



DEBT SECURITISATION AND DEBT TRADING
UNDER THE ISLAMIC LAW: A CASE STUDY OF
CAGAMAS BHD

BY

MAHADI AHMAD

A dissertation submitted in partial fulfilment of the
requirements for the degree of Master of Comparative
Law

Ahmad Ibrahim Kulliyyah of Laws
International Islamic University Malaysia

AUGUST 2009

ABSTRACT

It is a well known fact that one of the duties of the financial institutions is to finance some viable capital intensive projects on deferred payment basis that last for a lengthy period of time, often ranges between 15 to 30 years. This process, therefore, usually leads to accumulation of sizable financial claims owed to the banks by the financees. As a result of this, the bank may resort to sell those illiquid assets which are the financial claims on cash basis in order to have more liquidity to further finance other prospective financees. To achieve this purpose, the Malaysian government in 1986 established Cagamas Bhd to act as a catalyst for house ownership in the country, by purchasing those receivables. This type of transaction generates a lot of controversies among the contemporary experts in the field of Islamic finance. Therefore, the purpose of this research is to examine the seemingly unending problems which often arise through the process and the period involved, as well as the controversies generated by this type of transaction among the Muslim Jurists. Also, this is to proffer some vibrant solutions which may justify the aim of the government on the issue and which would be accommodated within the parameters of *maqāṣid al-Sharī'ah*. The methodology adopted in this research is a qualitative one. During the course of this research, it is discovered that the arguments of the earlier Muslim jurists on inability of the seller to deliver the debt could be narrowed down if the debt is in form of a commodity through the government regulations on the supervision of normal sale of debt. Similarly, a monetized debt, subject to the rules of *sarf*, is however found capable of being alternated by a transaction that will allow Cagamas Bhd to own a stake on the project that generates the debts through the issuance of tradable *ṣukūk* backed by that project and pay the bank from the proceeds of the *ṣukūk*.

ملخص البحث

المعلوم من أنشطة المؤسسات المالية أنها تسعى لتمويل مشاريع ذات نفقات طائلة , على أن يسدد العميل بأقساط منجمة على أزمدة التي قد تتراوح ما بين خمس عشرة سنة الى ثلاثين سنة. وبطبيعة الحال, يؤدي هذا النوع من العملية الى تراكم ديون فادحة على ذمم العملاء لصالح المصرف الممول. فبسبب هذا, قد يضطر المصرف الي بيع هذه الديون المستحقة لها ناقصة الأرباح بغية حصول على السيولة لتغطية عجز الصندوق التمويلي للعملاء اللاحقين. وسعيا الي تحقيق هذا الهدف السامي, أنشأت الحكومة الماليزية شركة "كاجامس" في عام ١٩٨٦م لتلعب دورا هاما في تيسير عمليات ملكية المنازل السكنية في ماليزيا, وذلك بشراء تلك الديون المستحقة للمصارف نقدا, غير أن عملية بيع الدين مسئلة مختلف فيها في الشريعة الإسلامية خاصة بين خبراء المالية الإسلامية المعاصرين. وبناء على هذا, فان هذا البحث المتواضع يسعى الى ايجاد الحلول الفعالة لهذه المشاكل, هذا مع مراعاة أهداف الحكومة ومن غير اختراق مقاصد الشريعة. وقد استعمل في هذا البحث الأسلوب التحليلي المتميز. وبعد اجراء دراسة متأنية للموضوع, توصلنا من خلال البحث الى أنه يمكن تفادي الخلاف الموجود بين الفقهاء القدامى فيما يتعلق بعدم امكانية تسليم الدين المبيع اذا كانت الديون سلعا, وذلك بوجود الرقابة والإشراف من الحكومة على بيع الديون أو الصكوك التي تمثل هذه الديون . وأما اذا كانت الديون نقودا فلا بدا أن يخضع بيعها لأحكام الصرف غير أنه يمكن ازالة هذه المشاكل بايجاد عقد تمويل ملكية المنازل الذي سيبيح لشركة "كاجامس" شرعا شراء جميع حصص البنك في المشروع , وأن تصدر صكوكا يكون هذا المشروع هو موجوداتها وتدفع للبنك حقه من حصائل هذه الصكوك.

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Comparative Law.

.....
Engku Rabiah Adawiah
Engku Ali
Supervisor

I certify that I have read this study and that in my opinion it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Comparative Law.

.....
Rusni Hasan
Examiner

This dissertation was submitted to the Department of Private Law and is accepted as a partial fulfilment of the requirements for the degree of Master of Comparative Law.

.....
Zuraidah Ali
Head, Department of
Private Law

This dissertation was submitted to the Ahmad Ibrahim Kulliyah of Laws and is accepted as a partial fulfilment of the requirements for the degree of Master of Comparative Law.

.....
Zaleha Kamarudin
Dean, Ahmad Ibrahim
Kulliyah of Laws

DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

Mahadi Ahmad

Signature

Date

INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA

**DECLARATION OF COPYRIGHT AND AFFIRMATION
OF FAIR USE OF UNPUBLISHED RESEARCH**

Copyright © 2009 by Mahadi Ahmad. All rights reserved.

