ISLAMIC MICROFINANCE REPORT

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for the

INTERNATIONAL DEVELOPMENT LAW ORGANISATION

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CONTENTS

1. INTRODUCTION

This report has been prepared to assist the International Development Law Organisation (**IDLO**) in understanding the basic Islamic law (*Shari'a* law) principles governing the provision of Islamic finance products and services, the processes typically involved in obtaining *Shari'a* approval for *Shari'a*-compliant financing transactions and products and the relationship between *Shari'a* law and secular law in certain jurisdictions. This report also summarises the results of our research into the state of Islamic microfinance in certain Middle Eastern, South Asian and Southeast Asian countries.

The information included in this report is derived from a combination of our experience of advising on *Shari'a*-compliant financing transactions and publicly available sources and materials. We have not independently verified the information obtained from external sources that we used and make no representations as to its accuracy or completeness. In addition, we did not undertake an exhaustive search of all information or materials which are publicly available in relation to Islamic microfinance and our research on the subject was based on the sources and materials which are listed in Section 11 (*Sources*).

This report has been prepared to assist IDLO in furthering its understanding of Islamic finance and the state of Islamic microfinance in a select number of countries. It does not constitute (nor should it be relied upon as) legal advice from Allen & Overy.[1] Allen & Overy disclaims any duty of care or liability to any person in connection with the contents of this report.

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2. *SHARI'A* LAW

2.1 *Shari'a* law defined

Shari'a (or Islamic) law is meant to regulate all aspects of a Muslim's way of life. It is broadly divided into two sets of rules: one relates to the obligatory worship of God (*ibadah*) and the other relates to daily life outside the context of obligatory worship (*muamalat*), including commercial and financial dealings.

Shari'a is not a codified body of law. It consists of general rules and principles derived from the *Qur'an* (the Muslim holy book), the practices (*sunnah*) and sayings (*ahadith*) of the Prophet Mohammed (as discussed in further detail below). These general principles are capable of interpretation and development to address new issues or circumstances that arise from time to time. Indeed, the *Shari'a* has been supplemented by extensive Islamic jurisprudence (*fiqh*) developed over centuries by different schools of thought (the *madhaa'hib*). The key point to note is that, while all the schools of thought agree on the fundamental *Shari'a* principles enshrined in the *Qur'an*, *sunnah* and *hadith*, they sometimes hold differing views on their interpretation and application.

2.2 Sources of *Shari'a* law

Shari'a law is derived from a number of primary and secondary sources.

(a) *Qur'an*

The *Qur'an* is a primary source of law and is believed by Muslims to contain the word of God as revealed to the Prophet Mohammed. Evidence found in other sources of *Shari'a* law is subject to the *Qur'an*.

(b) *Sunnah*

Sunnah literally means "well known path". The *sunnah* is a primary source of law and comprises traditional accounts of what the Prophet Mohammed said or did during his life which have legal content. *Sunnah* also comprises the sayings of others tacitly approved by the Prophet's silence.

(c) *Hadith*

A further primary source of law is the narrative record of sayings and actions of the Prophet Mohammed known as *hadith* (plural *ahadith*). The extent to which *sunnah* is derived or differentiated from *ahadith* depends on the context and school of thought being considered.

(d) *Qiyas*

Qiyas represents the process of reasoning whereby the principles found in the *Qur'an* and *sunnah* are extended to new cases by analogy.

(e) *Ijma*

Ijma represents the consensus of the Islamic community (whether at a local or global academic level) on a particular issue.

(f) *Ijtihad*

Ijtihad is the interpretation and the opinion of Islamic jurists on a particular issue. *Qiyas*, *ijma* and *ijtihad* are all secondary sources of *Shari'a* law.

2.3 Issues relating to interpretation and application of *Shari'a* law

Since *Shari'a* law is not a single codified body of law and is open to interpretation, the opinions of *Shari'a* scholars may differ on the same question of *Shari'a* law depending on the school of thought to which particular scholars belong.

In addition, scholars' views on questions of *Shari'a* law may change over time.

This can lead to uncertainty and inconsistency of interpretation and application of *Shari'a* law across the Islamic world.

