COLLATERAL AND SECURITY IN ISLAMIC COMMERCIAL LAW: THE CONCEPT AND OPERATION OF RAHN

Prof. Dr. Zainal Azam Abd. Rahman
(zainalazam@inceif.org)

DEBT AND SECURITY: CONCEPTUAL FRAMEWORK

- Rahn, mortgage, charge, pawn, pledge, collateral
- Multiple sources of debts and future obligation
- Qard or money lending/credit facility
- Sale with deferred payment (BBA, Bai' il taqsit..)
- Bai' al-Salam (advance purchase) or Istisna' sale
- Unpaid rent or salary, fee or commission
- Any other unpaid liabilities
QUANIC PROVISION ON DEBT CREATION: IDHA TADAYANTUM BI DAYNIN ( al-Baqarah 2:282)

- O ye who believe!, when you deal with each other in a transaction involving future obligation payable in a fixed period of time, reduce it to writing. And let a scribe write down faithfully as between the parties. And let not the scribe refuse to write as Allah has taught him. So let him write. And let him who incurs the liability dictate. And let him fear Allah his Lord and not diminish aught what he owes. If the liable party is mentally deficient or week or unable himself to dictate, let his guardian dictate faithfully.........

DOCUMENTATION AS A FORM OF SECURITY: SHARIAH ASPECTS

- The need for security to cover payment of debt and liabilities
- Why document is a form of security?
- Who to prepare the documents?
- The debtor is to dictate his liabilities to the scribe/lawyer
- The scribe must be faithful in following the debtor's instructions- impartiality and professionalism
- Who must possess necessary relevant knowledge- Islamic law of transaction/hukm
- The important roles played by lawyers and shariah advisors?
- Contemporary issues
THE SECURITY ASPECT OF EVIDENCE AND PROOF

- Debt and obligations payable in future can be denied for lack of proof or evidence
- The need for witnesses who are acceptable according to shariah criteria
- Highly recommended to have necessary number of witnesses to acknowledge the document/transaction
- Responsibility of witnesses to testify truthfully

QURANIC PROVISION OF THE CREATION OF A RAHN/COLLATERAL

- And if ye are on a journey, and cannot find a scribe, then a pledge with possession (may serve the purpose). And if one of you deposit a thing on trust with another, let the trustee (faithfully) discharge his trust, and let him fear Allah his Lord. And concealed not evidence, for whoever conceals it, his heart is tainted with sin, and Allah knoweth all that ye do".- al-Baqarah 2:282
SHARIAH COMPLIANCE: CREATION OF SECURITY: AL-RAHN/CHARGE/MORTGAGE

- A chargor can be debtor or third party
- A chargee can demand security as part of khiyar al-shart (pre-condition), although without the khiyar, rahn remains recommended (mandub)
- Charged property must be of reasonable value
- Offer and acceptance: made after or before debt creation?
- Debt or liability must be established prior to the creation of security
- Terms and conditions must be in line with the nature of security transaction

Applied Shariah- Lecture 4

SHARIAH COMPLIANCE: RAHN AS INCUMBERANCE ON ASSET

- Must the marhun be deposited with the chargee?
- Possessory and non-possessory rahn; effect of registration
- Mortgage, charge, pawn or pledge?
- Nature of chargee's possession: yadd daman or yadd amanah?
- Restrictions on dealing with the marhun that will defeat the security element
- When the chargee gives permission to chargor to deal with the marhun
- Maintenance of rahn is on the chargor
- When chargee maintains; can he be reimbursed or use the asset?