**DEBT SECURITISATION AND DEBT TRADING UNDER THE ISLAMIC
LAW: A CASE STUDY OF CAGAMAS BHD**

No part of this unpublished research may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise without prior written permission of the copyright holder except as provided below.

1. Any material contained in or derived from this unpublished research may only be used by others in their writing with due acknowledgement.
2. IIUM or its library will have the right to make and transmit copies (print or electronic) for institutional and academic purposes.
3. The IIUM library will have the right to make, store in a retrieval system and supply copies of this unpublished research if requested by other universities and research libraries.

Affirmed by Mahadi Ahmad.

.....
Signature

.....
Date

In the Name of Allah, the Most Beneficent, the Most Merciful
This dissertation is dedicated to my dear parents, Umoru Ahmad and Selimetu Umoru
Ahmad, my late grandfather, Mal. Ahmad Umoru, my grandmother, Hajiyah Lami
Ahmad and the entire family of Mal. Ahmad Umoru.

ACKNOWLEDGEMENTS

All praises are due to Almighty Allah *subhanahu wata'ālah*. If not His *tawfīq* and infinite mercy, this dissertation would not have come to a reality. May His blessing continue to follow His noble Prophet Muhammad s.a.w, his family and his companions. I express my child-fatherly obligatory appreciations and gratitude to my parents, my brothers and Sisters and the entire family of Mal. Ahmad Umoru and My maternal uncles, specifically the Late Salami Bawa for their encouragement and support for my studies.

I am indeed short of adjective that can best express the degree of my appreciation towards my humble supervisor, Assoc Prof, Dr. Enkgu Rabiah Adawiyah Enkgu Ali, who painstakingly supervised this dissertation, and refused to see the task as one of the University duty on her only, but also saw it as opportunity for training Muslim youths against their future challenges. Dr., I have nothing to say than “*jazaki Allah khairan al-jaza*”.

My gratitude also goes to Mal. Musa Magume my mallam in Zaria, My Principal Mal. Abdul Aziz Fati. I thank Sheikh Abdulwahab Ajia, and my friends, Abdul Ghani Isa, Abdullatif Ukashah, Abdulwahab Yusuf and Abdulbari Taqwa Allah who all encouraged me to come to Malaysia for studies. I also thank Mal. Nazir Salih from Kebbi, Mal-Auwal Mobla and Uthman Sulaiman Kano all of who offered me reception upon my arrival in Malaysia. I thank Arfa Ibrahim Ali Lafiaji and Arfa Abdullah Bola Joko for easing my registration process. My warm appreciation to the assistance rendered to me by Mr. Ozoya from Warrake while he was in Saudi Arabia.

I indeed owe Mal. Ibrahim Nuh and Mal. Abduljalil Yusuf Amuda gratitude for being the means Allah used to affirm my feet at the Kulliyyah of Laws when I was refusing prerequisite courses. I will feel disobedient to Allah if I could afford to forget Brother Mutalib Sekoni, Sheikh Bunyamin and Mal. Abdusamad who dealt with me in the spirit of Islam by offering financial assistance. I offer a tribute to brother Ibrahim Vamba from Liberian and Sheikh Uthman Ibrahim, my Ghanaian brother for the mutual financial assistance that subsisted among us. May Allah reward my foster father in Zaria, Mal. Muhammad Abu Bakar Gummi abundantly for accommodating me in his house throughout the Islamic secondary school studies.

My tribute also goes to Assoc prof. Dr. Rani, Assoc Prof, Dr. Najibah Zein for their prudent administration of the post graduate deanship, Dr. Uzaimah Ibrahim who gave me an insight on this research topic. My appreciation also goes to Mal. Ghali Ahmed for his advice from all ramifications, Mal. Kabiru Goje for his words of admonition at each time of trial, Mal Bashir Aliyu Adam who worked on the success of this admission on my behalf, Dr. Barrister Ibrahim Arowosaiye who shared his wealth of knowledge with me and financial assistance, and Barrister Umar Oseni who shared his research experience with me. I thank the Nigerian Professors in IIUM for their words of encouragement each time we have Nigerian Students gathering. My special gratitude also goes to Prof, Dr. Sano Koutoub Mustapha for his assistance on study issues, brother Ishaq Oyefolahan and anyone who had in one way or the other assisted me during the course of this program.

