undertaken except by a housing developer in possession of a license issued under this Act.¹⁶⁶

HDR on the other hand provides that the contract of sale for housing accommodation shall be in the prescribed form. It states that every contract of sale for the sale and purchase of a housing accommodation together with

¹⁶³ The regulation is made in exercise of the powers conferred by s. 24 of the Housing Development (Control and Licensing) Act 1966.

¹⁶⁴ S.3 of HDA

¹⁶⁵ S.3 of HDA provides that housing development means to develop or construct or cause to be constructed in any manner more than four units of housing accommodation and includes the collection of monies or the carrying on of any building operations for the purpose of erecting housing accommodation in, on, over or under any land; or the sale of more than four units of housing lots by the landowner or his nominee with the view of constructing more than four units of housing accommodation by the said landowner or his nominee.

¹⁶⁶ S.5 of HDA.

the sub divisional portion of land appurtenant thereto shall be in the form prescribed in Schedule G and where the contract of sale is for the sale and purchase of a housing accommodation in a subdivided building, it shall in the form prescribed in Schedule H.¹⁶⁷ Non-compliance with the provisions of HDR will lead to an offence and if convicted, the person will be penalized whether in the form of fine or imprisonment.¹⁶⁸

With reference to the above-mentioned provisions, several questions may arise as far as the applicability of *istiṣnā'* contract in Malaysia is concerned. Firstly is a financial institution such as bank allowed to be a housing developer? Islamic Banking Act 1983 (hereinafter referred to as IBA) defines Islamic bank as any company which carries out Islamic banking business and holds a valid licence; and all the offices and branches in Malaysia of such a bank shall be deemed to be one bank.¹⁶⁹ Islamic banking business has been defined as banking business whose aims and operations do not involve any element which is not approved by the religion of Islam.¹⁷⁰ Banking business is not defined under this Act as compared to Banking and Financial Institutions Act 1989 (hereinafter referred to as BAFIA). According to BAFIA, banking business means receiving deposits on current account,

¹⁶⁷ Regulation 11(1) of HDR.

¹⁶⁸ Regulation 13 of HDR. It provides that (1) Any person who contravenes any of the provisions of these Regulations shall be guilty of an offence and shall be liable on conviction to a fine not exceeding five thousand ringgit or to a term of imprisonment not exceeding three years or to both. (2) A breach of any condition in a licence or in any advertisement and sale permit shall be deemed to be in contravention of these Regulations. (3) Any person who knowingly and willfully aids, abets, counsels, procures or commands the commission of an offence against any provision of these Regulations shall be liable to be punished with the punishment provided for the offence.

¹⁶⁹ See s. 2 of IBA.

¹⁷⁰ Ibid.

deposit account, savings account or other similar account; paying or collecting cheques drawn by or paid in by customers; and provision of finance; or such other business as the bank, with the approval of the Minister, may prescribe.¹⁷¹ Furthermore the provision pertaining to the prohibition of acquiring or possessing an immovable asset except by way of security in BAFIA is absent in IBA.¹⁷² By virtue of inapplicability of BAFIA to Islamic banks, it is therefore submitted that the nature of banking business capable to be carried out by Islamic banks is much wider and Islamic banks can hold immovable assets such as houses, shop lots, commercial buildings and so on not necessarily as a security.¹⁷³

Nevertheless, there is an exception to the general rule that the banks governed by BAFIA cannot carry out businesses other than those defined under the said Act. This can be seen in Banking and Financial Institutions (Trading by Licensed Banks, Finance Companies and Merchant Banks) Order 1994 (hereinafter referred to as Order 1994) which allows those banks to engage in the sale of property at a price which includes a profit margin and/or the sale of property on deferred payment basis at a price which includes profit margin as long as the trade is not conducted on the basis of interest.¹⁷⁴ This provision basically refers to the conventional banks participating in the Islamic Banking

¹⁷¹ See s. 2 of BAFIA.

¹⁷² See s.66 (1)(b), s.66(2)(a)(i) and s.116 of BAFIA.

¹⁷³ S.124 (6) of BAFIA provides that this Act shall not apply to Islamic banks.

¹⁷⁴ Order 2 of 1994 Order.

Scheme.¹⁷⁵ Additionally, the legal restriction on investment and share holding is mitigated by another regulation namely Banking and Financial Institutions (Acquisition and Holding of Shares and Interest in Shares) (Licensed Banks, Licensed Finance Companies and Licensed Merchant Banks) Regulations 1991 (hereinafter referred to as Regulations 1991).¹⁷⁶

Second question is whether the bank being a housing developer can exclude itself from applying the terms and conditions as stipulated in Schedule G and H respectively since it has its own *istiṣnā'* documentation. S. 2 of HDA provides that Minister may by notification published in the *Gazette* exempt any housing developer from any or all of the provisions of HDA. Nevertheless, the same exemption does not exist in HDR.

The above-mentioned requirements will hinder the applicability of *istiṣnā'* or even parallel *istiṣnā'* in Malaysia in respect of housing development projects which fall under HDA.

¹⁷⁵ For a list of participating banks in Islamic Banking Scheme, see List of Financial Institutions Offering Islamic Banking Services, <http://www.bnm.gov.my/index.php?ch=174&pg=467&ac=36>.

¹⁷⁶ The permission is however subject to the condition that the total price paid for the acquisition of such shares or such interests in shares :- (a) held by it at any time in any single corporation, does not exceed ten per centum of either (i) in the case of licensed bank, a licensed finance company or a licensed merchant bank its paid up capital and published reserves; or (ii) in the case of a licensed foreign bank, its net working funds; or (iii) the paid-up capital of such single corporation; and (b) held by it at any one time in corporations do not, in the aggregate exceed twenty-five per centum of either- (i) in the case of licensed bank, a licensed finance company or a licensed merchant bank its paid up capital and published reserves; or (ii) in the case of a licensed foreign Bank its net working funds. See Regulation 2 of 1991 Regulations.

CHAPTER 5

Chapter 5

CONCLUSIONS

5.1 INTRODUCTION

Current Islamic banking and finance in Malaysia shows a vast conversion in a way we understand banking which conventionally offers an interest-based financing to a *Shari'ah* approved trading-based financing. This is mainly a vivid manifestation of the Quranic injunction in *Sūrah al-Baqarah* verse 275 whereby Allah s.w.t has recognized the method of gaining profit via sale and not through charging an interest.¹⁷⁷ Hence, it is widely known that *murābahah*, *istiṣnā'* and BBA are terms generally associated with Islamic banking in Malaysia as far as the modes of financing is concerned.

Nevertheless, the application of this contract has, to a great extent modified to suit modern day transactions taking into consideration the existing operational, legal and accounting framework.

This modification, *inter alia* requires the bank to play the role of financier and at the same time a trader or a contractor in the case of *istiṣnā'* financing. This approach is fine provided the material principles of sale are fully observed.

¹⁷⁷ There is an opinion that banking, in its original function and operational framework is said to be improper to carry out trading activities. It is suggested that the name be changed into a trading house.

Consequently, the burden is on Islamic banks and legal practitioners responsible in preparing Islamic financial instruments to ensure that the documents are trade-related and do not violate the Quranic injunctions as well as civil law. All trade-related documents will have the elements of employment of capital, labour and risk, failing which it may be tainted as a *ribāwī* transaction and treated as forbidden.

Based on a scrupulous discussion on *istiṣnāʿ* financing in Malaysia, it has in many aspects conform to the prescribed conditions. Even so, the practice is undoubtedly still dotted with *Sharīʿah* compliance issue especially when viewed from the stringent requirements imposed by Middle Eastern scholars.

The crux of the issue is whether the net result of the mode of financing as practised here differs much from the interest based loaning taking into consideration two fundamental issues lingering the *istiṣnāʿ* structure endorsed by Malaysian scholars. Firstly parallel *istiṣnāʿ* involving two similar parties and secondly exclusion of ownership risks by the bank. Another issue is regarding the application of *bayʿ al- dayn* contract at a second layer of *istiṣnāʿ* bond issuance process.

5.2 THE WAY FORWARD

5.2.1 TRIPARTITE PARALLEL *ISTIṢNĀ'*

Regarding parallel *istiṣnā'*, it is submitted that a tripartite arrangement is a better structure to avoid the so called *ḥiyāl* (legal trick) to avoid interest-based lending. Though named as *istiṣnā' contract*, structurally it is almost similar to *bay' al- 'īnah* which involves sale and buy back between two parties.

Apparently, it is now the time to get rid of *bay' al- 'īnah*. Several years ago, it is perhaps tolerable since we are still at an infancy stage in banking industry and the acceptance of such contract is regarded as *maṣlahah* (consideration of public interest) for the growth of Islamic banking at that particular time.

After 23 years, we should not be complacent about what we already have but efforts should be made towards innovating new products which are recognized by all scholars or at least free from being classified as legal trick to avoid *ribā*. Furthermore, with the change in BNM policy which allows foreign banks to be set up here, local

Islamic banks must attempt their best to introduce more competitive products.¹⁷⁸

At present, BNM has issued Islamic banking licenses to three foreign Islamic banks to operate in Malaysia i.e. Kuwait Finance House, Qatar Islamic Bank and Al-Rajhi Banking and Investment Corporation.

Thus, for house financing, the developer or individual contractor must be a party whilst for project financing involving the contract award, the awarder should also be a party. The problem is unwillingness on the part of these parties to have any legal relationship with the bank. What the housing developers are interested in is that the houses are fully sold and how the customers are going to pay is not their concern. Probability of individual contractor to have any relation with the bank is also low. The case is also the same with contract awarder whereby their concern is that the project is completed at the agreed time according to the specification and how the contractor is going to fund the project is not their business.

¹⁷⁸ As envisaged under recommendation 5.5 of the Sector Master Plan. However, the issuance on the Islamic banking licenses to qualified foreign players has taken place three years earlier than what has been spelt out in that Master Plan when it was issued in 2004. See Liberalisation in Islamic Banking, <http://www.bnm.gov.my/index.php?ch=8&pg=14&ac=719>, 13th March 2006.

It is therefore suggested that BNM to provide a policy requiring all housing developers or contractors seeking financing from Islamic banks to enter into a parallel *istiṣnāʿ* structure. Ministry of Housing and Local Government should also exempt all Islamic banks or banks which provide Islamic financing facilities from adopting the terms specified in Schedule G and H of HDR. Alternatively, a standard parallel *istiṣnāʿ* documentation can be adopted. Other than that, HDA should also explicitly exempt these banks from being subject to it. Hence, there is no need for these banks to apply for license and also from paying the prescribed fee.

5.2.2 OWNERSHIP RISK

On the issue of transferring the ownership risk to the customer whilst the house or the project is technically owned by the bank is unfair. It is submitted that to practically reflect a true trading transaction instead of mere financing, the application of option of defect should not be put aside. The cardinal point is it conforms with the principle of no risk no gain.

In the light of the above, the bank is exposed not only to a credit risk of the customer in terms of payment capability, but also the risk of non-completion of the project according to the agreed specification

within the stipulated time period. It is proposed that the agreement provides a clause to the effect that if non-completion is attributed to the negligence on the part of the developer or contractor, the cost incidental to it will be borne by the contractor or developer.

5.2.3 *MUSYĀRAKAH* AGREEMENT

Other than parallel *istiṣnā'*, another possible option is the bank enters into a *musyārahah* agreement with developer or contractor for a specific project whereby the bank will contribute a larger amount of capital compared to the developer. The partnership will then enter into an *istiṣnā'* agreement with the customer or contract awarder as the case may be. However, it is admitted that the bank will not in favour of this structure due to the nature of *musyārahah* agreement whereby loss is borne according to the capital contribution. Additionally, moral hazard issue is also another contributing factor which makes this type of contract unpopular.

Risk management is for the most part vital if this approach is going to be adopted. At the initial stage, the partner must be vigilantly selected. During the period of partnership, the bank must meticulously supervise the running of the project to ensure that the partner has properly utilized the fund towards the success of the venture. There

should be one unit or department with committed personnel who are responsible to monitor the progress of the project.

Another approach is by registering the name of the bank as a joint-owner of the property which is principally applicable when the project belongs to the customer cum developer himself such as housing developers. This is to avoid the issue of asking the partner to provide the security using the partnership asset. The method is possible since Islamic banks are not governed by BAFIA.¹⁷⁹ It follows therefore that the prohibition to own properties except as charged asset is not relevant to Islamic banks. It is also proposed for the partnership to provide a special fund for compensation purposes in case of loss as a result of negligence of the other partner.

The bank may also depart from the original principle that the profit be shared mutually and the loss is based on the capital contribution by invoking the concept of *tanāzul* (waiver of right).¹⁸⁰ In this context, it means the bank agrees to waive its right to claim a higher profit ratio provided that the ratio of losses is borne based on the agreement of the parties and not capital contribution.

¹⁷⁹ See s.124 (6) of BAFIA.

¹⁸⁰ This principle has been approved by SAC of SC in allowing basic preference share (non-cumulative) at its 20th meeting on 14th July 1999 where the right to profit of the ordinary shareholder is given willingly to a preference shareholder. This concept however is unacceptable by the Middle Eastern scholars.

5.2.3 If the venture succeeds, the house can be sold to the customer at a competitive price. Based on the current structure, the housing developer sells the house to the customer at a mark-up price. When the customer applies financing from the bank, once again the price is marked-up. With this proposal, the price is marked-up once only. From marketing aspect, it will attract more customers and at the same time abolish the public's perception on Islamic banks which are labeled as doing injustice due to charging a burdensome amount to be paid by the customer.

5.2.4 SUBSIDIARY COMPANY

Alternatively, the bank may set up a subsidiary company purposely to venture in construction, manufacturing or housing development projects. In this case, parallel *istiṣnā'* contract will be entered between the customer, subsidiary company and the bank. Since the project is carried out by its own subsidiaries, the inherent risks such as non-completion are mitigated and the cost of construction may also be reduced. Consequently, the selling price offered to the customer will be lower and may be lower than the price offered in a case of *musyārahah* proposal abovementioned by virtue of the relationship between the bank and its subsidiary.

5.2.5 BAY' AL-DAYN

The third issue is regarding the practice of *bay' al-dayn* which does not gain recognition by Middle Eastern scholars. It is to be noted that divergence of opinions (*ikhtilāf fuqaha'*) is an old phenomena since judicial interpretation is exercised by human being and therefore each of them may arrive at a different opinion as opposed to others. Muslim scholars regard differences in legal interpretation as positive and natural.

Hence, evaluating the arguments forwarded by Malaysian scholars in allowing sale of debt at a discounted rate, it is submitted that an effort should be made to convince the esteemed Middle Eastern scholars as to its legality. This is because the validity of such transaction has been supported with appropriate and approved methodology of *ijtihad* and not merely a generalized application of small-minded argued legal opinion.