3. KEY *SHARI'A* PRINCIPLES AND PROHIBITIONS RELEVANT TO FINANCE

There are a number of key *Shari'a* principles and prohibitions relevant to finance and commercial transactions which distinguish Islamic finance from the conventional forms. For completeness, it should be mentioned that there are two main branches within Islam: *sunnism* and *shiaism*. The majority of Muslims are *sunni* and the following is limited to the discussion of the general *Shari'a* principles relating to Islamic finance within *sunni* jurisprudence.

The key *Shari'a* principles which underpin Islamic finance, and have led to the creation of a separate finance industry, are as follows:

3.1 Prohibition on usury and interest (*riba*)

Under the *Shari'a*, it is not permissible to charge, pay or receive interest. The *Shari'a* does not recognise the time value of money and it is therefore not permissible to make money by lending it. Money must be used to create real economic value and it is only permissible to earn a return from investing money in permissible commercial activities which involve the financier or investor taking some commercial risk. This prohibition is the main driving force behind the development of the modern Islamic finance industry.

Riba can take one of two forms: *riba al-naseeyah* and *riba al-fadl*.

Riba al-naseeyah is the amount of excess received by a lender in addition to the capital amount lent. This type of *riba* is comparable to the traditional concept of interest in conventional lending activities. The second type, *riba al-fadl,* is excess compensation without any form of consideration in return.

In modern finance, *riba al-fadl* could be applicable to several exchange of commodities contracts. The idea is that when compensation is paid, it should be justified or be set against a specific activity and the return should also be associated with a specific risk. Therefore when parties exchange commodities of similar value and one party pays excessive compensation to the other party, this is considered *riba*.

3.2 Prohibition on realising a gain from speculation (*mayseer*)

It is not permissible to earn a profit from speculation. Gambling is therefore not permitted under *Shari'a*. Any contracts or arrangements which involve speculation are also not permitted. That said, it is accepted under the *Shari'a* that there is an element of speculation in most commercial arrangements and, unlike the absolute prohibition of interest, it is a question of the degree of speculation involved and whether the intention behind the transaction is to realise a gain from some productive effort or purely speculation.

The distinction between prohibited speculation and legitimate commercial speculation is not always clear in practice and there are examples where it can be difficult to distinguish between the two. For example, it is generally accepted that it is permissible to make an equity investment in a company engaging in a business activity that is permissible under the *Shari'a* with a view to realising future dividends and capital gains on the investment. There is of course a degree of commercial speculation involved about the future prospects of the company when an investor makes an equity investment, but whether such speculation is permissible or not would depend on the intention of the investor, i.e. was the intention to make a quick profit by speculating in the likely movement of the share price over a very short period of time (as is arguably the case with day trading), or was the decision made on the basis of careful evaluation of the company's past results and future prospects? At the other end of the spectrum, equity derivatives such as index-linked derivatives are generally viewed as unacceptable under *Shari'a* because they involve speculation on the movement of an equity index.

3.3 No uncertainty (*gharar*) in commercial transactions

Certainty of terms in any transaction is a key requirement under the *Shari'a*. Again, as with speculation, a degree of commercial uncertainty is acceptable but there must not be any uncertainty about the key terms of the transaction. For example, in a transaction for the sale of assets, the sale contract should set out a clear description of the assets being sold, the sale price and the time for delivering the assets to the purchaser. Similarly, a leasing contract needs to set out clearly the assets which are being leased, the duration of the lease and the rent payable under the lease. One of the reasons that conventional insurance contracts are not considered permissible under the *Shari'a* is that there is no certainty as to when a claim will be paid, given that there is no way of knowing if and when the insured event will occur.

In the context of modern day Islamic finance, key examples of *gharar* are:

(a) advising a customer to buy shares of a particular company that is the subject of a takeover bid, on the grounds that its share price can be expected to rise;

(b) buying a house, the price of which is to be specified in the future;

(c) when the subject matter or specifications to a contract are unknown; and

(d) deferred payment under a contract where the deferment is for an unknown period.

3.4 All activity must be for permitted purposes (*halal*)

Muslims must not engage in (or derive any benefit from) activities which are prohibited under the *Shari'a*. It is therefore not permissible for Muslims to invest in businesses which engage in prohibited activities such as casinos, a breweries or a factories making pork products. It is also not permissible for Islamic banks to provide any financing to such businesses. However, a very strict interpretation of these rules would mean that Muslims would only be able to invest in a very limited number of businesses internationally. For example, it would not be permissible for Muslims to invest in a hotel that serve alcohol, a food company which also manufactures pork products as part of its product range or any business that lends or borrows money at interest.