TABLE OF CONTENTS

Abstract	ii
Abstract in Arabic	iii
Approval Page.....	iv
Declaration Page	v
Copyright Page.....	vi
Dedication	vii
Acknowledgements.....	viii
List of Abbreviations	x
CHAPTER ONE: INTRODUCTION.....	1
1.0 Background of the Research	1
1.1 Summary of the Dissertation.....	6
1.2 Aims and Objectives	7
1.3 Statement of Problem.....	8
1.4 Hypothesis.....	9
1.5 Literature review	9
1.6 Scope and Limitations of the Study	14
1.7 Research Methodology.....	15
CHAPTER TWO: AN OVER VIEW OF <i>BAY' AL-DAYN</i>.....	16
2.0 Introduction	16
2.1 Definition of <i>Bay' al-Dayn</i>	17
2.1.1 Definition of <i>Bay'</i> (Sale contract) In <i>Sharī'ah</i>	17
2.1.2 Definition of <i>al-Dayn</i> (Debt)	19
2.1.3 Definition of <i>bay' al-Dayn</i> as concept.....	19
2.2 The Lawful and the Unlawful Aspects of <i>Bay' Al-dayn</i>	21
2.2.1 <i>Bay' Al-Dayn</i> in Mālikī School of Thought.....	21
2.2.2 <i>Bay' Al-Dayn</i> in the Four Schools of Thoughts	30
2.2.2.1 Selling Debt to the Debtor in the Mālikī <i>Madhhab</i>	31
2.2.2.2 Selling Debt to a Third Party in Mālikī <i>Madhhab</i>	31
2.2.2.3 Selling Debt to the Debtor in <i>al-Shāfi'i Madhhab</i>	32
2.2.2.4 Selling Debt to a Third Party in <i>al-Shāfi'i Madhhab</i>	33
2.2.2.5 Selling Debt to Debtor in the <i>al-Ḥanafī Madhhab</i>	35
2.2.2.6 Selling Debt to Third Party in <i>al Ḥanafī Madhhab</i>	36
2.2.2.7 Selling Debt to Debtor in <i>al Ḥanmbalī Madhhab</i>	37
2.2.2.8 Selling Debt to Third Party in <i>al Ḥanmbalī Madhhab</i> ...	39
2.3 Scholars' Comments on <i>ḥadīth 'Bay' al-Kāli Bi al-Kāli</i>	40
2.3.1 Narrators of this <i>Ḥadīth</i>	40
2.3.2 Comments of the Scholars on the Status of This <i>Ḥadīth</i>	41
2.4 The <i>Ijmā'</i> on the Prohibition of <i>Bay' al-Dayn Bi al-Dayn</i>	42
2.5 <i>Sharī'ah</i> Advisory Council of the Securities Commission	42
2.6 Position of the AAOIFI.....	43
2.7 <i>Ḥawālah</i> and Its Relevance to <i>Bay' al-Dayn</i>	44
2.7.1 Literary Meaning of <i>Ḥawālah</i>	44

2.7.2. Definition of <i>Hawālah</i> in the Juristic Technical Usage	45
2.7.3 Types of <i>hawālah</i>	46
2.7.4 Difference Between <i>Hawālah Muṭlaqah</i> and <i>Muqayaddah</i>	46
2.7.5 <i>Hawālah al-Dayn</i> and <i>Hawālah al-Ḥaqq</i>	47
2.5.6 The <i>Sharī'ah</i> Position on <i>Hawālah</i>	49
2.7.7 Relevance of <i>Hawālah</i> to <i>Bay' al-Dayn</i>	50
2.8 Sale of <i>Dayn al-Salam</i> (Object of <i>Salam</i> Contract).....	51
2.8.1 Definition of <i>Salam</i>	51
2.8.2 Proofs of Validity of <i>Salam</i>	51
2.8.3 Conditions of a Valid Contract of <i>Salam</i>	52
2.8.4 <i>Fuqahā'</i> Position on Sale of <i>Salam</i> prior to Delivery.....	53
2.9 <i>Ṣarf</i> (Exchange of money for money).....	60
2.9.1 Literary Meaning of <i>Ṣarf</i>	60
2.9.2 Technical Meaning of <i>Ṣarf</i>	61
2.9.3 Conditions of A Valid <i>Ṣarf</i>	61
2.10 Conclusion.....	63
CHAPTER THREE: SALE OF DEBTS IN CAGAMAS	66
3.0 Introduction to Cagamas	66
3.1 Sample of Loan and Debt Purchased By Cagamas	66
3.2 The Concept of Mortgage Market.....	68
3.2.1 Introduction	68
3.2.1.1 Definition of Mortgage Market.....	70
3.3 Why Islamic Financial Institutions Opt to Sell Receivables.....	73
3.3.1 Introduction to Islamic House Financing Debts	74
3.3.1.1 Purchase of Islamic House Financing Debts	75
3.3.1.2 Eligibility Criteria of Islamic House Financing Debts ...	77
3.4 Islamic Hire Purchase and the Concept of AITAB.....	79
3.4.1 Mode of Selling Hire purchase Debts in Cagamas	79
3.4.2 Eligibility Criteria of Islamic Hire Purchase Debts	80
3.5 Sale with Recourse in Cagamas	81
3.6 Sales without Recourse in Cagamas	82
3.7 The <i>Shar'iah</i> Observation on <i>Bay al-Dayn</i>	82
3.8 Conclusion.....	88
CHAPTER FOUR: CAGAMAS ISLAMIC DEBTS SECURITIES.....	85
4.0 Introduction	85
4.1 Definition of Securitization from Conventional Perspective	85
4.1.1 Definition of securitization From Islamic perspective.....	87
4.1.2 History of Securitization	88
4.2. Cagamas Securitisation.....	89
4.2.1 Brief History of Cagamas Securitization	89
4.2.1.2 Cagamas Islamic Asset Backed Securities	90
4.2.1.3 The Concept of Cagamas Islamic Commercial Paper ...	91
4.2.1.4 The Concept of Cagamas Islamic Medium Term Note..	92
4.3 Credit Enhancement	93
4.3.1 Definition of Credit Enhancement	93
4.3.2 Cagamas Credit Enhancement.....	94
4.4 Conclusion.....	94