5.2.6 RECONCILING LOCAL AND INTERNATIONAL OPINION

In respect of variance of opinions, it has been recommended that the present method of deducing legal ruling be improved and standardized by prescribing basic guidelines on how to administer analysis and

preference (*tarjīh*) between conflicting views in *madhhab* or inter *madhhāhib*.¹⁸¹ Locally, the guidelines can be prepared by venerated bodies such as SAC of BNM or SC or Malaysian Accounting Standard Board and internationally by Islamic *Fiqh* Academy or AAOIFI.¹⁸²

If this can be achieved, it may contribute to a more uniform result in the legal rulings or *fatwā* or even if the results still differ, they will still be acceptable by the parties since they are achieved through a commonly accepted standard or formula.¹⁸³

Another reconciliatory option is through joint application (*al-jam‘ wa al- tawfīq*) of the rulings which means as long as the rulings are substantiated by sound arguments and authorities, we can apply all or any of the rulings to suit our circumstances and the divergence is considered as tolerated (*al- ikhtilāf min jihat al-mubāḥ*).¹⁸⁴

Sometimes, we can also exercise *talfīq* by way of selecting between different opinions and form a coherent legal view, which is unprecedented as illustrated in the formulation of the Muslim Ottoman Civil Code i.e. the *Majallah*.¹⁸⁵

¹⁸¹ Engku Rabiah Adawiah Engku Ali, *Development of Islamic Banking in Malaysia: Constraints and Opportunities from the Jurisprudential Perspective*, (2003) IIUMLJ p.56.

¹⁸² Ibid.

¹⁸³ Ibid.

¹⁸⁴ Ibid.

¹⁸⁵ Ibid. p 257.

Internationally, distinguished bodies such as AAOIFI, Islamic *Fiqh* Academy and *Dāllah al-Barakah* should jointly collaborate in initiating efforts towards formulating *Sharī'ah* standards for Islamic financial institutions with the aim of patching up the differences of opinion among various *Muslim* countries. It is hoped that forums or round-table discussions among these scholars can provide a proper avenue to harmonise the differences of opinion which are currently real such as what has been discussed throughout the previous chapter.

5.2.7 HUMAN RESOURCE

Development of human resource with *Sharī'ah* background to occupy a variety of roles in Islamic banking is pertinent not only for product development but also other fields such as accounting, operation, information technology, marketing, audit, compliance, risk management and so on. These personnel will help to minimize the non-compliance risk in every aspect of banking activities.

The establishment of the International Centre for Education in Islamic Finance (INCEIF) is regarded as one solution to develop superior talent for the global Islamic finance industry.¹⁸⁶ INCEIF is Malaysia's

¹⁸⁶ It is a non-profit organization set-up by BNM to develop and enhance human capital in Islamic finance to meet the growing needs of the global Islamic finance industry. For more details, see <http://www.inceif.org>.

initiative to promote educational excellence in Islamic finance for the domestic and international finance community.

To conclude, the government whether acting as a legislator or policy maker, *Sharī'ah* advisors as well as the bankers should cooperate if they really want to see a factual implementation of *Sharī'ah* compliant products in general and *istiṣnā'* financing in particular.

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APPENDICES

APPENDIX 1

بسم الله الرحمن الرحيم

الحمد لله رب العالمين والصلاة والسلام على سيدنا محمد خاتم النبيين وعلى آله وصحبه أجمعين

قرار رقم: 64 (7/2) [1]

بشأن البيع بالتقسيط

إن مجلس مجمع الفقه الإسلامي الدولي المنعقد في دورة مؤتمره السابع بجدة في المملكة العربية السعودية من 7-12 ذي القعدة 1412 الموافق 9 - 14 أيار (مايو) 1992م،
بعد اطلاعه على البحوث الواردة إلى المجمع بخصوص موضوع البيع بالتقسيط، واستكمالاً للقرار 51 (6/2) بشأنه،
وبعد استماعه إلى المناقشات التي دارت حوله،

قرر ما يلي:

أولاً: البيع بالتقسيط جائز شرعاً، ولو زاد فيه الثمن المؤجل على المعجل.

ثانياً: الأوراق التجارية (الشيكات - السندات لأمر - سندات السحب) من أنواع التوثيق المشروع للدين بالكتابة.

ثالثاً: إن حسم (خصم) الأوراق التجارية غير جائز شرعاً، لأنه يؤول إلى ربا النسيئة المحرم.

رابعاً: الحطيطة من الدين المؤجل، لأجل تعجيله، سواء أكانت بطلب الدائن أو المدين (ضع وتعجل) جائزة شرعاً، لا تدخل في الربا المحرم إذا لم تكن بناء على اتفاق مسبق، وما دامت العلاقة بين الدائن والمدين ثنائية. فإذا دخل بينهما طرف ثالث لم تجز، لأنها تأخذ عندئذ حكم حسم الأوراق التجارية.

خامساً: يجوز اتفاق المتدينين على حلول سائر الأقساط عند امتناع المدين عن وفاء أي قسط من الأقساط المستحقة عليه ما لم يكن معسراً.

سادساً: إذا اعتبر الدين حالاً لموت المدين أو إفلاسه أو مماتلته، فيجوز في جميع هذه الحالات الحط منه للتعجيل بالتراضي.

سابعاً: ضابط الإعسار الذي يوجب الإنظار: ألا يكون للمدين مال زائد عن حوائجه الأصلية يفي بدينه نقداً أو عيناً.

والله أعلم ::

توضیحات و تفسیر

این سند به منظور توضیح و تفسیر موارد فوق الذکر تهیه شده است و به عنوان مرجع برای کلیه پرسنل در نظر گرفته می شود.

تاریخ: ۱۳۹۵/۰۵/۰۱

محل: تهران

این سند به منظور توضیح و تفسیر موارد فوق الذکر تهیه شده است و به عنوان مرجع برای کلیه پرسنل در نظر گرفته می شود.

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تاریخ: ۱۳۹۵/۰۵/۰۱

APPENDIX 2

تاریخ: ۱۳۹۵/۰۵/۰۱

محل: تهران

تاریخ: ۱۳۹۵/۰۵/۰۱

محل: تهران

تاریخ: ۱۳۹۵/۰۵/۰۱

تاریخ: ۱۳۹۵/۰۵/۰۱

تاریخ: ۱۳۹۵/۰۵/۰۱

محل: تهران

تاریخ: ۱۳۹۵/۰۵/۰۱

محل: تهران

تاریخ: ۱۳۹۵/۰۵/۰۱

تاریخ: ۱۳۹۵/۰۵/۰۱

تاریخ: ۱۳۹۵/۰۵/۰۱

تاریخ: ۱۳۹۵/۰۵/۰۱

بسم الله الرحمن الرحيم

الحمد لله رب العالمين والصلاة والسلام على سيدنا محمد خاتم النبيين وعلى آله وصحبه أجمعين

قرار رقم: 65 (7/3)[1]

بشأن عقد الاستصناع

إن مجلس مجمع الفقه الإسلامي الدولي المنعقد في دورة مؤتمره السادس بجدة في المملكة العربية السعودية من 7-12 ذي القعدة 1412 الموافق 9 - 14 أيار (مايو) 1992م،

بعد اطلاعه على البحوث الواردة إلى المجمع بخصوص موضوع عقد الاستصناع،

وبعد استماعه للمناقشات التي دارت حوله، ومراعاة لمقاصد الشريعة في مصالح العباد والقواعد الفقهية في العقود والتصرفات، ونظراً لأن عقد الاستصناع له دور كبير في تنشيط الصناعة، وفي فتح مجالات واسعة للتمويل والنهوض بالاقتصاد الإسلامي،

قرر ما يلي:

أولاً: إن عقد الاستصناع - وهو عقد وارد على العمل والعين في الذمة - ملزم للطرفين إذا توافرت فيه الأركان والشروط.

ثانياً: يشترط في عقد الاستصناع ما يلي:

أ- بيان جنس المستصنع ونوعه وقدره وأوصافه المطلوبة.

ب- أن يحدد فيه الأجل.

ثالثاً: يجوز في عقد الاستصناع تأجيل الثمن كله، أو تقسيطه إلى أقساط معلومة لآجال محددة.

رابعاً: يجوز أن يتضمن عقد الاستصناع شرطاً جزائياً بمقتضى ما اتفق عليه العاقدان ما لم تكن هناك ظروف قاهرة.

والله أعلم؛؛

[1] مجلة المجمع (العدد السابع، ج 2 ص 223).

بسم الله الرحمن الرحيم

الحمد لله رب العالمين والصلاة والسلام على سيدنا محمد خاتم النبيين وعلى آله وصحبه أجمعين

قرار رقم: 65 (7/3) [1]

بشأن عقد الاستصناع

إن مجلس مجمع الفقه الإسلامي الدولي المنعقد في دورة مؤتمره السادس بجدة في المملكة العربية السعودية من 7-12 ذي القعدة 1412 الموافق 9 - 14 أيار (مايو) 1992م،

بعد اطلاعه على البحوث الواردة إلى المجمع بخصوص موضوع عقد الاستصناع،

وبعد استماعه للمناقشات التي دارت حوله، ومراعاة لمقاصد الشريعة في مصالح العباد والقواعد الفقهية في العقود والتصرفات، ونظراً لأن عقد الاستصناع له دور كبير في تنشيط الصناعة، وفي فتح مجالات واسعة للتمويل والنهوض بالاقتصاد الإسلامي،

قرر ما يلي:

أولاً:

إن عقد الاستصناع - وهو عقد وارد على العمل والعين في الذمة - ملزم للطرفين إذا توافرت فيه الأركان والشروط.

ثانياً:

يشترط في عقد الاستصناع ما يلي:

أ- بيان جنس المستصنع ونوعه وقدره وأوصافه المطلوبة.

ب- أن يحدد فيه الأجل.

ثالثاً:

يجوز في عقد الاستصناع تأجيل الثمن كله، أو تقسيطه إلى أقساط معلومة لأجل محددة.

رابعاً:

يجوز أن يتضمن عقد الاستصناع شرطاً جزائياً بمقتضى ما اتفق عليه العاقدان ما لم تكن هناك ظروف قاهرة.

والله أعلم !!

[1] مجلة المجمع (العدد السابع، ج 2 ص 223).

بسم الله الرحمن الرحيم

الحمد لله رب العالمين والصلاة والسلام على سيدنا محمد خاتم النبيين وعلى آله وصحبه أجمعين

قرار رقم: 109 (12/3) [1]

بشأن موضوع

الشرط الجزائي

إن مجلس مجمع الفقه الإسلامي الدولي المنبثق عن منظمة المؤتمر الإسلامي في دورته الثانية عشرة بالرياض في المملكة العربية السعودية، من 25 جمادى الآخرة 1421 هـ - 1 رجب 1421 هـ الموافق 23 - 28 أيلول (سبتمبر) 2000م.

بعد اطلاعه على البحوث الواردة إلى المجمع بخصوص موضوع (الشرط الجزائي)، وبعد استماعه إلى المناقشات التي دارت حول الموضوع بمشاركة أعضاء المجمع وخبرائه وعدد من الفقهاء.

قرر ما يلي:

أولاً:

الشرط الجزائي في القانون هو اتفاق بين المتعاقدين على تقدير التعويض الذي يستحقه من شرط له عن الضرر الذي يلحقه إذا لم يتخذ الطرف الآخر ما التزم به، أو تأخر في تنفيذه.

ثانياً:

يؤكد المجلس قراراته السابقة بالنسبة للشرط الجزائي الواردة في قراره في السّلم رقم 85(9/2)، ونصه: "لا يجوز الشرط الجزائي عن التأخير في تسليم المسلم فيه؛ لأنه عبارة عن دين، ولا يجوز اشتراط الزيادة في الديون عند التأخير"، وقراره في الاستصناع رقم 65(7/3). ونصه: "يجوز أن يتضمن عقد الاستصناع شرطاً جزائياً بمقتضى ما اتفق عليه العاقدان ما لم تكن هناك ظروف قاهرة"، وقراره في البيع بالتقسيط رقم 51(6/2) ونصه: "إذا تأخر المشتري المدين في دفع الأقساط بعد الموعد المحدد فلا يجوز إلزامه أي زيادة على الدين بشرط سابق أو بدون شرط، لأن ذلك ربا محرم".

ثالثاً:

يجوز أن يكون الشرط الجزائي مقترناً بالعقد الأصلي، كما يجوز أن يكون في اتفاق لاحق قبل حدوث الضرر.

رابعاً:

يجوز أن يشترط الشرط الجزائي في جميع العقود المالية ما عدا العقود التي يكون الالتزام الأصلي فيها ديناً؛ فإن هذا من الربا الصريح.

وبناء على هذا، يجوز هذا الشرط - مثلاً - في عقود المقاولات بالنسبة للمقاول، وعقد التوريد بالنسبة للمورد، وعقد الاستصناع بالنسبة للصانع إذا لم يتخذ ما التزم به أو تأخر في تنفيذه.

ولا يجوز - مثلاً - في البيع بالتقسيط بسبب تأخر المدين عن سداد الأقساط المتبقية سواء، كان بسبب الإعسار، أو المماطلة، ولا يجوز في عقد الاستصناع بالنسبة للمستصنع إذا تأخر في أداء ما عليه.

خامساً: الضرر الذي يجوز التعويض عنه يشمل الضرر المالي الفعلي، وما لحق المضرور من خسارة حقيقية، وما فاتته من كسب مؤكد، ولا يشمل الضرر الأدبي أو المعنوي.

سادساً: لا يُعمل بالشرط الجزائي إذا أثبت من شرط عليه أن إخلاله بالعقد كان بسبب خارج عن إرادته، أو أثبت أن من شرط له لم يلحقه أي ضرر من الإخلال بالعقد.

سابعاً: يجوز للمحكمة بناء على طلب أحد الطرفين أن تُعدّل في مقدار التعويض إذا وجدت مبرراً لذلك، أو كان مبالغاً فيه.

ويوصي المجمع بما يلي:

ب عقد ندوة متخصصة لبحث الشروط والتدابير التي تقترح للمصارف الإسلامية لضمان حصولها على الديون المستحقة لها.

APPENDIX 4

والله أعلم !!

[1] مجلة المجمع (العدد الثاني عشر ج 2، ص 91).

Bank Negara Malaysia was formed by three new entities including the existing Bank of Malaya. This was done to ensure the independence of the Islamic Banking system and to ensure the stability of the financial system. The new Bank Negara Malaysia was established on 1.1.1963.

The following conditions will be adopted in assessing the merits of applications:

The applicant must be a financially sound, licensed Islamic financial institution or a foreign institution with a subsidiary in Malaysia.

The applicant must be regulated by a competent regulatory authority and must have a strong reputation in the financial industry.

The applicant must have a sound business plan, including the ability to manage risk and ensure the stability of the financial system. The applicant must also have a strong financial position and a good track record.

The following conditions will be adopted in assessing the merits of applications:

The applicant must be a financially sound, licensed Islamic financial institution or a foreign institution with a subsidiary in Malaysia.

The applicant must be regulated by a competent regulatory authority and must have a strong reputation in the financial industry.