Applied Shariah- Lecture 4
SHARIA COMPLIANCE:
APPOINTMENT OF TRUSTEE: al-Adl

- When the marhun is deposited with a trustee with consent of both chargee and chargor
- Qualifications of trustee/al-adl
- Roles and responsibilities of trustee
- Liabilities of trustee is based on fault principle
- Can trust be created on the basis of wakalah
- Corporate trustee: fee and liability

SECURITY IN RESPECT OF COMMON ASSET
(property held in common): musha’ or mal mushtarak

- Asset held in common by individuals cannot be charged according to the Hanafi school, but acceptable according to other schools (jumhur opinion)
- Whether asset is charged to co-owners?
- Or is charged to outsiders or 3rd party?
- The issue of consent of co-owners
- Charge of landed property with buildings under construction when there is no separate document of title
- Enforcement of security and implication for co-owners
CREATION OF SECOND/SUBSEQUENT CHARGES

- When the first chargee gives his consent
- When consent is refused
- Value of the charged asset and the issue of validity of subsequent charge
- When security is used for Islamic and conventional facilities
- Enforcement of security in the case of default: order of priority

FURTHER AMOUNT TO BE COVERED BY SAME SECURITY/COLLATERAL

- Whether the whole of asset/property charged to secure the first debt?
- Whether the asset/property is charged to several creditors?
- What happens when one debt is due?
- Can security be released/sold once first debt is paid or not paid?
RISK FACTOR IN RAHN

- Loss or damage due to chargee's wrongdoing or fault- chargee in possession's risk
- Loss or damage due to act of God/natural calamities ie. fault of no one
- Effects on the secured debt/obligation: Hanafi and other juristic opinions
- Yadd daman V yadd amanah principles
- Legal implications and right to indemnities

ENFORCEMENT OF SECURITY

- Events of default and ethics of making demand of payment, eventual court action to enforce security
- Debtor who is in genuine financial distress must be treated fairly: grant of more time to pay
- Debtor needs to be given chance to sell the security or find buyer (by the court)
- What happen when he refuses to do so?
- Contempt proceeding against the debtor until he sells it according to Abu Hanifah's opinion
- Forced sale by the court is possible according majority opinion
- When the proceed can not cover the liability: what happen?: Hanafi and other views
FORECLOSURE STEPS AND PROCEDURES

- Whole debt becomes due and payable at once upon demand by creditor when events of default occur?
- Can the facility be "restructured"?
- Mutual termination of original contract: al-iqalah
- Formation of a new contract as substitute
- Precautions to take when negotiating "restructuring"
- The issue of ibra' for early payment
- Whether the principle of discounting based on Da' wa t'ajjal can be applied for early payment?

DEBENTURE AND CORPORATE BORROWING

- Debenture as proof of corporate indebtedness/borrowing
- Whether can issue/create debenture founded upon debt emanating from unpaid purchased price?
- Debenture founded upon loan with interest is non-shariah compliant
FIXED AND FLOATING CHARGES

- Islamic view on floating charge
- To be considered rahn, the moment of crystallization of floating charge is critical factor to consider
- Before crystallization, debtor is free to utilized the relevant assets i.e no encumbrance
- Encumbrance comes with crystallization

RELEVANT SHARIAH ISSUES

- Can floating charge be considered conditional rahn?
- Whether future assets can be subject of rahn?
- Whether rahn can cover future liabilities
- Uncertainty may lead to invalidity of rahn
- Open money clause and effect on security
- The need to "deliver" charged property to the chargee and the binding effect of rahn
BAI' AL-WAFA' as security

- Meaning and concept of bai' al-wafa'
- Juristic opinions on bai' al-wafa'
- BW is invalid sale
- BW is valid sale
- BW is to be treated as Rahn
- BW and Malay custom of *Jual-Janji*
- Assessment of the opinions

OTHER TYPES OF SECURITY

- Guarantee/kafalah: why fee cannot be charged for issuance of guarantee?
- Assignment/hiwalah: can be conditional or unconditional
- Set-off/muqassah: mandatory and non-mandatory
- Lien/mabda' al-zafar ala al-haqq: self-help measure to protect the innocent party
- Takaful coverage: a show of solidarity with friends in distress
- Deposit/urbun: compensation for loss of opportunity
- Assignment of rights as security?