CHAPTER FIVE: CONCLUSION AND RECOMMENDATIONS	96
5.0 Introduction	96
5.1 Findings.....	96
5.2 Recommendations	97
5.3 Conclusion.....	101
BIBLIOGRAPHY	105

LIST OF ABBREVIATIONS

AAOIFI	Accounting and auditing for islamic financial institutions
ABS	Asset backed securities
AITAB	<i>al-Ijarah thumma al-bay'</i> (islamic hire purchase)
BBA	<i>Bay' bithaman Ājil</i> (sale on deferred installment payment)
IBI	Islamic banking institution
IISG	Islamic instrument study group (IISG)
MBS	Mortgage backed securities
OC	Overcollateralization
OIC	Organisation of Islamic conference
REMICs	Real estate mortgage investment conduits
S.A.W	<i>Ṣalla Allāh 'alayhi wasallam</i> (may the blessings of Allah be with him)
SAC	<i>Sharī'ah</i> advisory council
SPV	Special purpose vehicle

CHAPTER ONE

INTRODUCTION

1.0 BACKGROUND OF THE RESEARCH

Debt trading is defined as "a transaction that involves the sale and purchase of securities or debt certificates that conform to the *Shari'ah*. Securities or debt certificate will be issued by a debtor to a creditor as an evidence of indebtedness".¹

Debt trading is a controversial issue among the scholars of Islamic commercial law. This controversy is more felt in the contemporary Islamic finance because of receivables of banks that continue to accumulate from financing projects that are capital intensive. The Islamic economic system and its modes of fund sourcing are subject to *Shari'ah* compliance. However, compliance in some issues may differ from one school of thought to another. As a result of these differences, some financial institutions adopt a practice which some scholars do not see to be *Shari'ah* compliant. Nevertheless, not every difference in Islamic jurisprudence nullifies an opposite opinion. This is because, under the principles of Islamic jurisprudence, a *mujtahid* is not bound by the ruling of another *mujtahid*.² It is on this principle that the scholars formulated a legal maxim that says:

لا يُنكَرُ الْمُخْتَلَفُ فِيهِ ، وَإِنَّمَا يُنكَرُ الْمُجْمَعُ عَلَيْهِ^٣

In a recognized juristic disagreement, no objection is to be raised at adoption of one of the varying views, but objection must be raised at violation of *ijma'*.⁴

¹ Securities Commission Guidelines on the Offering of Islamic Securities 2004.

² Muhammad bin Ahmad bin Abdul Aziz bin al-Najjar, *Sharh al-Kawkab al-Munir*, (Riyadh: Maktabah al-'Ubaykan, 1997), 4:515; Muhammad al-Amīn bin Muhammad al-Mukhtār al-Shanqīṭī, *Mudhakkirah fī 'Uṣūl al-Fiqh*, (Saudi Arabia: Maktabah al-'Ulūm Wa al-Ḥikam, 2004), 371.

³ Al-Zarkashī, *al-Manthūr fī al-Qawā'id*, (Kuwait: Wizārah al-Awqāf wa al-Shu'ūn al-Islāmiyyah, 1405 AH), 3:364; 'Abd al-Rahmān al-Suyūṭī, *al-Ashbāh wa al-Nazāir Fi, Qawā'id Wa Furū' al-Shafi'yyah*, (al-Qāhirah: Dār al-Salām, 2004), 344.

In essence, this legal maxim states that, in an issue of juristic disagreement, no one is to be prevented from preferring any of the contesting views to the other, but one is to be prevented from violating an *ijmā'* that was confirmly reported.

However, there are exceptions to this general rule which are as follows:

1. If he believes that the ruling he is acting upon is prohibited, then, he is to be prevented from adopting the ruling. For example, someone who has the belief that, it is prohibited to have conjugal relation with a wife upon whom a revocable divorce has been pronounced before he returns to her.
2. If such *madhhab* is far from a recognized *Shari'ah* proof, whereby the proof it relied upon is contradictory, therefore, the person that follows such view is to be prevented from doing so. Also, those emulating him should be prevented from emulating him on the issue in question. It is on this ground that punishment of *hadd* is imposed on a mortgagee who was given a slave girl as a mortgage and eventually had conjugal relation with her. Here, the scholars did not take 'Aṭāu's dissenting view (which ruled that there is no *hadd* on the mortgagee for having such illicit affairs) into consideration, because it is far from a recognised proof of *Shari'ah*.
3. If a complaint was made to a Judge, verily he is to preside over the judgment based on what he believes in, and his position on a given issue. It is on this ground that a Ḥanafī follower is imposed *hadd* if he drinks *nabīdh*.⁵ This is so, because it is not permitted for a judge to deliver judgment contrary to what he believes to be the *Shari'ah* position.