The applicant must have a sound business plan, including the ability to manage risk and ensure the stability of the financial system. The applicant must also have a strong financial position and a good track record.

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APPENDIX 4

Liberalisation in Islamic Banking

Bank Negara Malaysia will issue up to three new Islamic banking licences to qualified foreign players. This will bring forward the liberalisation of the Islamic banking industry to 2004 with respect to issuance of new licences, three years earlier than envisaged under recommendation 5.5 of the Financial Sector Masterplan.

The following criteria will be adopted in assessing the merits of applicants:

- The applicant must be a financially sound licensed foreign Islamic banking institution or a foreign financial institution with experience in Islamic banking business;
- The applicant must be regulated and supervised by a competent home regulatory authority and preferably, with a strong reputation in their own national jurisdictions; and
- The applicant must be able to demonstrate, through its business plans, that the new Islamic bank in Malaysia will have the expertise and resources that can contribute constructively to the development of the domestic Islamic financial sector and the economy of Malaysia.

The business plan should include, among others:

- o details on the competency, integrity, qualifications and experience of the proposed senior management team (including the board of directors);
- o the proposed operating plan and internal controls (including the corporate governance structure and risk management framework); and
- o the projected financial condition and pro forma financial statements for the new Islamic bank for the first three years (including its capital adequacy status).

Apart from the above criteria, the applicant must submit the proposed ownership structure of the new Islamic bank, including the source of capital, its direct and indirect controlling and major shareholders (shareholders with a minimum equity interest of 10%), their financial strength, the review of their previous banking and non-banking business ventures, their integrity and reputation.

The new Islamic bank must be locally incorporated and licensed under the Islamic Banking Act 1983 as a full-fledged Islamic bank. The new Islamic bank will be required to have a minimum capital of RM300 million (USD78.95 million). Similar to the incumbent locally incorporated licensed foreign banks in the conventional banking system in Malaysia, the new Islamic bank may have a foreign equity interest of up to 100%. This can take the form of a wholly owned subsidiary or a joint venture with domestic investors or other foreign financial institutions that fulfil Bank Negara Malaysia's criteria.

This move is part of the overall efforts to strengthen the global integration of the domestic Islamic banking system and increase the potential to tap new growth opportunities as well as facilitate international trade and investment flows between Malaysia and the rest of the world. It is also a step forward in the development of Malaysia as a regional financial centre for Islamic banking and finance.

Submission of applications to Bank Negara Malaysia should be made by 31 March 2004.

DATED THIS

DAY OF

200

BETWEEN

The party (that) named in Section 2 of the Agreement
(the "Company")

APPENDIX 5

(Company Name)
(Address)

IN WITNESS WHEREOF, I have hereunto set my hand and seal
this _____ day of _____, 200__

DATED THIS

DAY OF

200

BETWEEN

The party (ies) named in Section 2 of First Schedule
(**"Customer(s)"**)

AND

ABC BANK BHD
(Company No. 1234-W)
(**"ABCBB"**)

**ISTISNA' FACILITY AGREEMENT
(HOME CONSTRUCTION)**

THIS ISTISNA' FACILITY AGREEMENT (HOME CONSTRUCTION) (hereinafter referred to as "this Agreement") is made on the day and year as stated in Section 1 of First Schedule hereto between:

- (1) The party (ies) whose name(s) and description(s) are as stated in Section 2 of First Schedule hereto (hereinafter referred to as "the Customer(s)") of the one part; and
- (2) **ABC BANK BHD** (Company No. 1234-W), a company incorporated in Malaysia under the Companies Act, 1965 and having its registered office at 30th Floor Menara ABC Kuala Lumpur and its branch as stated in Section 3 of First Schedule (hereinafter referred to as "ABCBB") of the other part.

(The Customer(s) and ABCBB are hereinafter collectively referred to as "Parties" and individually referred to as "Party", as the context may require).

WHEREAS

- A. The Customer(s) is the registered and/or beneficial proprietor of the property as described in Section 4 of First Schedule hereto (hereinafter referred to as "the Said Property").
- B. The Customer(s) is desirous of obtaining the building (hereinafter referred to as "the Building") as described in Section 5 of First Schedule hereto (hereinafter referred to as "Works") in accordance with the document(s) as specified in Section 6 of First Schedule (hereinafter referred to as "the Construction Document(s)").
- C. At the request of the Customer(s), ABCBB has agreed to grant to the Customer(s) the Facility (as hereinafter defined) pursuant to a letter of offer (which includes any amendment, variation, supplement or modification whatsoever) and which is more described in Section 9 of First Schedule hereto (hereinafter referred to as "the Letter of Offer") to finance the Works on the Building in accordance with the Syariah principle of Bai' Al-Istisna', the terms of this Agreement and the Security Documents (as set out herein).

NOW THIS AGREEMENT WITNESSETH AND THE PARTIES HEREBY AGREE AS FOLLOWS:

1. DEFINITIONS AND INTERPRETATIONS

1.1 Definitions

In this Agreement, where the context so admits, the following words and expressions shall have the same meaning set out opposite them herein below except as specifically stated otherwise:

"Availability Period" means:

- (a) the period as specified in Section 10(a) of First Schedule for the execution of the Security Documents and upon expiry of such period,

ABCBB shall have the right to terminate the Facility; or

- (b) the period as specified in Section 10(b) of First Schedule for the first disbursement of the Purchase Price or any part thereof and upon expiry of such period, ABCBB shall have the right to terminate the Facility;

as the case may be;

“Bai’ Al-Istisna’”

means the Syariah principle that concerns with the order, construction and delivery of a specified item to be manufactured or constructed, asset or property at a future date in accordance with the specifications as particularly described in the Construction Document(s) under Section 6 of First Schedule;

“BNM”

means Bank Negara Malaysia, a body corporate established under the Central Bank of Malaysia Act, 1958 of Jalan Dato’ Onn, 50480 Kuala Lumpur;

“ABCBB”

means Abc bank bhd (Company No: 6175-W) and includes person deriving title hereunder, its successors-in-title, transferees and assigns;

“ABCBB’s Solicitors”

means the solicitor(s) as specified under Section 16 of First Schedule;

“Building”

means the building as specified in Section 5 of First Schedule hereto;

“Business Day”

means any day (other than public holidays) on which ABCBB is open for business;

“Construction Document(s)”

means the document(s) detailing the specifications of the Works as stated in Section 6 of First Schedule hereto;

“Contractor”

means the party whose name and description are as stated in Section 7 of First Schedule hereto and includes its successors-in-title, permitted transferees and assigns;

“Customer(s)”

means the party whose name and description

	are as stated in Section 2 of First Schedule hereto and includes its successors-in-title, permitted transferees and assigns;
"Event of Default"	means an event of default under this Agreement or any of the Security Documents or any event which, with the lapse of time and/or giving of notice and/or determination being made under the relevant paragraph would constitute an event of default;
"Facility"	means the financing facility known as Istisna' Home Construction granted by ABCBB to the Customer(s) on deferred payment basis in accordance with the Syariah principle of Bai' Al-Istisna' subject to the terms herein and the Security Documents;
"Financing Amount"	means the amount as specified in Section 8 of First Schedule hereof granted by ABCBB to the Contractor;
"IBA"	means the Islamic Banking Act, 1983 including any amendments, modifications and re-enactments thereof in force;
"Istisna' Purchase Agreement"	means the Istisna' purchase agreement entered into between ABCBB of the one part and the Contractor of the other part as per Annexure 2 whereby ABCBB agrees to request the Contractor to construct and/or undertake the Works and the Contractor agrees to sell and ABCBB agrees to purchase the Works to be constructed and delivered by the Contractor directly to the Customer(s);
"Istisna' Sale Agreement"	means the Istisna' sale agreement entered into between the Customer(s) of the one part and ABCBB of the other part as per Annexure 1 whereby the Customer(s) agrees to request ABCBB to construct and/or undertake the Works and ABCBB agrees to sell and the Customer(s) agrees to purchase the Works to be constructed and delivered by ABCBB;
"Letter of Offer"	means the Letter of Offer as described in Section 9 of First Schedule hereto issued by ABCBB and duly accepted by the Customer(s) (which includes any amendment, variation, supplement or

	modification whatsoever);
"Month"	means the Gregorian calendar month;
"Outgoings"	means all quit rent, rates, taxes, assessment and other charges imposed or to be imposed by the government or other competent authority or authorities and other charges in respect of the Building;
"Outstanding Sum"	includes any amount (whether present or future, actual or contingent, secured or unsecured) owed by the Customer(s) (whether as principal or surety including the total amount of Selling Price specified in the Istisna' Sale Agreement, premium and other charges) and all other sums of money howsoever due including but not limited to costs (including legal costs on a solicitor and client basis) to ABCBB under this Agreement and/or the Security Documents;
"Purchase Price"	means the price to be paid by ABCBB to the Contractor under the Istisna' Purchase Agreement as described in Section 11 of First Schedule hereto for the execution and completion of the Works, delivery of the completed Building and remedying of any defects therein in accordance with the provisions of this Agreement and the Istisna' Purchase Agreement;
"Ringgit", "RM" and "Sen"	means the lawful currency of Malaysia;
"Said Property"	means the property described in Section 4 of First Schedule hereto together with all or any buildings and fixtures erected or affixed or to be erected or affixed thereon or thereto or any part or portion thereof;
"Security Documents"	as applicable, include but not limited to: <ul style="list-style-type: none">(i) this Agreement;(ii) the Istisna' Sale Agreement;(iii) the Istisna' Purchase Agreement;(iv) the Letter of Offer;(v) the Supervision of Construction Agreement;(vi) the Form 16A of the National Land Code and the Lampiran (Annexure) thereof or the Deed of Assignment (as

applicable);

(vii) the original Sale and Purchase Agreement; and

(viii) such other agreements or instruments,

as described in Section 15 of First Schedule, which shall constitute securities to ABCBB, and all other documents whatsoever as may be executed under this Agreement or other agreement referred to the above and the same as amended or varied from time to time and "Security Document" means any one (1) of them;

"Security Interest"

includes an assignment, mortgage, charge, pledge, lien, right of set-off or any security interest whatsoever or howsoever created or arising from the Security Documents;

"Security Party(ies)"

means the party executing the Security Documents with or in favour of ABCBB or such other persons presently or in future providing any security to ABCBB for payment of the Outstanding Sum therein and any reference to the "Security Party" includes references to any one (1) of them;

"Selling Price"

means the price to be paid by the Customer(s) to ABCBB under the Istisna' Sale Agreement as described in Section 12 of First Schedule hereto;

"Supervision of Construction Agreement"

means the supervision of construction agreement entered into between the Customer(s) and the Contractor for the purpose of supervising the construction of the building on the Said Property in accordance with the specifications as detailed out in the Construction Document(s);

"this Agreement"

means this Istisna' Facility Agreement (Home Construction), the Schedules, Appendices, Annexures and any amendment, variation and/or supplemental made thereto from time to time; and

“Works”

means the construction of the Building in accordance with the specifications as detailed out in the Construction Document(s).

1.2 Interpretations

In this Agreement, where the contexts so admits:

- (a) an “agreement” also includes a concession, contract, deed, franchise, licence, treaty or undertaking (in any case, the same shall be reduced in writing);
- (b) “encumbrances” shall be any mortgage, charge (whether fixed or floating), pledge, lien, hypothecation, assignment, security, interest, title retention or other encumbrance of any kind or any right conferring priority in payment in respect of any obligation of any person but does not include liens arising in the ordinary course of business by operation of law and not by way of contract;
- (c) a “guarantee” also includes any other obligation (whether so called) of any person to pay, purchase, provide funds (whether by way of the advance of money, the purchase of or subscription for shares or other securities, the purchase of assets or services, or otherwise) for the payment of or the indemnity against the consequences of default in the payment of, or otherwise be responsible for, any indebtedness of any other person;
- (d) a “liability” includes any obligation whatsoever (whether present or future, actual or contingent, secured or unsecured, as principal or surety or otherwise) for the payment or repayment of money;
- (e) “law” includes common or customary law and any constitution, decree, judgment, legislation, order, ordinance, regulation, statute, treaty or other legislative measure in any jurisdiction or any present or future directive, regulation, request or requirement (in each case, whether or not having the force of law but, if not having the force of law, the compliance with which is in accordance with the general practice of persons to whom the directive, regulation, request or requirement is addressed);
- (f) “Syariah principles” shall be construed as the principles of law derived from Al-Quran, Hadith, Ijma And Qiyas;
- (g) “assets” shall be construed as a reference to the whole or any part of a person’s undertakings, properties, assets, revenues and rights;
- (h) something having a “material adverse change” on the Customer(s) is a reference to having a material adverse change (1) on its financial condition or business or on its consolidated financial condition or business or (2) on its obligations under the Security Documents;

- (i) words applicable to natural persons include a body of persons, company, corporation, firm or partnership, corporate or unincorporate;
- (j) the words "hereof", "herein", "hereon", "hereinafter" and "hereunder" and words of similar import, when used in this Agreement, shall where the context requires or allows, refer to this Agreement as a whole and not to any particular provision of this Agreement;
- (k) references herein to Clauses, Schedules, Appendices and Annexures are references to Clauses, Schedules, Appendices and Annexures in this Agreement unless otherwise specified;
- (l) the headings and sub-headings to the Clauses of this Agreement are inserted for purposes of convenience only and shall not be deemed to be a part thereof or be taken into consideration in the interpretation or construction thereof of this Agreement;
- (m) the Recitals, Schedules, Appendices and Annexures to this Agreement are to be taken, read and construed as essential and integral part of this Agreement;
- (n) where an act is required to be done within a specified number of days after or from a specified date, the period is inclusive of and begins to run from the date so specified;
- (o) a period of a month from the happening of an event or the doing of an act or thing shall be deemed to be inclusive of the day on which the event happens or the act or thing is or is required to be done;
- (p) any reference to legislation and statutes and the rules made thereunder includes all subsidiary legislation thereunder, modifications, amendments, or re-enactments which may be enacted or made at any time and from time to time;
- (q) if the Customer(s) is a company, the provisions contained herein which are primarily and literally applicable to the case of natural persons shall be construed and take effect as if the Customer(s) were a natural person, and shall bind all of its assigns and successors-in-title. Accordingly any references herein relating to bankruptcy shall thereafter be references relating to winding-up, liquidation, amalgamation or reconstruction as the case may be of the Customer(s);
- (r) "subsidiaries" "corporation" and "related corporations" shall be construed in accordance with the provisions of the Companies Act, 1965;
- (s) words importing the masculine gender include the feminine and neuter genders;

- (t) words importing the singular number includes the plural number and vice-versa; and
- (u) no rule of construction shall apply to the disadvantage of a party because that party was responsible for the preparation of this Agreement or any part of it.

2. AGREEMENT FOR FACILITY

2.1 The Facility

At the request of the Customer(s) and upon the terms and subject to the conditions hereof, ABCBB has agreed to grant to the Customer(s) the Facility to finance the Works on the Building in accordance with the Syariah principle of Bai' Al-Istisna'.