⁴ Translated by the researcher.

⁵ *Nabīdh* is a kind of drink made of date or grape or the like, and it is called *nabīdh* before it becomes intoxicating. If it intoxicates it becomes alcohol. See Muhammad Rawwās Qan'ajī, *M'ujam lughah al-Fuqahā'* (Bayrūt: Dār al-Nafāis, 1996), 444; 'Umar bin Muhammad al-Nasafī al-Ḥanafī, *Ṭalabah al-Ṭalabah*, (Bayrūt: Dār al-Kutub al-'Ilmiyyah, 1997), 285.

4. If the person refusing the contrary view has a right to refuse such view.

This is as in the case of someone whose wife takes *nabīdh*, though the latter believes that *nabīdh* is permitted.⁶

In general, if an opinion is not backed by an accepted proof, it will suffer from a universal disapproval. Be that as it may, debt trading is one of the Islamic banking practices that have been a subject of argument amongst the Muslim scholars. Some of its proponents have the view that it is *Shari'ah* compliant and claimed that the *Ijmā'* on its prohibition is not authentic and unfounded.⁷ This research seeks to employ the classical juristic opinions and relevant proofs from the primary sources of Islamic law to analyse the *Shari'ah* compliance or otherwise of debt trading. The study further becomes very necessary by virtue of the preparation of Cagamas to expand its business towards the Middle East. This announcement was made in the Middle East business press that the company will extend its business activities of *Shari'ah* compliant debt trading and mortgage debts to the Middle East.⁸

Cagamas Berhad, the National (Malaysian) Mortgage Corporation, was established in 1986 to promote the secondary mortgage market in Malaysia.⁹ Its corporate mission is to provide financial products that would make housing loans more accessible and affordable to Malaysians, particularly the lower income group. It borrows money by issuing debt securities and uses the funds to finance the purchase of housing loans/debts from financial institutions, selected corporations and the

⁶ Al-Zarkashī, *al-Manthūr fī al-Qawā'id*, (Kuwait: Wizārah al-Awqāf Wa al-Shu'ūn al-Islāmiyyah, 1405 AH), 3:364; Abdulrahman al-Suyūfī, *al-Ashbāh Wa al-Nazāir fī Qawā'id Wa Fur'ū al-Shafī'yyah*, (Cairo: Dar al-Salam, 2004), P: 344.

⁷ Hashim Kamali, *Islamic Commercial Law, an Analysis of Futures and Options*, (Kuala Lumpur: Ilmiah Publisher, 2000), 127.

⁸ Malaysian Mortgage firm eyes Gulf Islamic Market, <<http://www.arabianbusiness.com/529009-malaysian-mortgage-firm-eyes-gulf-islamic-market>> (accessed 2 Jan 2009).

⁹ A secondary mortgage market is one in which existing mortgages are bought and sold. This is in contrast to the primary market, where mortgages are originated. See Terrence M. Clauretje and G. Stay Sirmans, *Real Estate Finance, Theory and Practice*, (United States of America: Thomson Southwestern, 2003), 188.

Government. The provision of liquidity at a reasonable cost to the primary lenders of housing loans encourages further financing of houses at an affordable cost.¹

In view of the corporate mission of Cagamas, there is no doubt that it is a financial institution that facilitates the acquisition of house ownership by house buyers in Malaysia, and so, there is a need to conduct research to find solutions to the grey areas of the transaction of these products. In view of this, this research seeks to study the *Sharī'ah* issues of this transaction so that the result may be used to clarify the stance of Islamic commercial law as regard to the transaction. It is true that there is *Sharī'ah* ruling that prohibits *bay' al-dayn bi al-dayn*, but the prohibition does not extend to all types of transactions that contain *bay' al-dayn*. For example, the jurists had a unanimous agreement on the prohibition of *bay al-kāli bi al-kāli* (exchange of debt for another debt) in general, but they allow some forms of *bay' al-dayn*. While some scholars like Ibn Taymiyyah, hold that there is neither general text nor *ijmā'* on the prohibition of *bay al-dayn bi al-dayn*, and that the *ḥadīth* only came on the prohibition of *al-kāli bi al-kāli*.¹ He (Ibn Taymiyyah), interpreted this as saying, it is “*al-muakkkhar alladhi lam yuqbaḍ bi al-muakkkhar alladhi lam yuqbaḍ*, that is, delayed payment with delayed subject matter.¹ In elaborating further,² he cited an example with *salam* contract. The *Sharī'ah* ruling is that, the payment should be made immediately after the contract agreement, while the subject matter is to be delivered in a predetermined future period. But, if the payment is delayed also, the contract will be tantamount to *al-kāli bi al-kāli* which the *Sharī'ah* has prohibited with unanimous

¹ <<http://www.cagamas.com.fmy>>

¹ Ibn Taymiyyah, *Majmū' al-Fatāwa*, ed. Anwar Bāz, (Saudi Arabia: Maktabatu Dār al-Wafā', 2005), 20:512. Source: Electronic Library, *Maktabah al-Shāamilah*.

¹ Nazih Ḥammād, *Bay' al-Kāli Bi al-Kāli fi al-Fiqh al-Islāmi*, (Saudi Arabia: King Abdul Aziz University, 1986), 14.

agreement of the scholars.¹ However, scholars like² Nazih Hamad held in contrary to this view that there are other forms of *bay' al-dayn* that are prohibited¹ .

4

The challenge to do this case study was further prompted by the involvement of the Islamic banks in debts trading with Cagamas. For example, the Islamic debt purchased by Cagamas from 2003 to 2007 are as follows: RM200 millions with total number of debt 7,165, RM1,600 millions with total number of debts 40,727, RM900 millions with total number of debts 34,006, RM3,500 millions with total number of debts 116,194, RM3,360 millions with total number of debts 69,467.¹

5

The figure illustrating the percentage of some debts sold by the Islamic financial institutions is shown in Chapter Three. The popular legal maxim that says that, the original presumption of things is permissibility, is a proof that legalises *bay' al-dayn*, and so, the prohibition can only be assumed if any proof from the sources of Islamic law rule as such. The debt securities practiced by Cagamas involve the process of issuing securities to the investors, thereafter, the proceeds of those securities would be used to finance the purchase of home and hire purchase loans/debts from financial Institutions (both Islamic and conventional).¹

6

This research seeks to study the *Shari'ah* compliance of this practice in the Islamic commercial law and tries to pinpoint the parts that are lawful and those that are not. It also aims to initiate, if possible, mechanisms to implement *Shari'ah* compliant debt trading in the contemporary era.

¹ Ibn Taymiyyah, *Majmū' al-Fatāwa...*, 20:512.

¹ Nazih Hamad, 14. What the⁴ researcher understands from Ibn Taymiyya's statement is that, *ijmā'* is only on *al-kāli bi al-kāli*, not that he refuses the fact that there are other forms of *bay' al-dayn* that are prohibited.

¹ Financial Highlights <http://www.cagamas.com.my/caga-docs/html-dir/fi_pur.html> (accessed 28 June 2008).

¹ Cagamas bonds and notes, <http://www.cagamas.com.my/caga-docs/html-dir/de_bond.html> (accessed 28 June 2008).

In conclusion, suggestions will be made where necessary for further improvement of the existing products. Harmonization of conflicting principles where appropriate will also be taken into consideration, using the *Shari'ah* principle of *maṣlahah* where applicable. This will be done in a very strict adherence to the guidelines of applying *maṣlahah*.¹

7

1.1 SUMMARY OF THE DISSERTATION

Chapter One of this thesis is the research proposal which contains introduction, the aims and objectives, statement of the problem, hypothesis, literature review, scope and limitation as well as research methodology. Chapter Two on the other hand discusses the classical jurists' stands regarding debt trading, either by selling the debt to the debtor or to a third party. The research found that all the four schools of thoughts permit the former, while the later is permitted by the Mālikī School with conditions that must be fulfilled. Some of the Shāfi'ī scholars like al-Shīrāzī, Imam al-Nawawī in one of his opinion and al-Suyūṭī, some of the Ḥanafī scholars like Zufar and al-kāsānī, all agreed with the position of the Mālikī school, but all stipulated condition that is either explicit or implicit, that there is nothing that will make the sales be tainted with *riba* or violation of any act prohibited by the *Shari'ah*.

In the case of selling debt (the *muslam fihi*) of *salam* contract prior to taking its delivery, the majority did not permit it, but it is permitted by the *Mālikī* school, and is seconded by opinion of Imam Ahmad bin Ḥanbal as attributed to him by Ibn

¹ al-Ghazālī stated that *maṣlahah* is divided into three categories; a category the Supreme lawmaker accredited, a category He annulled and a category He neither accredited nor annulled. See al-Ghazali, *al-Mustasfa Fi 'Ilmi al-Usul*, (Bayrūt: Dār al-Kutub al-Ilmiyyah, 1412 AH), 1:173. In explaining what is meant by *maṣlahah*, he said, in the original meaning, it is the process of obtaining benefit and avoidance of vices; however, this is not what is meant. He then said, "what it means is to preserve the objectives of *Shari'ah*, the objectives of *Shari'ah* in the creature are five; to preserve their religion, soul, intellect, offspring and property. Anything that contains the preservation of these five essentials is *maṣlahah*, anything that causes the loss of any of them is *mafsadah*, and so, it is compulsory to avoid it". Ibid. 1, 174.

Taymmiyyah. He (Ibn Taymiyyah) debunked the opinion held by the vast majority of the Ḥanbalī scholars which says that Imam Aḥmad bin Ḥanbal did not permit selling *muslam fihi* (object of salam contract) prior to taking its delivery.

Islamic legal ruling on securitisation of debt and the tradability in the secondary market will take the ruling of selling debt to a third party. Hence, if the debt is not money but commodity, then securitization of such is permitted based on the ruling of some *madhāhib* that allowed sales to a third party with conditions outlined by them.