2.2 Purpose of financing the Financing Amount

The Financing Amount herein granted shall be utilised exclusively to finance the carrying out of the Works. In the event the Customer(s) shall require the Financing Amount or any part thereof for any other purposes but related or ancillary to the Works, the Customer(s) shall obtain the prior written consent of ABCBB. However, ABCBB is not bound to check and to ensure that the Financing Amount is used exclusively for the purpose as mentioned above and that the obligations of the Customer(s) under this Agreement shall not in any way be prejudiced or affected or diminished by reason that all or any part of the Financing Amount is utilised for some other purpose (whether or not ABCBB has notice of that fact).

2.3 Utilisation

The Financing Amount or any part thereof shall be made available by ABCBB to the Contractor in the manner of payment of the Purchase Price as described in Clause 6 herein.

2.4 Istisna' Sale Agreement

In accordance with the Syariah principles, upon the Customer(s) having agreed to the specifications as per the Construction Document(s), the Customer(s) agrees to request ABCBB to construct or undertake the Works whereupon the Parties shall enter into an Istisna' Sale Agreement whereby ABCBB shall sell and the Customer(s) shall purchase the Works to be constructed and delivered by ABCBB as per Annexure 1 herein and subject to the terms and conditions therein contained.

2.5 Istisna' Purchase Agreement

In accordance with the Syariah principles, upon the entry of the Parties into the Istisna' Sale Agreement, ABCBB and the Contractor shall enter into an Istisna' Purchase Agreement whereby ABCBB agrees to request the Contractor to construct or undertake the Works and the Contractor shall sell and ABCBB

shall purchase the Works to be constructed and delivered by the Contractor to the Customer(s) as per Annexure 2 herein and subject to terms and conditions therein contained.

2.6 Supervision of Construction Agreement

The Parties hereby agree that upon the entry of ABCBB and the Contractor into the Istisna' Purchase Agreement, the Customer(s) shall enter into a Supervision of Construction Agreement with the Contractor to supervise and oversee the construction of the Building by the Contractor in accordance with the Construction Document(s).

2.7 Relation of Partnership in Law

None of the Security Documents or otherwise for the purpose of securing the Outstanding Sum shall in any way or for any purpose whatsoever constitute or create partnership liabilities or obligations whatsoever between the Customer(s) and/or Contractor, as the case may be, and ABCBB.

2.8 Statement of Account

It is hereby agreed and declared that the statement of account in writing stating the amount(s) payable by the Customer(s) under this Agreement and the Istisna' Sale Agreement and indicating how the amount(s) has (have) been calculated and duly certified by the manager or any authorised officer of ABCBB shall, in absence of manifest error, be conclusive evidence that such amount is (are) in fact due and payable by the Customer(s).

3. CONDITIONS PRECEDENT

3.1 Conditions Precedent

This Agreement is subject to and conditional upon the fulfilment of the conditions precedent as specified in the Second Schedule of this Agreement.

3.2 Waiver of Conditions Precedent

It is hereby expressly acknowledged and declared that the conditions hereinbefore contained are inserted for the sole benefit of ABCBB and may therefore be waived wholly or in part by ABCBB at the sole and absolute discretion of ABCBB without prejudicing the rights of ABCBB under any document entered into between ABCBB and/or the Customer(s) and such waiver shall not prejudice the rights of ABCBB from insisting on the Customer(s)'s compliance with any such waived conditions at any subsequent time.

3.3 Cancellation Pending Compliance

Pending the fulfilment in manner satisfactory to ABCBB of the conditions hereinbefore stipulated, ABCBB may at its absolute discretion suspend the payment of the Financing Amount or any part thereof should ABCBB discover

any irregularities or false information given to ABCBB at the time of the approval of Letter of Offer or application of the Facility.

4. REPRESENTATIONS AND WARRANTIES

4.1 Representations and Warranties

The Customer(s) acknowledges that ABCBB has entered into this Agreement and granted the Facility in full reliance of the representations and warranties by the Customer(s) on the terms and the Customer(s) now represents and warrants to ABCBB that:

- (a) that the Customer(s) has full legal right, authority and power to grant the security hereunder and to enter into and bind itself by the Security Documents;
- (b) that the Security Documents constitute the legal, valid and binding obligations of the Customer(s) respectively, enforceable in accordance with their respective terms and the obligations of the Customer(s) hereunder and thereunder in respect of the payment of whatever monies due and payable;
- (c) that the Customer(s) is not currently or by executing this Agreement be in default under the Security Documents or any existing mortgage, indenture, contract or debenture binding on the Customer(s) or to which it is subject to;
- (d) the execution, delivery and performance of the Security Documents by the Customer(s) thereto do not and shall not violate or contravene the provisions of:
 - (i) any law, or regulation, or any order, or decree of any governmental authority, agency or court to which it is subject;
 - (ii) any contract of whatever nature, or other undertaking, or instrument, to which it is a party or which are binding upon them or any of its assets and shall not result in the creation, imposition of, or any obligation to create, or impose, any mortgage, lien, pledge or charge on any of its assets pursuant to the provisions of any such contract, or other undertaking, or instrument;
- (e) all consents, or licences, or approvals or authorisations, or orders and exemptions of any Ministry, agency, department or authority in Malaysia which are required or advisable to be obtained in connection with the execution, delivery, performance, legality or enforceability of the Security Documents or any of them have been obtained and are in full force and effect and no further consent, licence, approval, authorisation, order or exemption is required thereof;

- (f) the Customer(s) is not in default under any agreement to which it is a party or by which it may be bound and no litigation, arbitration, or administrative proceedings are presently current, or pending, or threatened and which default, litigation, arbitration or administrative proceedings (as the case may be) might materially affect its solvency or might affect its ability to perform its obligations under each of the Security Documents;
- (g) no bankruptcy proceedings or winding up proceedings have been commenced against the Customer(s);
- (h) the Customer(s) has filed all tax returns which the Customer(s) is required by law to file and have paid or made adequate provision for the payment of all taxes, assessments, fees and other governmental charges assessed against it or upon any of its properties or assets, income or franchise or any of them;
- (i) the Customer(s) is not in default in the payment or performance of any of its obligations for borrowed money, or in respect of other liabilities;
- (j) the Customer(s) is the legal and beneficial owners of the Said Property or any assets or property which are offered as security to ABCBB under the Security Documents;
- (k) the information furnished by the Customer(s) in connection with the Security Documents do not contain any untrue statement or omit to state any fact and all expressions of expectation, intention, belief and opinion and all projections contained herein and therein were honestly made on reasonable grounds after due and careful enquiry;
- (l) save and except as disclosed to ABCBB, (a copy of which is annexed herewith as the Third Schedule), none of the assets of the Customer(s) is affected by any encumbrance, and the Customer(s) is not a party to, nor is it or any of its assets bound by, any order, agreement or instrument under which the Customer(s) is, or in certain events may be required to create, assume or permit to arise any encumbrances, other than those created pursuant to the Security Documents;
- (m) the information furnished by the Customer(s) in connection with this Agreement do not contain any untrue statements or omit to state any fact or omission which will make the statements therein, in the light of the circumstances under which they were made, misleading, and all expressions of expectations, intention, belief and opinion contained therein were honestly made on reasonable grounds after due and careful enquiry by the Customer(s); and
- (n) the Customer(s) has fully disclosed in writing to ABCBB all facts relating to the Customer(s) which the Customer(s) knows or should reasonably know and which are material for disclosure to ABCBB in the context of this Agreement.

4.2 Continuing Nature of Representations and Warranties

Any payment of the Financing Amount made under the provisions of this Agreement shall, unless the Customer(s) notifies ABCBB to the contrary, be deemed to be made on the basis of a representation and warranty by the Customer(s) that:

- (a) as from the date when the Customer(s) first executed the Letter of Offer, there has been no material alterations or changes in the affairs of the Customer(s) which could or might adversely affect its ability to perform its obligations under the Security Documents; and
- (b) at the time of each payment of the Purchase Price, no Event of Default has occurred under the Security Documents and that the representations and warranties contained in Clause 4.1 are true, accurate and correct in all respects and will be correct and complied with in all respects as at the date of such payment if repeated then by reference to the then existing circumstances.

5. COVENANTS, UNDERTAKINGS AND GUARANTEE

5.1 Affirmative Covenants

The Customer(s) hereby expressly covenants and undertakes with ABCBB at all times during the continuance of the Facility and the Security Documents that it shall:

- (a) keep all structures and fixtures now or at any time hereafter erected on or affixed to the Said Property in tenable repair and condition. In default whereof it shall be lawful but not obligatory upon ABCBB to carry out such repairs and if ABCBB shall carry out repairs, the costs and expenses thereof shall be for the account of the Customer(s) and until repaid or reimbursed by the Customer(s), the compensation for late payment at the rate of one per centum (1%) per annum on such amount shall be payable by the Customer(s) to ABCBB;
- (b) permit ABCBB, the Contractor and their agents and workmen at all reasonable times of the day to enter upon the Said Property and have access to any fixture thereon and to view and inspect the condition or repair thereof;
- (c) comply with and observe all the conditions, restrictions and category of use, express or implied, imposed upon, relating to, or affecting the Said Property or to which the Said Property are subject as well as the provisions of any Act of Parliament ordinance or enactment for the time being in force and of any rule or order made thereunder affecting the same;
- (d) inform ABCBB of any application, demand, notice, order whatsoever or any other notice, document or transaction in any way affecting, or concerning the Said Property or any part thereof forthwith upon its

issue, publication or service (time being of essence in respect hereof) and produce the same to ABCBB whether demanded or not and the Customer(s) shall do all acts and take all steps necessary or expedient to safeguard and preserve the Building or any part thereof or the title or ownership thereto and ABCBB may if it think fit and on behalf of or in the name and at the expense of the Customer(s) do all such acts and employ all such persons as ABCBB shall deem fit for the purpose of safeguarding and preserving the Said Property;

- (e) punctually pay all the Outgoings whatsoever payable from time to time in respect of the Said Property as and when the same shall become due and payable;
- (f) punctually pay all its indebtedness under the Security Documents when due and owing;
- (g) perform all its other obligations under the Security Documents promptly and diligently;
- (h) comply with any directive of ABCBB or the Contractor which may be issued from time to time;
- (i) notify ABCBB of the occurrence of any Event of Default hereunder or any event of default in relation of its other indebtedness or of any occurrence of which it becomes aware not later than three (3) Business Days, which in its reasonable opinion might affect its ability to perform and fully comply with its obligations hereunder;
- (j) maintain such insurance in respect of its assets and shall punctually pay all premiums necessary for maintaining such insurance;
- (k) promptly notify ABCBB of any litigation or other proceedings of any nature whatsoever being threatened or initiated against the Customer(s) before any court, tribunal or administrative agency and/or authority which may materially affect the financial condition of the Customer(s) and all such notification to be given to ABCBB not later than fourteen (14) days after the Customer(s) has knowledge of the change or of the litigation or other proceedings or threat thereof and the amount of any contingent liability if such amount is ascertainable; and
- (l) in the event ABCBB requests for an appointment of any independent advisor and/or consultant to conduct any audit, monitoring and/or investigation on the Customer(s), the Said Property, Building and/or the Works and to report the findings thereof to ABCBB, immediately appoint such independent advisor and/or consultant to conduct such audit, monitoring and/or investigation on the Customer(s), the Said Property, Building and/or the Works at the Customer(s)' own cost and expense and such appointed advisor and/or consultant shall act for, and in the interest of, ABCBB. Notwithstanding that the appointed independent advisor and/or consultant is acting for, and in the interest of, ABCBB, ABCBB shall not be liable for any losses, damages or

liabilities in all respects which may arise from any act, omission, deed and/or misconduct of such independent advisor and/or consultant.

5.2 Restrictive Covenants

The Customer(s) hereby covenants and undertakes that during the continuance of the Facility and the Security Documents, it shall not without the consent in writing of ABCBB first having been obtained:

- (a) assign, transfer, sell, charge, dispose or otherwise howsoever deal with the Security Party's rights, title and interest under the Said Property or any part thereof or any interest therein or make the same subject to any charge, encumbrance, liability or lien whatsoever or rescind, remove or amend any condition or restriction affecting the Said Property;
- (b) lease, let out, or grant any licence or otherwise howsoever part with the possession or make or accept the surrender of any lease whatsoever of or in respect of the Said Property or any fixture, structure or any part thereof to any person firm or company;
- (c) alter, pull down, demolish or remove any fixture now or at any time hereafter erected on or affixed to the Said Property or any part thereof. Where it is intended that there is to be erected any building or buildings on the Said Property or that the Facility is to be utilised for the purposes thereof, the Customer(s) shall procure to complete the erection of such building or buildings in accordance with the approved plans thereof of such competent authority or authorities necessary for the obtaining of and shall obtain a Certificate of Fitness for Occupation not later than such date as ABCBB may stipulate;
- (d) terminate or seek to terminate, commit or threaten to commit a breach, amend or seek or grant any waiver in respect of any of the provisions of:
 - (i) any of the Security Documents; or
 - (ii) any other agreements entered into in connection with, or in pursuance of this Agreement;
- (e) pledge any of its Security Interest to secure any financing loan or credit and/or enter into any agreement or arrangement to dispose any of its Security Interest to any party, create or permit to exist any lien on any assets of the Customer(s) secured by this Agreement except any tax or other statutory lien, provided that such lien shall be discharged within thirty (30) days after final adjudication unless the same be contested in good faith by appropriate proceedings by the Customer(s) and the same is notified in writing to ABCBB; and
- (f) vary, amend or do any act which may result in substantial variation of the Works as set out under the Construction Document(s).

For the purpose of this paragraph, the expression "lien" includes mortgages, pledges, charges, privileges and priorities of any kind.

5.3 Guarantee

The Customer(s) hereby unconditionally and irrevocably guarantees the due and punctual payment of the Selling Price together with all costs, charges and all other sums, as and when the same shall become due and payable to ABCBB and the due performance and observance of all the agreements, terms, warranties, covenants and undertakings on the part of the Customer(s) contained in the Security Documents.

5.4 Ranking

The liability of the Customer(s) under this Agreement ranks and shall rank (and would rank if the Security Documents were neither executed nor required) prior to and/or higher than, its other unsecured liabilities (both actual and contingent) except liabilities which are preferred solely by Malaysian law and not by reason of any Security Interest.

6. PAYMENT OF PURCHASE PRICE

- 6.1 Subject to the fulfilment of the conditions precedent as set out in Clause 3 hereof, the Second Schedule and other terms and conditions as contained in this Agreement, the Contractor may request for the payment of the Purchase Price or any part thereof by issuing to ABCBB the Payment/ Disbursement Notice in the form set out in Fifth Schedule duly verified and affirmed by the Customer(s), and supported by such documentary evidence relating to the Works as may be acceptable to ABCBB.
- 6.2 Subject to Clause 6.1, when ABCBB receives a Payment/Disbursement Notice from the Contractor, ABCBB is hereby authorised to pay the Purchase Price or any part thereof to the Contractor or such other person(s) responsible for or concerned with the carrying out of the Works or to any other person, as the case may be, at such times in such manner by such amounts and upon such contingencies and conditions as ABCBB may in its absolute discretion decide and/or by progressive releases or otherwise in accordance with the schedule of payment set out in the Construction Document(s) or such variations in the order of the schedule of payment as ABCBB may in its absolute discretion deem fit and the acknowledgement of receipt by the aforesaid party(ies) shall be as good and sufficient and effective as if the same had been made or given by the Customer(s) personally and it is hereby further irrevocably agreed and confirmed by the Customer(s) that the Customer(s) shall not be entitled to object to or to restrain such payment by ABCBB.
- 6.3 Without prejudice to ABCBB's powers and rights conferred herein, it is hereby expressly agreed between the Parties herein that in the event of any default on the part of the Contractor or such other third parties in their obligations to ABCBB and the existing chargee in respect of the Said Property (if any) for the purpose of discharging/ reassigning the same in favour of ABCBB or in the opinion of ABCBB, the Contractor or such other third parties is/are in breach of

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- 6.3 Without prejudice to ABCBB's powers and rights conferred herein, it is hereby expressly agreed between the Parties herein that in the event of any default on the part of the Contractor or such other third parties in their obligations to ABCBB and the existing chargee in respect of the Said Property (if any) for the purpose of discharging/ reassigning the same in favour of ABCBB or in the opinion of ABCBB, the Contractor or such other third parties is/are in breach of

the Construction Document(s) or the terms and conditions of the Supervision of Construction Agreement, ABCBB shall be at liberty to withhold the disbursement of the Purchase Price or any part(s) thereof.

- 6.4 The payment of the Purchase Price by ABCBB to the Contractor as aforesaid in the manner set out herein shall be deemed to be effective payment thereof to or for the benefit of the Customer(s) provided however that ABCBB shall not be bound to make payment unless and until the differential sum between the total cost of the Works and the Purchase Price shall have been duly paid by the Customer(s) to the Contractor and subject further that the conditions precedent set out herein shall have been fulfilled and complied with by the Customer(s).

7. PAYMENT AND PREPAYMENT OF SELLING PRICE

7.1 Payment

- (a) The payment period of the Selling Price shall be in accordance with Section 13 of First Schedule hereto.
- (b) The Customer shall pay the Selling Price to ABCBB in accordance with the mode set out under Section 14 of First Schedule hereto.
- (c) Notwithstanding anything to the contrary contained herein, it is hereby agreed that on the satisfaction by payment or otherwise of the Outstanding Sum, all the provisions herein contained shall not be of any effect but without prejudice to ABCBB's rights and remedies against the Customer(s) and/or the Security Party(ies) or any of them in respect of any antecedent claim or breach of covenant.

7.2 Prepayment

Subject to the principles of Syariah, the Customer(s) may prepay to ABCBB, the Selling Price subject to the following conditions:

- (a) ABCBB shall have received from the Customer(s) not less than thirty (30) days prior written notice of its intention to make prepayment specifying the relevant installment to be prepaid and the date of such prepayment;
- (b) the Customer(s) has paid in full all other monies due and outstanding under the Security Documents; and
- (c) the amount payable by the Customer(s) in respect of such prepayment shall be determined by ABCBB at its sole discretion.

7.3 Notice of Prepayment irrevocable

Any prepayment notice once given pursuant to Clause 7.2 shall be irrevocable and the Customer(s) shall pay the amount as determined by ABCBB in accordance with Clause 7.2 on the date specified in such prepayment notice.

8. COMPENSATION FOR LATE PAYMENT

The Customer(s) shall be liable to pay ABCBB compensation on overdue instalments and payments of Selling Price on the due date as set out in Section 13 of First Schedule hereto as follows:

- (a) for failure to pay any instalments of the Selling Price from the date of first disbursement until the due date as set out under Section 13 of First Schedule hereto, the compensation rate that shall be applied shall be one per centum (1%) per annum on the overdue amount or any other method approved by BNM;
- (b) for failure to pay any instalments/ payments and which failure continues beyond the due date as set out under Section 13 of First Schedule hereto, the compensation rate that shall be applied shall be ABCBB's current Islamic Money Market Rate on the principal balance or any other method approved by BNM;
- (c) the amount of such compensation shall not be compounded on the principal amount.

9. SECURITY

9.1 Security

In consideration of ABCBB granting the Facility and as security for the payment by the Customer(s) of the Outstanding Sum, the Customer(s) shall in addition to this Agreement and prior to or contemporaneously with the execution of this Agreement execute or cause the Security Party (ies) to execute the Security Documents as more particularly described in Section 15 of First Schedule of this Agreement.

9.2 Continuing Security

- (a) The security (ies) herein created is expressly intended to be and shall be a continuing security for all monies whatsoever now or hereafter and from time to time owing to ABCBB by the Customer(s) whether alone or jointly and severally with another or others and whether as principal or surety notwithstanding that the Customer(s) may at any time cease to be indebted to ABCBB for any period or periods.
- (b) This Agreement shall be without prejudice to any security already given by the Customer(s) to ABCBB or any security which may hereafter be given to ABCBB whether the same be for securing payment of the Outstanding Sum together with all other costs and charges thereon or any other monies covenanted to be paid herein or whether it is taken as additional or collateral security or otherwise howsoever.

9.3 ABCBB's Other Securities

Nothing herein contained shall prejudice or affect any lien to which ABCBB is entitled to or any securities which the Customer(s) may at any time or from time to time hold for or on account of the monies hereby secured nor shall anything herein contained operate so as to merge or otherwise prejudice or affect any guarantee, mortgage, charge, lien or other security which the Customer(s) may for the time being have for any money intended to be hereby or otherwise secured or right or remedy of ABCBB thereunder.

9.4 Modifications and Obligations

Subject to the principles of Syariah, the liabilities and obligations created by this Agreement shall continue to be valid and binding for all purposes whatsoever notwithstanding:

- (a) any time or indulgence which ABCBB may from time to time grant to the Customer(s) for the payment of monies due to ABCBB for the observance or performance of any term, stipulation, covenant or undertaking on the part of the Customer(s) to be observed and performed under the terms of this Agreement;
- (b) any arrangement entered into or any composition accepted by ABCBB modifying its rights and remedies under this Agreement or any alteration in the obligations, terms, stipulations, covenants and undertakings contained herein or by any forbearance whether as to pay time performance or otherwise.

10. SPECIAL COVENANT

The Customer(s) hereby covenants with ABCBB that notwithstanding any provision herein to the contrary, it shall continue to observe and perform all the stipulations, conditions or obligations on its part to be performed and observed under the Construction Document(s) and the Supervision of Construction Agreement and further covenants with ABCBB that it shall at all times indemnify ABCBB and save and hold ABCBB harmless against all losses, damages, claims, proceedings, demands, actions, penalties, costs and expenses, (including legal costs on a solicitor and client basis) brought or made against it or ABCBB by the Contractor or any other party or parties, howsoever caused, arising from the Construction Document(s), the Supervision of Construction Agreement or any other documents derived therefrom or the Security Documents or that may be incurred by ABCBB as a result thereof and the Customer(s) shall promptly upon a demand being made by ABCBB, pay to ABCBB all amounts so paid or suffered by ABCBB.

11. EVENTS OF DEFAULT

11.1 Events of Default

The Outstanding Sum and any other monies due and outstanding under the Security Documents shall become due and immediately payable on demand and ABCBB shall forthwith be entitled to recover the same and to exercise the rights

and powers upon default as provided by the Security Documents and by law in any of the following events:

- (a) any breach by the Customer(s) of the terms of the Security Documents;
- (b) if the Customer(s) fails to pay any sums due under any of the Security Documents whether on demand being made by ABCBB or not;
- (c) if a petition shall be presented or an order is made for bankruptcy or winding up or other analogous proceedings are instituted against the Customer(s);
- (d) if a distress or execution or other process of a court of competent jurisdiction be levied or issued against any of the properties of the Customer(s) and such distress execution or other process as the case may be shall not be satisfied by the Customer(s) within seven (7) days;
- (e) if the Customer(s) commits or threatens to commit a breach of any covenants or stipulations herein contained and/or in the Security Documents;
- (f) if in the opinion of ABCBB that the Facility hereby granted is being threatened or placed in jeopardy for any reason whatsoever;
- (g) if any legal proceedings or any other similar action shall be instituted against the Customer(s) and if after ABCBB has reviewed the matter with the Customer(s) ABCBB is of the opinion that this materially affects the Customer(s)'s ability to pay the Outstanding Sum;
- (h) if any facility, loan, debt, guarantee or other obligation whatsoever constituting indebtedness of the Customer(s) becomes due prior to its scheduled maturity (by demand acceleration or otherwise) or such indebtedness shall not be paid at the maturity thereon or within any period of grace allowed for payment thereof or if the Customer(s) is otherwise in breach of or in default under any agreement deed or mortgage pursuant to which such indebtedness was created, incurred or assumed;
- (i) if the Customer(s) shall fail to satisfy any judgment which is pending in any appropriate court;
- (j) if any authorisation, exemption or undertaking referred to in this Agreement shall be revoked, terminated, restricted or modified in a manner unacceptable to ABCBB or an event shall have occurred which in the opinion of ABCBB (which opinion shall be conclusive and binding on the Customer(s)) makes it improbable that the Customer(s) will be able to perform or indicates that the Customer(s) is unwilling to perform its obligations under this Agreement;

- (k) if any of the property and assets of the Customer(s) shall become the subject matter of any seizure, forfeiture, confiscation or expropriation by any authority or Government, the Customer(s) shall inform ABCBB of any legal proceedings litigation claims (of a material nature) involving them;
- (l) if any representation or warranty or statement made in connection with the execution and delivery of this Agreement or in connection with any request for utilisation hereunder shall be found to have been incorrect for a period of thirty (30) days after written notice thereof shall have been given to the Customer(s) by ABCBB;
- (m) if ABCBB's securities under the Security Documents are in jeopardy;
- (n) if any provision of the Security Documents is or becomes, for any reason, invalid or unenforceable;
- (o) if any law is brought into effect which purports to render ineffective or invalid any provision of any of the Security Documents or which would prevent the Customer(s) and/or any of the third parties or the guarantor(s) from performing any of their respective obligations hereunder or thereunder;
- (p) if any part of the Building or any structures thereon is damaged or destroyed and the result, whether by reason of the insurance over the Works or structure proving to be invalid or unenforceable or for any other reason is, in the determination of ABCBB adversely to affect the financial condition of the Customer(s)'s ability to observe or perform its obligations under any of the Security Documents;
- (q) if default is made in effecting, maintaining or renewing any insurance required to be effected, maintained or renewed by the Customer(s) or the Security Party;
- (r) if the Customer(s) commits or threatens to commit a default under any of its contractual obligations with any other party including ABCBB with regard to its borrowing and indebtedness howsoever; and
- (s) if the Customer(s) allows a second charge to be registered against the Said Property without the consent of ABCBB first having been obtained;

then ABCBB shall have the right to suspend the Facility and ABCBB shall by written notice to the Customer(s) declare all Outstanding Sum under this Agreement to be immediately due and payable and the Customer(s) hereby waives any necessary requirement for the presentment of demand, notice of dishonour or protest and the Outstanding Sum shall thereupon become so payable. Provided that any action taken by ABCBB shall be without prejudice to the rights of ABCBB to enforce any other claim against the Customer(s).

11.2 Enforcement of Security Documents

If the Customer(s) shall fail to pay the Outstanding Sum after a demand for payment of the same has been made by ABCBB under the provisions of Clause 14(a) hereof, ABCBB shall be entitled to enforce any or all of the remedies available to ABCBB under the Security Documents.

11.3 Suspense Account

Any money received hereunder may be placed and kept to the credit of a suspense account for so long as ABCBB thinks fit without any obligation in the meantime to apply the same or any part of it in or towards the discharge of any monies or liabilities due or incurred by the Customer(s) to it. Notwithstanding any such payment in the event of any proceedings in or analogous to bankruptcy liquidation composition or arrangement ABCBB may prove for and agree to accept dividend or composition in respect of the whole or any part of such monies and liabilities in the same manner as if this Agreement, the Istisna' Sale Agreement, the Istisna' Purchase Agreement or the securities had not been created. If the Customer(s) shall without the consent of ABCBB execute or cause to execute or create any encumbrance over any asset of the Customer(s) or any part thereof in favour of any other corporation person or persons of which ABCBB shall receive notice either actual or constructive, ABCBB may on receiving such notice, forthwith open a new or separate account with the Customer(s) in its books and if ABCBB does not in fact open such new or separate accounts, ABCBB shall nevertheless be deemed to have done so at the time when ABCBB received or were deemed to have received such notice and as from and after such time, all payments to account made by the Customer(s) to ABCBB shall (notwithstanding any legal or equitable rule or presumption to the contrary), be placed or deemed to have been placed to the credit of the new or separate account so opened or deemed to have been opened and shall not go in reduction of the amount due by the Customer(s) to ABCBB at the time when ABCBB received or was deemed to have received the aforesaid notice. Provided Always that the provisions of this Clause shall not prejudice the security otherwise available under the Security Documents for the monies payable by the Customer(s) notwithstanding that the same may become due or owing or be incurred after the time when ABCBB received or was deemed to have received the aforesaid notice.

11.4 Right to Consolidate

Upon the occurrence of Event of Default ABCBB may without notice to the Customer(s) combine consolidate or merge all or any of the Customer(s)'s accounts with and liabilities to ABCBB and/or ABCBB's branches and ABCBB may set-off or transfer any sum outstanding to the credit of any such accounts in or towards the satisfaction of any of the Customer(s)'s liabilities to ABCBB under the Security Documents.

11.5 Cross Default

It is hereby expressly agreed and declared that any breach by the Customer(s) of the terms, conditions, stipulations and agreements contained in the Security Documents shall be deemed to be a breach hereunder and shall entitle ABCBB to enforce all or any of the remedies hereinbefore mentioned

12. SPECIAL CONDITIONS

The Customer(s) hereby agrees that subject to the principles of Syariah, ABCBB shall have the sole right and discretion to add, vary, delete, cancel, amend, supplement or enforce all and/or any terms and/ or conditions of the Security Documents and Special Conditions as set out under Fourth Schedule and such addition, variation, deletion, cancellation, amendment, supplemental and enforcement of all and/or any terms and/or condition thereof shall be deemed to form an integral part of this Agreement. The Parties further agree that in the event of conflict between the terms under Fourth Schedule and the other terms of this Agreement, the terms under Fourth Schedule shall prevail.