Chapter Three discusses practices of Cagamas on *bay' al-dayn*. This includes purchase of Islamic house financing debts and Islamic hire purchase debt. It also discusses mortgage, both its primary and secondary types from the conventional perspective. In addition, the chapter also explained what is meant by sale with recourse and sale without recourse.

Chapter Four is about securitisation in Cagamas, this includes the Concept and historical perspective of securitisation, and asset backed securities, Islamic commercial notes and Medium term notes. It also explained what is meant by credit enhancement, the type that is applied by Cagamas and how to make it become Sharī'ah compliant, while Chapter Five summarises, concludes, analyses the findings and gives recommendations.

1.2 AIMS AND OBJECTIVES OF THE STUDY

There is a continuous controversy on the Islamic banking practice of *bay' al-dayn* owing to the complicated nature of the Islamic law rules on it. Therefore, this research aims at making a case study of Cagamas Bhd which is dealing in *bay' al-dayn* and debt securitisation. In addition, it also aims at applying the Islamic jurisprudence to

the practices of Cagamas. To this effect, the objectives of this research centers on the following;

1. To unravel the position of Islamic law regarding sales of debts and debt securitisation through the appraisal of the evidences adduced by every *madhhab*.
2. To scrutinise the present practices between the Islamic banks and Cagamas Bhd.
3. To evaluate the various criticisms advanced against the practice of debt trading.
4. To contribute some suggestions on how to make the practice by Islamic banks to be fully *Shari'ah* compliant.
5. To suggest alternative *Shari'ah* compliant mechanism for sales of debt and debt securitization that is free from controversy.
6. To actualize attainment of *maqāṣid al-Sharī'ah* in the Islamic finance.

With the Malaysia's aspiration to become international Islamic financial hub, a focused research topic such as this is needed to initiate solutions to existing SharĤ'ah problems in the practices of Islamic banking and finance.

1.3 STATEMENT OF THE PROBLEM

The banking industry is competitive, specifically among the conventional banks. Therefore, the Islamic financial institutions must involve in huge-return transactions such as project financing. Owing to the fact that lending with interest/usury is prohibited in Islam, the alternative which conforms to the *Shari'ah* is inevitable. An Example of such an alternative is to get involved in financing projects on deferred payment basis. This process keeps much of the funds outside for over a long period of

time. Therefore, to be capable of meeting subsequent demands of customers seeking project financing, sale of debts becomes necessary as one of the available sources of raising more funds. However, there is juristic disagreement in some aspects of it since the era of the early classical jurists, like the four Imams of the popular schools of thoughts and their followers. This disagreement continues till now.

1.4 HYPOTHESIS

The selling of debt by Islamic financial institutions as one of their means to have quick recovery of their receivables, as well as having more cash in the financing portfolio, makes some of their transactions to be tainted with *riba* and *gharar*. In addition, despite the popular ruling by the scholars that *bay al-dayn* is prohibited; it has some aspects that are still permitted.

1.5 LITERATURE REVIEW

With the available literatures that were within the reach of the researcher, it was discovered that much have been written on *bay al-dayn*, by renowned classical Muslim jurists. These include but not limited to: Imam al-Nawawī in *Minhāj al-Ṭālibin*¹ and *al-Rawḍah al-Ṭālibīn*.¹ Similarly, al-Kāsānī also discussed the issue in his *Badāi' al-Ṣanāi' fi Tartīb al-Sharā'i*.² *al-Bahjah Fi Sharhi Tuḥfah al-Ḥukkām* is a *Mālīkī fiqh* book which one of its chapters also discussed sale of debt, its varieties and the conditions for the lawful aspect of it.²

¹ Al-Nawawī Abu Zakariyyāh Yahya bin Sharaf, *Minhāj al-Ṭālibīn*, (Bayrūt: Dār al-Bashāir al-Islāmiyyah, 2005), 2: 44

¹ Al-Nawawī Abu Zakariyyāh Yahya bin Sharaf, *Rawḍah al-Ṭālibīn*, (Lebanon : Dār al-kutub al-Ilmiyyah), 3: 174.

² Al-Kāsānī, *Badāi' al-Ṣanāi' fi Tartīb al-Sharā'i*, (Bayrūt: Dār al-Kitāb al-Arabī, 1982), part 5 p: 148

² Ibn 'Āṣim al-Andolisy, *al-Bahjah Fi Sharh al-Tuḥfah*, (Lebanon: Dār al kutub al-ilmīyyah, 1998), 2:78-90.

Nevertheless, a viable solution that is compatible to the contemporary economic system and complies with the *Shari'ah* at the same time is necessary. To this effect, a plethora of the contemporary Muslim jurists have written on this issue in various perspectives but no one has specifically written on Cagamas and its' practices on *bay' al-dayn* and its securitization.