13. TAKAFUL

13.1 Takaful in Joint Names

The Customer(s) shall keep and cause to keep, at its own costs and expenses, the Building and all fixtures, fittings, furniture and furnishings whatsoever therein and thereon situated in good order and condition and insured for a sum satisfactory to ABCBB against loss or damage by fire and against any other risk as ABCBB may from time to time decide and to keep the same so insured throughout the duration of this Agreement to their full insurable value to the satisfaction of ABCBB an insurance company as approved by ABCBB and shall arrange with such insurance company to have ABCBB's interest as chargee and loss payee taken note of and endorsed on the policy or policies effected in default whereof it shall be lawful for but not obligatory upon ABCBB to insure the same and all monies expended by ABCBB shall be recoverable from the Customer(s) and shall be repaid on demand for the same being made by ABCBB.

13.2 Restriction Against Additional Insurance/Takaful

The Customer(s) shall not except at the request of or with the consent in writing of ABCBB, effect or keep on foot any insurance/takaful against any risk in respect of any of the assets referred to in Clause 13.1 when ABCBB has effected or has kept on foot such insurance/takaful.

13.3 Custody of Takaful Policies and Premium Receipts

The Customer(s) shall permit all takaful policies and the receipts or other evidence of payment of premium by the Customer(s) to remain in the custody of ABCBB, and will when required, deliver or produce to ABCBB or to such persons as ABCBB may direct any policy of takaful effected by the Customer(s) and the receipt or the evidence of payment of the current premium

in respect thereof.

13.4 Application of Takaful Monies

ABCBB may require any monies received on any takaful policies whether effected by ABCBB or by the Customer(s) to be applied in or towards making good the loss or damage in respect of which the money is received or receivable in or towards the discharge of any monies whatsoever owing by the Customer(s) to ABCBB and the Customer(s) shall hold any money paid and received on such takaful policies in trust for ABCBB and ABCBB may receive and give a good discharge for any such monies.

14. SERVICE OF NOTICE AND LEGAL PROCESS

- (a) Save as otherwise herein provided, any demand for payment of the monies to be paid by the Customer(s) and any notice or request required or permitted to be given or made under the Security Documents to the Customer(s) or ABCBB shall be in writing, and in the case of ABCBB shall be under the hand of any Director, Manager, Secretary, Accountant or any other duly authorised officer of ABCBB or a solicitor or firm of solicitors purporting to act for ABCBB to the addresses set out in the relevant section of First Schedule or as may be subsequently notified.
- (b) Any demand, notice or request shall be deemed to have been sufficiently given or made if sent by A.R. registered post, addressed as aforesaid or delivered by hand to such address or faxed to such address and shall in the case of delivery by hand be deemed to have been duly served on and duly received by the other party at the time of delivery and in the case of delivery by A.R. registered post shall be deemed to have been duly served on and duly received by the other party after the expiration of three (3) Business Days from the date it was posted notwithstanding that such letter may be subsequently returned unclaimed by the post office and in the case of facsimile shall be deemed to have been duly served on and duly received by the other party against due transmission evidenced by a print-out record for such transmission, subject to the condition that if such transmission is made after 5.00 p.m. on the day of transmission, it shall be deemed to have been served on the following Business Day. Any demand, notice or request by fax shall be followed by registered post or delivered by hand to such address as soon as practicable thereafter.
- (c) No change in the address of the Customer(s) herein stated howsoever brought about shall be effective or binding on ABCBB unless actual notice of the change of address has been given to ABCBB. In the event of a change in address of the Customer(s), the Customer(s) shall as soon as practicable but within fourteen (14) Business Days prior to such change notify in writing to ABCBB of the change.
- (d) Any notice or other communication to be given under or in respect of this Agreement shall be delivered, given or sent to the addressee at the address or facsimile number (or such other address or facsimile number as the addressee may give notice of to the other party in accordance with the provisions of this

Clause from time to time) set out in the relevant section of First Schedule hereto.

15. SUCCESSORS AND ASSIGNS

This Agreement shall be binding upon the heirs, representatives, administrators, executors, successors and permitted assigns of the Customer(s) and successors-in-title and assigns of ABCBB.

16. MISCELLANEOUS

16.1 Waiver

No failure or delay on the part of ABCBB in exerting nor any omission to exercise any rights, power, privilege or remedy accruing to ABCBB under this Agreement, or any security in favour of ABCBB upon any default on the part of the Customer(s) shall impair any such right, power, privilege remedy or be construed as waiver thereof or any acquiescence in any default, affect or impair sort whether in relation to or effecting the Customer(s) shall in any way affect the security liabilities and or obligations created by the Security Documents in relation to any transaction whatsoever whether past, present or future.

16.2 Disclosure of information

- (a) Without limiting the subsequent provisions of this Clause, ABCBB may at any time, disclose to any person who may in ABCBB's absolute discretion, require such information or access thereof any documents or records of, or information about the Security Documents or assets, business or affairs of the Customer(s) whether or not confidential and whether or not the disclosure would be in breach of any law or of any duty owed to the Customer(s) provided that in respect of documents, records or information which the Customer(s) has informed ABCBB to be confidential, the person receiving such information from ABCBB may be required to undertake to maintain the confidentiality of documents, records or information received, whether past, present or future.
- (b) The Customer(s) hereby permits ABCBB to disclose any documents or records of, or information about the Security Documents, the Facility, or the assets, business or affairs of the Customer(s), whether or not confidential and whether or not the disclosure would be in breach of any law or of any duty owed to the Customer(s):
 - (i) to the Central Credit Unit, Biro Maklumat Cek, BNM, any governmental agency or such other authority having jurisdiction over ABCBB; or
 - (ii) for or in connection with the enforcement of preservation of any rights of ABCBB under this Agreement and the other Security Documents; or

- (iii) to any third party, if required by any law, regulation or by-law; or
 - (iv) to any party pursuant to any arrangement, composition, restructuring or any proposed arrangement, composition or restructuring between the creditors of the Customer(s).
- (c) ABCBB may disclose to any person who derives or may derive rights or obligation under or by reference to the Security Documents (including but not limited to an assignee or transferee or prospective assignee or transferee) such information about the Customer(s) in relation to the Facility or the Security Documents as shall have been made available to ABCBB generally.
- (d) The Customer(s) hereby acknowledges and agrees that the permission given under this Clause is deemed to be the permission given for the purposes of Section 34(3) of IBA and that no further consent from the Customer(s) is required for the purposes of Section 34(3) of IBA.

16.3 Disclosure Among Branches, Subsidiaries or Parent Company

The Customer(s) hereby agrees that as long as this Agreement continues and/or as long as the Outstanding Sum remains outstanding, ABCBB shall be entitled to disclose information on the Customer(s)'s business with ABCBB (including its account and/or future accounts) to ABCBB's Solicitors, auditors, branches, subsidiaries, parent company or companies which are or which in future may be a subsidiary of ABCBB and the branches, subsidiaries or parent company of ABCBB shall also be entitled to make such disclosure to ABCBB and ABCBB shall take all reasonable care to ensure that such information shall remain confidential between ABCBB's group of subsidiaries.

16.4 Security Documents Deemed Incorporated

The Security Documents shall be read and construed as part and parcel of this Agreement and shall be applicable in full force and effect in all respect as if the same were spelt out and stated in this Agreement.

16.5 Costs

The Customer(s) shall be liable to pay all fees and expenses in connection with or incidental to the preparation of the Security Documents including ABCBB's Solicitor's fees (on a solicitor and client basis) in connection with the preparation and execution of the Security Documents and other documents related thereto. If the Outstanding Sum or any part thereof shall be required to be recovered through any legal process, the Customer(s) shall pay (in addition to the monies then due and payable under this Agreement) ABCBB's Solicitor's fees (on a solicitor and client basis) and any other fees and expenses incurred in respect of such action.

16.6 Legal Proceedings

It is hereby declared and agreed that if ABCBB takes legal action to recover any monies due to it from the Customer(s) or to enforce any term or condition of the Security Documents then ABCBB shall be at liberty to proceed simultaneously in the same or separate proceedings against the Customer(s), and any of the Security Parties and all other parties liable to satisfy the Outstanding Sum to ABCBB and to claim and execute judgment for monies due and ABCBB shall discontinue such proceedings immediately upon the recovery of the full amount due to it.

16.7 Letter of Offer

It is hereby expressly understood by the Parties hereto that ABCBB's Letter of Offer to the Customer(s) as described in Section 9 of First Schedule hereto shall be deemed to be incorporated in this Agreement and shall be read and construed as one document and in the event of any conflict or discrepancy between the provisions of this Agreement and the Letter of Offer, the provisions of this Agreement shall prevail for the purpose of interpretation and enforcement of this Agreement.

16.8 Lien and Set-Off

In addition to all liens upon and rights of set-off against the monies, securities or other property of the Customer(s) given to ABCBB by law, ABCBB shall have a lien upon and a right of set-off against all monies, securities and other assets of the Customer(s) in any currency now or hereafter in the possession of or on deposit with ABCBB, or any of its affiliates, at any branch or office, whether held in a general or special account of deposit, or for safe-keeping or otherwise and such lien and right of set-off may be exercised with or without notice to the Customer(s). No lien or right of set-off shall be deemed to have been waived by any act or conduct on the part of ABCBB, or by any neglect to exercise such right of set-off or to enforce such lien, or by any in so doing and every right of set-off and lien shall continue in full force and effect until such right of set-off or lien is specifically waived or released by an instrument in writing executed by ABCBB.

16.9 Illegality

If by reason of any change in any applicable law, regulation or regulatory requirement or in the interpretation or application thereof (after the date of this Agreement) by any governmental or any authority whereby it shall become unlawful for ABCBB to comply with its obligations hereunder, ABCBB shall promptly inform the Customer(s) of the relevant circumstances whereupon:

- (a) any outstanding obligations of ABCBB shall forthwith be terminated and cancelled; and
- (b) the Customer(s) shall upon demand refund to ABCBB all monies covenanted to be paid by the Customer(s) under and in relation to the Security Documents.

16.10 Variation of Terms

It is hereby expressly agreed and declared by the Parties hereto that notwithstanding any of the provisions of this Agreement to the contrary, the provisions and terms of any of the Security Documents may at any time and from time to time be varied or amended by means of a mutual exchange of letters or supplemental agreements or such other means as the Parties may agree from time to time and thereupon such amendments and variations shall be deemed to have been amended or varied accordingly and shall be read and construed as if such amendments and variations have been incorporated in and had formed part of this Agreement at the time of execution thereof. Any variation to be made under this Clause shall be subject to the principles of Syariah.

16.11 Imposition of Terms by BNM

The transaction arising from this Agreement shall at all times be subject to all procedures, terms, rules, directives regulations (whether or not having the force of law) as may be imposed by BNM or such other authority having jurisdiction over ABCBB from time to time.

16.12 Section 25 of IBA

The Customer(s) hereby declare that the Customer(s) has had notice of Section 25 of IBA and confirm that the said Section 25 has not been infringed and hereby undertake to advise ABCBB if any of the relationships set out in the said Section is established or discovered at any time. ABCBB reserves the right to terminate the grant of the Facility in the event of any infringement of the said section.

16.13 Evidence of Outstanding Sum

In any proceeding relating to this Agreement, a statement as to any amount due and payable to ABCBB under this Agreement which is certified as being correct by an officer of ABCBB shall, unless otherwise provided in this Agreement, save for manifest error, be prima facie evidence that amount is in fact due and payable.

16.14 English Language

All notices or communications under or in connection with this Agreement shall be in the English language or in Bahasa Malaysia. In the event of conflict between the English text and the text in any other language including Bahasa Malaysia, the English text shall prevail.

16.15 Distribution of Proceeds

After this Agreement shall become enforceable by ABCBB, all monies and other property or assets held or received by ABCBB shall (subject to the payment of debts which by law have priority) be applied:

- Firstly to pay for all costs, charges and expenses incurred and payments made by ABCBB under the provisions of the Security Documents (if any) and any other taxes payable under any written law for the time being in force.
- Secondly in payment of or provision for all costs, charges, expenses, fees and liabilities whatsoever incurred by ABCBB in or about the carrying out of its duties powers and discretion under the Security Documents including the costs and expenses all fees and charges payable to ABCBB by way of indemnity or compensation.
- Thirdly in or (*pari passu* and rateable and without preference or priority on account of the date when the Outstanding Sum arose or otherwise) towards the payment of the Outstanding Sum in the proportion to the respective amount disbursed pursuant to the Security Documents bearing the Outstanding Sum then due.
- Fourthly in payment of the surplus (if any) to the Customer(s) or any other person or persons entitled thereto.

Provided That if ABCBB shall be of the opinion that the sum so recovered may prove deficient, or any part thereof before any other sum or sums owing to ABCBB has been paid but such alteration in the order of payment shall not prejudice the right of ABCBB to receive the full amount to which they would have been entitled if the primary order of payment had been observed or any such amount which the sum ultimately realised may be insufficient to pay.

Provided Further That any balance of the Outstanding Sum and/or other payments due to ABCBB hereunder remaining outstanding or unsatisfied after the application of the proceeds of sale as aforesaid shall be made good and paid by the Customer(s) to ABCBB within seven (7) days of a demand being made by ABCBB and the amount thereof shall be recoverable as a debt due to ABCBB.

16.16 Concurrent Remedies

- (a) Notwithstanding any provision hereof it is hereby expressly agreed that immediately upon the occurrence of an Event of Default, ABCBB shall thereafter have the right to exercise all or any of the remedies available whether by the Security Documents or by law or otherwise and shall be entitled to exercise such remedies concurrently including pursuing all remedies of sale or possession and instituting civil suit to recover all monies due and owing to ABCBB.
- (b) In the event ABCBB does not wish to exercise such remedies concurrently, ABCBB shall be entitled at its discretion to institute civil suit to recover all monies outstanding or to dispose of the Works or vice versa.

16.17 Time

Time in relation to all the provisions of this Agreement and in particular to the payment of the Outstanding Sum or any part thereof and the payment of all monies due by the Customer(s) to ABCBB under the Security Documents shall be of the essence.

16.18 Liabilities and Obligations

Liabilities and obligations created by this Agreement shall continue to be valid and binding for all purposes whatsoever notwithstanding:

- (a) any time or indulgence which ABCBB may from time to time grant to the Customer(s) for the payment of monies due to ABCBB for the observance or performance of any term stipulation covenant or undertaking on the part of the Customer(s) to be observed and performed under the terms of this Agreement; and
- (b) any arrangement entered into or any composition accepted by ABCBB modifying its right and remedies under this Agreement or any alteration in the obligations terms stipulations covenants and undertakings contained herein or by any forbearance whether as to pay time performance or otherwise.

16.19 Governing Law and Principles

The Security Documents shall be governed by and construed in all respect in accordance with the laws of Malaysia and the Syariah principles on all matters connected with the obligations and liabilities of the Parties under the Security Documents and the Parties further agree that the service of any writs or summons of any legal process in respect of any action arising out of or connected with the Security Documents may be effected by forwarding a copy of the writ of summons and statement of claim and other legal process by A.R. registered post to their respective addresses set out in Clause 14 hereof.

16.20 Severability

Any term, condition, stipulation, provision, covenant or undertaking contained herein which is illegal prohibited or unenforceable in any jurisdiction shall, as to such jurisdiction, be ineffective to the extent of such illegality, prohibition or unenforceable without invalidating the remaining provisions hereof and any such illegality, prohibition or unenforceability in any jurisdiction shall not invalidate or render illegal, void or unenforceable any such term, condition, stipulation or undertaking in any other jurisdiction.

16.21 Notification

Any notification by ABCBB concerning any of the matters shall, save for any manifest error, be conclusive and binding on the Customer(s).

16.22 Reconstruction of ABCBB

The security liabilities and obligations created by this Agreement shall continue to be valid and binding for all purpose whatsoever notwithstanding any change by amalgamation reconstruction otherwise which may be made in the constitution of ABCBB and it expressly declared that no change whatsoever in relation to or affecting ABCBB shall in any way affect the security, liabilities and obligations created hereunder in relation to any transaction whatsoever whether past, present or future.

16.23 Cross Reference

The Customer(s) hereby covenants and agrees that all the provisions, covenants, stipulations, conditions, undertakings and agreements contained in the Security Documents shall unless repugnant to any of the provision contained herein to be read as part of this Agreement and shall be applicable with full force and effect as if the same was set out hereunder.

16.24 Assignment by ABCBB and the Customer(s)

- (a) ABCBB shall be at liberty at any time to assign its rights and obligations hereunder without the concurrence of the Customer(s).
- (b) The Customer(s) shall not assign its rights hereunder or any interest herein without the prior written consent of ABCBB and it shall in any event remain liable for all its obligations hereunder. All undertakings, agreements, covenants, representations and warranties given made or entered into by the Customer(s) herein shall survive the making of any assignment hereunder.

16.25 Application of Malay Reservation Enactment(s)

For the avoidance of doubt it is hereby agreed and declared that this Agreement is entered into for the purpose of and in order to effect the financing transaction in accordance with the Islamic banking principle of Bai' Al-Istisna' and in the event that the provisions of the respective Acts or any Malay Reservation Enactment(s) of the States of Peninsular Malaysia shall become applicable or would be contravened in the process unless an approval of a Ruler in Council or any other approval under the applicable Acts is obtained or become necessary, it shall be the sole responsibility of the Customer(s) to obtain such approval prior to the execution of this Agreement and/or the Security Documents and the Customer(s) hereby undertake(s) with ABCBB to obtain or cause to obtain such approval prior to the release of the Purchase Price.

16.26 Indemnity

The Customer(s) shall fully indemnify ABCBB from and against any expense, loss, damage or liability as to the amount of which the certificate of ABCBB (indicating how the total amount has been calculated) shall, in the absence of manifest error, be conclusive that they may incur as a consequence of the occurrence of any Event of Default under the Security Documents or otherwise

howsoever in connection with this Agreement. Without prejudice to its generality, the foregoing indemnity shall extend to any fees or other sums whatsoever paid or payable in connection with the preservation or enforcement or attempted preservation or enforcement of any of the rights of ABCBB under the Security Documents or related documents.

16.27 Indulgences

The liabilities and obligations of the Customer(s) shall not be impaired or discharged by reason of any time, forbearance or other indulgences being granted by or with the consent of ABCBB to the Customer(s) or to any person who or which may be in any way liable to pay any of the monies secured hereby or by any other security in favour of ABCBB or by reason of any arrangement being entered into or composition accepted by ABCBB modifying the operation of law or otherwise the rights and remedies of ABCBB under the provisions of the Security Documents.

16.28 Cumulative Rights and Remedies

The rights and remedies provided herein are cumulative and are not exclusive of any other rights and remedies provided by law.

16.29 Expenditure Incurred by ABCBB for and on behalf of the Customer(s)

All monies expended by ABCBB under the Security Documents from time to time for and on behalf of the Customer(s) and for its account shall be recoverable from the Customer(s) and shall be repaid on demand. In default of payment, such monies shall be deemed to form part of the indebtedness by the Customer(s) to ABCBB and shall be secured by the Security Documents.

16.30 Force Majeure

Notwithstanding any provision of the Security Documents, ABCBB shall not be liable for any failure on the part of ABCBB to perform any obligation under the Security Documents resulting directly or indirectly from the action or inaction of any governmental or local authority or any strike, boycott, blockade, Act of God, civil disturbance or cause beyond the control of ABCBB.

16.31 No Variation to the Works

It is hereby expressly agreed between the Parties that the Customer shall not, without prior written consent from ABCBB, vary, amend or do any act which may result in substantial variation of the Works as set out under the Construction Document(s).

7. STAMPING

IT IS HEREBY AGREED AND DECLARED that this Agreement and the other Security Documents and any other agreements or documents are all instruments employed in one transaction to secure the Outstanding Sum and profit thereon and any other sums which are due and payable by the Customer(s) to ABCBB (subject to the

terms of the Security Documents) and all other charges, costs and expenses whatsoever within the meaning of Section 4(3) of the Stamp Act, 1949 and for the purpose of the said Section, this Agreement is deemed to be the principal or primary instrument and the other Security Documents are the subsidiary or auxiliary instruments. Stamp duty payable on this Agreement and the other Security Documents, shall be paid by the Customer(s).

As Attorney for and on behalf of
ABC BANK BERHAD
 (Company No. 1234-W)
 in the presence of:

By its Attorney:

*If Individual:

SIGNED by

NRIC No.

in the presence of

Name:

NRIC No.

*If Company:

The Company is duly incorporated in Malaysia

with its registered office at

and its principal place of business at

in the presence of

Name:

Signature:

NRIC No.

(If under power)

IN WITNESS WHEREOF the Parties hereto have caused this Agreement to be duly executed day, month and year first above written.

SIGNED by)
)
as Attorney for and on behalf of)
ABC BANK BERHAD)
(Company No. 1234-W)) by its Attorney(s)
in the presence of:)

*(If individual)

SIGNED by)
)
(NRIC No.)
in the presence of)

.....
Name:
NRIC No:

*(If by Common Seal)

The Common Seal of the Customer(s)
was hereunto affixed)
in accordance with its Articles of)
Association in the presence of:)

.....
Name:
Designation:
NRIC No:
*(If under hand)

.....
Name:
Designation:
NRIC No:

ACKNOWLEDGMENT BY THE CONTRACTOR

SIGNED by)
)
(NRIC No.))
for and on behalf of)
)
(Company No.))
in the presence of)

.....
Name:
NRIC No:

.....
The Contractor
.....
was lawfully
in accordance with the Articles of
Association in the presence of

.....
Director

.....
SIGNED by)
)
(NRIC No.))
for and on behalf of)
)
(Company No.))
in the presence of)

.....
Name:
NRIC No:

ACKNOWLEDGMENT BY THE CONTRACTOR

*We, _____, a company incorporated in Malaysia and having its registered office at _____, hereby agree to observe and be bound by the terms and conditions herein contained.

*We, _____, an enterprise registered in Malaysia and having its office at _____, hereby agree to observe and be bound by the terms and conditions herein contained.

*(If under seal)
The Common Seal)
(Company No.)
was hereunto affixed)
in accordance with its Articles of)
Association in the presence of:)

.....
Director

.....
Director / Secretary

*(If under hand)
SIGNED by)
(NRIC No.)
for and on behalf of)
(Company No.)/
(Business Registration No.))
in the presence of)

.....
Name:
NRIC No:

FIRST SCHEDULE

(which is to be taken, read and construed as an essential part of this Agreement)

SECTION	PARTICULARS	DESCRIPTION
1	The day year of this Agreement	Dated the day of 200
2	Name and description of the Customer(s)	Name: Address: Company No. (if applicable): Telephone No: Facsimile No:
		Name: Address: Telephone No: Facsimile No:
3	Name and address of the branch under this Agreement	ABC BANK BHD (Company Registration No. 6175-W) of
4	Particulars of Said Property	
5	Description of Building	

6	Description of Construction Document(s)	
7	Name and description of the Contractor	Name: Company No: Contractor's Licence No: Address: Telephone No: Facsimile No: For Attention of:
8	Financing Amount	Up to the amount of Ringgit Malaysia
9	Letter of Offer	Dated
10	Availability Period	10(a) 10(b)
11	Purchase Price	Ringgit Malaysia
12	Selling Price	Ringgit Malaysia

13	Payment Period of Selling Price	
14	Mode of Payment of Selling Price	
15	Security Documents	
16	ABCBB's Solicitors	

SECOND SCHEDULE

Conditions Precedent pursuant to Clause 3

- (a) submission of ABCBB's Letter of Offer duly accepted and stamped by the Customer(s);
- (b) the Security Documents have been duly executed and have been stamped and deposited with the High Court or presented at any relevant registry for registration (where applicable);
- (c) ABCBB's Solicitors shall have confirmed that a search on the Said Property has been conducted at the relevant land registry or office (which costs shall be paid by the Customer(s)) confirming that the Said Property is free from any encumbrance whatsoever, unless such encumbrance is acceptable and consented to by ABCBB;
- (d) the duly stamped original copies of the Security Documents have been deposited with ABCBB;
- (e) the Customer(s) shall have submitted evidence satisfactory to ABCBB, that all approvals, licences, authorisations and consents (if any) necessary for any matter or thing contemplated by or relating to the Said Property, Security Documents and the Works have been obtained and remain in full force and effect;
- (f) the Customer(s) shall have furnished or cause to be furnished to ABCBB the relevant documents evidencing its title and/or interest in the Said Property;
- (g) ABCBB's Solicitors shall have received written confirmation from the Official Assignee's Office confirming that no bankruptcy action has been taken against the Customer(s) or any of the Directors of the Customer(s);
- (h) where the separate document of title in respect of the Said Property has been issued by the relevant authority, the Customer(s) shall have furnished or cause to be furnished to ABCBB the issue document of title to the Said Property;
- (i) where required by ABCBB, a private caveat or line-holder's caveat, if so required, shall have been entered by or on behalf of ABCBB in respect of the Said Property;
- (j) the Customer(s) shall have delivered the original copy of the sale and purchase agreement in relation to the Said Property to ABCBB to be held in custody, if applicable;
- (k) the Customer(s) shall have submitted to ABCBB the original quit rent receipt for the current year due and payable in respect of the Said Property and/or evidence of payment of the other Outgoings;
- (l) where required by ABCBB, a valuation of the Said Property in the form and substance satisfactory to ABCBB confirming that the forced sale value/open market value of the Said Property, whichever is required is not less than the amount stated in the Letter of Offer and verification of the address of the Said Property by a valuer appointed by ABCBB shall have been done at the cost and expense of the Customer(s);

- (m) the Customer(s) has complied with all its obligations under this Agreement to the satisfaction of ABCBB and the Customer(s) has paid other charges payable or agreed to be payable to ABCBB for or in connection with the Security Documents;
- (n) all other documents and instruments which are deemed necessary or expedient by ABCBB have been duly executed, stamped and registered (where applicable) and the originals thereof have been deposited with ABCBB and are in the form and substance satisfactory to ABCBB;
- (o) ABCBB is satisfied that no event has occurred so as to render the Outstanding Sum to become immediately payable and no Event of Default under the Security Documents or arrangement has occurred or is threatened;
- (p) ABCBB is satisfied that no extraordinary circumstances, governmental action or other material adverse change or event has occurred which in the opinion of ABCBB prejudices the ability of the Customer(s) to observe and perform the covenants and obligations on its part to be performed under the Security Documents;
- (q) ABCBB has received such other documents, opinions, certificates, authorisations or assurances pertaining to the terms of this Agreement as ABCBB may reasonably request and all relevant undertakings, disclaimers, confirmations required by ABCBB to ABCBB's satisfaction;
- (r) all expenses including stamp duties and ABCBB's Solicitor's fees for the preparation of the Security Documents and any other related fees or charges have been duly paid by the Customer(s);
- (s) ABCBB shall have received documentary evidence in form and substance satisfactory to it that the Customer(s) has paid the differential sum between the total cost of the Works and the Purchase Price, if applicable;
- (t) ABCBB is satisfied that any other conditions reasonably requested by ABCBB have been fulfilled;
- (u) ABCBB shall have received written confirmations from ABCBB's Solicitors that the Security Documents are in order and protect ABCBB's interest and all the conditions have been duly complied with by the Customer(s) and that the terms are valid and enforceable against the Customer(s);
- (v) if required, the Customer(s) shall procure the Contractor to confirm to ABCBB that it has insured all buildings, structures, fixtures, infrastructure, equipment and machinery for a sum satisfactory to ABCBB against loss or damage by fire, lightning, tempest, flood, landslides, riot, civil commotion, malicious acts and strike and such other risks as ABCBB may require or may from time to time require with an insurance company acceptable to ABCBB with an endorsement in favour of ABCBB as chargee and loss payee and shall have deposited the policies thereof with ABCBB;
- (w) ABCBB is satisfied that any disbursement shall, at the time of request therefore, be needed by the Contractor for the purpose of undertaking the Works;

- (x) if the Contractor is a body corporate, the Customer(s) shall ensure that ABCBB or ABCBB's Solicitors shall have received:
 - (a) written confirmation from the Official Receiver's Office confirming that no winding-up petition has been made against the Contractor;
 - (b) certified true copies of its Memorandum and Articles of Association, Form 9, Form 24, Form 44 and Form 49;
- (y) if the Contractor is an enterprise, the Customer(s) shall ensure that ABCBB or ABCBB's Solicitors shall have received:
 - (a) written confirmation from the Official Assignee's Office confirming that no bankruptcy action has been taken against the Contractor;
 - (b) certified true copies of its certificate of registration and other establishment documents;
- (z) the Customer(s) has produced documentary evidence acceptable to ABCBB evidencing the cost of the Works and where the payment of the Purchase Price is by progressive releases, receipt by ABCBB from the Contractor of documentary evidence, duly verified by the Customer(s) as may be acceptable to ABCBB;
- (aa) all representations and warranties in Clause 4 hereof shall have been complied with in all respects;
- (bb) the written consent from the existing financiers of the Customer(s) (if any) has been obtained for the creation of the securities under this Agreement;
- (cc) other terms and conditions deemed necessary as advised by ABCBB's Solicitors.

THIRD SCHEDULE

Disclosure pursuant to Clause 4.1(l)

FOURTH SCHEDULE**Special Conditions pursuant to Clause 12**

To: ABC BANK LTD

Attention:

Date:

Dear Sirs,

ISTISNA' PURCHASE AGREEMENT DATED:

Payment/Indorsement Name:

We refer to the Istisna' Purchase Agreement dated 1 January 2014 between ABC Bank Ltd and XYZ Corporation (the "Istisna' Purchase Agreement") and the Special Conditions (the "Special Conditions") which have the same meanings as above.