However, among those who have written on the topic of *bay' al-dayn* is Nazih Hammād in his book entitled *Bay' al-Kāli bi al-Kāali*. Among all the literatures reviewed by the researcher on this topic, this book has been one of the most comprehensive ones. The author explained in details the major issues, the laws, and the jurists' opinions in the four schools of thoughts. In addition to that, he also mentioned what has been wrongly included in *bay' al-dayn* but irrelevant to it. However, he did not discuss about the practice of Cagamas. This does not reduce the value of the book in anyway, because it was meant to examine the stance of Islamic law on the sale of debt. It did not examine any particular practice of any Islamic institution either.²

2

Also, a renowned contemporary Muslim jurist, Wahbah al-Zuhaili, in his book, *bay' al-dayn fī al- Shari'ah al- Islāmiyyah* addressed this issue. The author laid a solid foundation for researchers in the topic in question. He defined *bay' al-dayn*, and then mentioned the major opinions of various schools of thoughts but with a bigger focus on *madhhab al-Shāfi'i*.² However, he did not refer to the practices in various Islamic institutions or compare with Cagamas practices.

Al-Şiddīq al-Ḍarīr, in OIC Fiqh Academy Conference held in Baḥrain in November 1998, gave a holistic view of his opinion on *bay' al-dayn*. He categorised

² Nazih Hammad.

2

² Wahbah al-Zuhaylī, *Bay' al-Ḍayn Fi al-Shari'ah al-Islāmiyyah*, (Lebanon: Dār al-Maktabī, 1997), 20, 37.

bay' al-dayn into four types namely, selling debt to the debtor and selling debt to a third party. And either of these two may be sold on cash or on debt.² The following is the elaborative list of these four forms:

4

1. Selling debt to the debtor on cash,
2. Selling debt to the debtor on deferred payment,
3. Selling debt to a third party on cash,
4. Selling debt to a third party on deferred payment.

Moreover, he arrived at the conclusion that most of the *fuqahā'* (Muslim jurists) permit selling debt to the debtor as opposed to selling to a third party which is sharply rejected by the majority. However, he concluded that in his view all the four types are permitted. In addition, he also said that it is not correct to claim that there is an *ijmā'* on prohibition of *bay' al-dayn bi al-dayn*. Though, he conceded that the type that is prohibited is the one that contains *riba*.² Nonetheless, his statement did not comprise the practice of Cagamas. He did not give suggestion of the way-out of the disagreement on this issue.

Hashim Kamali made *bay' al-dayn* the focus of chapter twelve of his book, "Islamic Commercial Law: An Analysis of Futures and Options." The researcher found that he almost nullified the opinions of the classical jurists that disallowed *bay' al-dayn*. What is apparent from his work is that, he did not mention other forms of *bay' al-dayn* which are permitted by the classical jurists.² He also asserted that the acclaimed *ijmā'* on the prohibition of *bay' al-dayn* is clearly unfounded.²

7

² "al-Ta'qīb Wa al-Munāqashah," *Majallatu Majma' al-Fiqh al-Islāmī*, Vol. 1 no. 11 (November, 1998): 389.

² Ibid. 5

² Hashim Kamali, 127-129. 6

² Ibid., 127. 7

In addition to the aforementioned literatures, Sano Koutoub in his book, “Sale of debt as Implemented in The Islamic Financial Institutions in Malaysia”, has also spent an immense effort in this area. He discussed securitization and sales of debt in Malaysian Practice in general,² but not Cagamas practice in particular and did not give suggestion of the way-out from the sharp disagreement among the opponents which is one of the components of this research.

‘Abd al-Rahman al-Şādiq al-Garyāni in his book, *Mudawwanah al-Fiqh al-Māliki Wa Adilatuh* discussed about *bay‘ al-dayn* extensively in certain part of the second volume of his book and cited comprehensive examples of different types of *bay al-dayn*.² However, the book is on general juristic issues and not specifically on *bay‘ al-dayn*.

An MBA dissertation³ was also written on the area of debt securities. This thesis is one of the most relevant literatures as its focus was debt securitisation both conventional and Islamic. However, the work was not focused on the Shariah compliance of *bay al-dayn*.

Besides the aforementioned, there is also a published master’s thesis by Khālid Muhammad Turbān from Islamic University of Gazah. In his thesis, he diligently examined the opinions of the scholars.³ Nevertheless, the study was not on Cagamas practices on *bay al-dayn* and securitization.

Another relevant work is titled *Ahkām al-Awrāq al-Tijāriyyah*, authored by Turkī Sa‘īd al-Khuthnānī. In this book, the author did a thorough study on negotiable

² Sano Koutoub Mustapha, *The Sale of Debt As Implemented by The Malaysia Islamic Financial Institutions*, (Malaysia: IIUM Press, 2001).

² ‘Abd al-Rahman al-Şādiq al-Gharyānī, *Mudawwanatu al-Fiqh al-Mālikī Wa Adilatuh*, (Lebanon: Muasasah al-Rayyān, 2002), .3:398-404.

³ Cheong Sun, “Analysis of Yield difference between Islamic and Conventional” (MBA Dissertation, International Islamic University, Malaysia, 2002).

³ Khālid Muhammad Turbān, *bay‘ al-dayn Ahkāmuhū Wataṭbīqātuh al-Muāşirah*, (al-Qāhirah: Dār al-Bayān, 2003).