I/WE HEREBY:

(1) The purchase price of the goods to be purchased by the Buyer from the Seller, as set out in the Schedule, shall be:

(2) as follows:

(a) The purchase price shall be payable in full by the Buyer to the Seller on the date of delivery of the goods to the Buyer, as set out in the Schedule, and shall be subject to the following conditions:

(b) The purchase price shall be payable in full by the Buyer to the Seller on the date of delivery of the goods to the Buyer, as set out in the Schedule, and shall be subject to the following conditions:

(c) The purchase price shall be payable in full by the Buyer to the Seller on the date of delivery of the goods to the Buyer, as set out in the Schedule, and shall be subject to the following conditions:

(d) The purchase price shall be payable in full by the Buyer to the Seller on the date of delivery of the goods to the Buyer, as set out in the Schedule, and shall be subject to the following conditions:

FIFTH SCHEDULE

Payment/ Disbursement Notice

To: **ABC BANK BHD**

Attention: •

Date: •

Dear Sirs,

ISTISNA' PURCHASE AGREEMENT DATED •**- Payment/ Disbursement Notice**

We refer to the Istisna' Purchase Agreement dated • between AbC Bank Bhd and myself/ourselves. Terms defined in the Istisna' Facility Agreement (Home Construction) shall have the same meanings herein.

I/WE HEREBY:

- (1) give you irrevocable notice for the payment/disbursement of Ringgit Malaysia • (RM•.00) only; and
- (2) confirm that:
 - (a) we have completed [per centum (•%)] of the Works as per the Construction Document(s) and are pleased to enclose documentary evidence reflecting the same, as follows:

[Contractor to attach supporting documents]
 - (b) all governmental permits, licences and approvals required for the Works continue to be in full force and effect; and
 - (c) I/We have submitted evidence satisfactory to you, that all renewal for approvals, authorisations and consents (if any) necessary for any matter or thing contemplated by or relating to the Works have been obtained and remain in full force and effect.

Thank you.
Yours faithfully,

Contractor / Authorised Signatory of the Contractor

VERIFICATION BY THE CUSTOMER(S)

I/We hereby verify and affirm that the Contractor has completed the Works as stated under Item 2(a) above and the documentary evidence reflecting the same has been duly checked by me/us to my/our satisfaction.

Pursuant to the same, I/we verily confirm that it is in order for ABCBB to effect payment of the sum specified under Item (1) above to the Contractor and I/we shall hold ABCBB harmless from and against any claim, loss, damage or liability which ABCBB may incur or sustain as a consequence of any action or omission or default attributable to me/us or the Contractor in relation to the above.

Thank you.

Yours faithfully,

Customer(s)/ Authorised Signatory of the Customer(s)

ANNEXURE 1**ISTISNA' SALE AGREEMENT**

THIS AGREEMENT made the _____ day of _____ 200__ between the Customer(s) and ABCBB wherein pursuant to the Istisna' Facility Agreement (Home Construction) dated the _____ day of _____ 200__ ("the Istisna' Facility Agreement"), the Customer(s) and ABCBB HEREBY AGREE AND DECLARE as follows:

1. SAID PROPERTY

The Customer(s) is the registered or beneficial owner of the Said Property. The Customer(s) is desirous of obtaining the Building in accordance with the Construction Document(s).

2. SALE AND DELIVERY BY ABCBB

- 2.1 The Customer(s) has requested ABCBB to construct or to undertake the Works in accordance with the Construction Document(s), pursuant to which, ABCBB hereby agrees to undertake the Works, deliver and sell the Building and the Customer(s) hereby agrees to accept and purchase the Building to be constructed and delivered by ABCBB at the Selling Price subject to and in accordance with the terms and conditions of this Agreement.
- 2.2 For purposes of the carrying out the Works and delivery of the Building, ABCBB hereby undertakes to the Customer(s) that it would take all necessary measures to perform the Works according to the specifications and according to general and specific conditions as detailed in the Construction Document(s), which specifications are annexed herewith in Appendix 1.
- 2.3 The Parties to this Agreement hereby agree that ABCBB shall have the right to request any party to complete the Works for ABCBB subject to an agreement to be entered into between ABCBB and the said party and in the event ABCBB requests such party to complete the Works, the Customer(s) hereby unconditionally agrees to the appointment of such party in accordance with the terms and conditions of the Istisna' Purchase Agreement.
- 2.4 The Parties agree and acknowledge that the period of completion for the Works shall be in accordance with the period as specified under the Construction Document(s).

3. PAYMENT OF SELLING PRICE

- 3.1 The payment of the Selling Price by the Customer(s) to ABCBB shall be in accordance with Clause 7 of the Istisna' Facility Agreement.
- 3.2 The Customer(s) shall pay to ABCBB the Selling Price or such other amount as reduced by ABCBB under Clause 3.1 above within such number of days as stated in Section 14 of the First Schedule of the Istisna' Facility Agreement,

failing which, ABCBB shall have the right to enforce any of the security(ies) under the Security Documents.

4. SECURITY

The Customer(s) shall furnish securities to ABCBB to ensure the payment of the Selling Price by executing or procuring the execution of the Security Documents as described in Section 15 of First Schedule of the Istisna' Facility Agreement.

5. CONSTRUCTION OF THE BUILDING

The Building shall be constructed by ABCBB in accordance with the Construction Document(s). The Parties hereby agree that in ensuring that the Works comply or meet with the specifications as contained in the Construction Document(s), ABCBB shall appoint the Customer(s) to supervise and oversee the construction works upon terms and conditions as set out in the Supervision of Construction Agreement to be entered into by the Customer(s) and the Contractor.

6. DELIVERY OF THE BUILDING

- 6.1 ABCBB shall deliver or procure the delivery of the Building upon completion of the Works to the Customer(s).
- 6.2 Pursuant to Clause 5 above, in the event the Works do not comply or meet with the specifications as contained in the Construction Document(s) due to the occurrence of any Event of Default and due to the default attributable to the Contractor, the Customer(s) shall accept the Building at its existing state and shall pay all amount disbursed pursuant to the Istisna' Purchase Agreement together with profit margin, premium and other charges and all other sums of money howsoever due including but not limited to costs (including legal costs on a solicitor and client basis) to ABCBB.

7. FAILURE TO COMPLETE

The Customer(s) hereby agrees that in the event that there is any amount of the Financing Amount being unutilised at the end of the Availability Period or in the event ABCBB or the party appointed by ABCBB to undertake the Works for ABCBB under the Istisna' Purchase Agreement fails to complete the Works and deliver the Building within the time period as stipulated in the Construction Document(s) which results in the failure of ABCBB to deliver the Building to the Customer(s) under this Agreement, the Customer(s) agrees to accept the uncompleted Building from ABCBB at its existing state and shall pay all amount disbursed pursuant to the Istisna' Purchase Agreement together with profit margin, premium and other charges and all other sums of money howsoever due including but not limited to costs (including legal costs on a solicitor and client basis) to ABCBB.

8. TERMS AND CONDITIONS

The terms and conditions as set out in the Istisna' Facility Agreement are hereby repeated and shall be binding upon the parties hereto and the successors-in-title, permitted transferees and assigns of the Customer(s) and the successors-in-title and

assigns of ABCBB. In this Agreement, unless otherwise stated, all the terms and references shall bear the same meaning as designated to them in the Istisna' Facility Agreement.

(End of Clauses)

IN WITNESS WHEREOF the parties hereto have caused this Agreement to be duly executed day, month and year first above written.

SIGNED by)
)
as Attorney for and on behalf of)
BANK MUAMALAT MALAYSIA)
BERHAD)
(Company No. 6175-W))
in the presence of:)

by its Attorney(s)

*(If individual)

SIGNED by)
)
(NRIC No.))
in the presence of)

.....

.....
Name:
NRIC No:

*(If by Common Seal)

The Common Seal of the Customer(s))
was hereunto affixed)
in accordance with its Articles of)
Association in the presence of:)
in the presence of:-)

.....
Name:
Designation:
NRIC No:

.....
Name:
Designation:
NRIC No:

*(If under hand)

SIGNED by

(NRIC No.
for and on behalf of

(Company No.
in the presence of

)
)
)
)
)
)
)

.....

.....

Name:
NRIC No:

APPENDIX I

Specifications of the Works

1. THE WORKS TO BE DONE

1.1. Description of the Works

1.1.1. Description of the Works

1.1.2. Description of the Works

1.1.3. Description of the Works

2. SALE AND DELIVERY

2.1. Description of the Works

2.2. Description of the Works

2.3. Description of the Works

2.4. Description of the Works

2.5. Description of the Works

2.6. Description of the Works

2.7. Description of the Works

2.8. Description of the Works

2.9. Description of the Works

2.10. Description of the Works

2.11. Description of the Works

2.12. Description of the Works

2.13. Description of the Works

2.14. Description of the Works

2.15. Description of the Works

2.16. Description of the Works

2.17. Description of the Works

2.18. Description of the Works

2.19. Description of the Works

2.20. Description of the Works

2.21. Description of the Works

2.22. Description of the Works

2.23. Description of the Works

2.24. Description of the Works

2.25. Description of the Works

2.26. Description of the Works

2.27. Description of the Works

2.28. Description of the Works

2.29. Description of the Works

2.30. Description of the Works

2.31. Description of the Works

2.32. Description of the Works

2.33. Description of the Works

2.34. Description of the Works

2.35. Description of the Works

ANNEXURE 2**ISTISNA' PURCHASE AGREEMENT**

THIS AGREEMENT made the day of 200 between the Contractor and ABCBB wherein pursuant to the Istisna' Facility Agreement (Home Construction) dated the day of 200 between ABCBB and the Customer(s), ("the Istisna' Facility Agreement"), ABCBB and the Contractor HEREBY AGREE AND DECLARE as follows:

1. SAID PROPERTY

Upon the request of the Customer(s) to ABCBB to undertake the Works, the Customer(s) and ABCBB have on even date entered into an Istisna' Sale Agreement whereby ABCBB has agreed to undertake the Works, deliver and sell the Building and the Customer(s) has agreed to accept and purchase the Building to be constructed and delivered by ABCBB in accordance with the specifications as contained in the Construction Document(s) at the Selling Price as specified in the Istisna' Sale Agreement payable by the Customer(s) to ABCBB on a deferred term basis in accordance with the Syariah principle of Bai' Al-Istisna'.

2. SALE AND DELIVERY BY THE CONTRACTOR

2.1 ABCBB is now desirous of requesting the Contractor to undertake the Works upon which the Contractor hereby agrees to construct, deliver and sell and ABCBB hereby agrees to accept and purchase the Building to be constructed and delivered by the Contractor at the Purchase Price and subject to and in accordance with the terms and conditions of the Istisna' Facility Agreement. The Customer(s) hereby acknowledges and agrees to the request made by ABCBB to the Contractor to undertake the carrying out of the Works under this Clause.

2.2 For purposes of the construction and delivery of the Building, the Contractor hereby undertakes to ABCBB that it would take all necessary measures to perform its responsibilities and obligations according to the specifications and the period for completion of the Works, as contained in the Construction Document(s), which specifications are annexed herewith in Appendix 1.

2.3 ABCBB hereby acknowledges, agrees and authorises the Contractor to deliver the completed Building directly to the Customer(s) in accordance with the terms and conditions of the Construction Document(s).

3. PAYMENT OF THE PURCHASE PRICE**3.1 Disbursement**

(a) ABCBB shall pay the Contractor or the Contractor may authorise ABCBB to pay to such other person(s) responsible for or concerned with the carrying out of the Works or to any other person, as the case may be any amount in such manner and upon such terms and conditions

as ABCBB deems fit in such manner by such amounts and upon such contingencies and conditions as ABCBB may in its absolute discretion decide and or by progressive releases or otherwise in accordance with the Payment/ Disbursement Notice in the form set out in Fifth Schedule, duly verified and affirmed by the Customer(s), or such variation as ABCBB may deem fit and an acknowledgement from the recipient shall be deemed as if the same had been made or given by the Contractor personally or to such other person(s) responsible for or concerned with the carrying out of the Works or to any other person, as the case may be.

- (b) ABCBB shall not entertain any request from the Contractor to defer or stop payment of any amount of the Purchase Price to the abovesaid party mentioned under Clause 3.1(a) above if ABCBB has given an undertaking to disburse the Purchase Price to such party as required or requested by the Contractor or such party provided court order has been obtained prior to the request.
- (c) The Contractor shall indemnify ABCBB for all costs, expenses, claims and demand made on ABCBB pursuant to ABCBB, having at the request of the Contractor giving an express or implied undertaking or covenant to any person, including the Contractor, if any or their solicitors purporting to act for any of them.

3.2 Pre-Disbursement Conditions

Notwithstanding any other provisions herein contained to the contrary, ABCBB shall not be bound to release the Purchase Price or any part thereof unless the Contractor shall comply with the terms and conditions as stated herein and the Customer(s) shall comply the terms and conditions as stated herein, the Istisna' Facility Agreement, the Supervision of Construction Agreement and more specifically, the conditions precedent as stipulated in Clause 3 and the Second Schedule of the Istisna' Facility Agreement (ABCBB may waive any conditions and precedent without prejudicing ABCBB's right or recovery) and that each of the representations and warranties as stipulated in Clause 4 of the Istisna' Facility Agreement and Covenants, Undertakings and Guarantee as contained in Clause 5 of the Istisna' Facility Agreement is hereby repeated.

3.3 Disbursement within Availability Period

Notwithstanding the above, no disbursement shall be made after the expiry of the Availability Period.

4. CONSTRUCTION OF THE BUILDING

The Building shall be constructed by the Contractor in accordance with the Construction Document(s). The Parties hereby agree that in ensuring that the Works comply or meet with the specifications as contained in the Construction Document(s), ABCBB shall appoint the Customer(s) to supervise and oversee the construction works upon terms and conditions as set out in the Supervision of Construction Agreement to be entered into by the Customer(s) and the Contractor.

5. FAILURE TO COMPLETE

- 5.1. In the event the Contractor fails to complete and deliver the Building within the time period as stipulated in the Construction Document(s), ABCBB shall upon receipt of notification from the Customer(s) stop any payments (if any) due to the Contractor.
- 5.2 The Parties hereby agree that upon occurrence of Clause 5.1 above, the Customer(s) shall have the absolute right to deal or make alternative arrangements with any other third party in relation to the Building without further reference to the Contractor.
- 5.3 In the event ABCBB and/or the Customer(s) has suffered any losses or damages resulting from the failure of the Contractor to complete construction of the Building within the time period stipulated, ABCBB authorises the Customer(s) to proceed with any legal action against the Contractor for damages and compensation.

(End of Clauses)

IN WITNESS WHEREOF the parties hereto have caused this Agreement to be duly executed day, month and year first above written.

SIGNED by)
)
as Attorney for and on behalf of)
ABC BANK BERHAD)
(Company No1234-W)) by its Attorney(s)
in the presence of:)

*(If by Common Seal)

The Common Seal of the Contractor)
was hereunto affixed)
in accordance with its Articles of)
Association in the presence of:)

.....
Name:
Designation:
NRIC No:

.....
Name:
Designation:
NRIC No:

*(If under hand)

SIGNED by)
)
(NRIC No.)
for and on behalf of)
)
(Company No.)/
(Business Registration No.))
in the presence of)

.....

.....
Name:
NRIC No:

APPENDIX I

Specifications of the Works