In light of the practical considerations of international commerce and in order to enable Muslim investors to participate in it, a number of prominent *Shari'a* scholars have advanced the view that it is permissible for Muslims to invest in businesses or companies which are not entirely *Shari'a*-compliant so long as certain conditions are met. These conditions include (among other things):

(a) the principal business activity must be permissible under *Shari'a*;

(b) any income derived from prohibited activities should only form a small percentage of the overall income of the company or business (this percentage ranges from 5 to 20 per cent. of overall income depending upon the nature of the prohibited activity and the *Shari'a* scholars involved);

(c) the aggregate amount of interest-bearing debt incurred by a company or business must not exceed a certain percentage of its assets or market capitalisation (there are disagreements between *Shari'a* scholars as to what percentage is acceptable and it ranges from 25 to 35 per cent. of total assets or market capitalisation depending upon the scholars involved); and

(d) the accounts receivable of the company on the business must not exceed a certain percentage of its assets or market capitalisation (usually set between 25 and 33 per cent.).

4. *SHARI'A* SCHOLARS AND *SHARI'A* BOARDS

4.1 Role of *Shari'a* scholars

One of the key distinguishing features of Islamic finance is the role played by *Shari'a* scholars. *Shari'a* scholars play both an advisory and a supervisory role in Islamic finance. They are ultimately responsible for determining whether a particular transaction or product complies with *Shari'a* law. They can do so acting individually or (as is more usually the case) acting through a *Shari'a* board comprising two or more scholars (see below for more details).

There is no formal training or qualification for a person to assume the role of a *Shari'a* scholar. However, a person must have a deep understanding and knowledge of the *Qur'an*, *ahadith*, *sunnah* and *Shari'a* law generally in order to be recognised and accepted as a *Shari'a* scholar. This knowledge and understanding is typically acquired through studying at a traditional religious institution. *Shari'a* scholars who are active in the Islamic finance industry tend to also have a background in economics and finance.

4.2 Key scholars active in the industry

There are a number of reputable scholars who specialise in the application of *Shari'a* principles to finance. These scholars are based predominantly in the Middle East, Pakistan and Malaysia. Among the most well-known scholars active in the industry, are:

- Sheikh Taqi Usmani (Pakistan);
- Sheikh Nizam Yaquby (Bahrain);
- Dr. Mohammed Ali Elgari (Saudi Arabia);
- Dr. Abus Sattar Abu Ghuddah (Syrian based in Saudi Arabia);
- Dr. Muhammad Imran Ashraf Usmani (Pakistan);
- Dr. Hussain Hamid Hassan (United Arab Emirates); and
- Dr. Mohammad Daud Bakar (Malaysia).

4.3 Role of *Shari'a* boards

Shari'a boards are typically responsible for reviewing an institution's Islamic operations, products and transactions in order to ensure that they comply with *Shari'a* law.

The scope of the role undertaken by a *Shari'a* board varies from institution to institution and across jurisdictions, as most jurisdictions have yet to develop a detailed regulatory framework governing the appointment of *Shari'a* boards, the scope of their duties or the qualifications required for someone to become a *Shari'a* scholar. Indeed, some jurisdictions do not even require an institution offering *Shari'a*-compliant products and services to have a *Shari'a* board. As such, most arrangements involving *Shari'a* boards are voluntary and the scope of their involvement can range from getting involved in the operations of the institution and holding regular meetings with its management (as is the case with some traditional Islamic banks) to only being engaged on a transaction-by-transaction basis to review and approve proposed transactions or products as being *Shari'a*-compliant.

Shari'a scholars sitting on *Shari'a* boards are typically commercially astute and generally have exposure to a broad range of issues through acting on several *Shari'a* boards for various institutions.

4.4 The work of *Shari'a* scholars and boards in practice

Shari'a scholars (either individually or as part of a *Shari'a* board) can be engaged on a transaction-by-transaction basis or be appointed to a permanent *Shari'a* board of a financial institution. For the reasons mentioned below, even though an institution may not be required to appoint a *Shari'a* scholar or establish a *Shari'a* board there are various benefits in doing so (such as credibility with potential investors and customers).

A *Shari'a* board working on a transaction or reviewing a particular product will typically consist of at least three *Shari'a* scholars. Where it is involved in a transaction, the *Shari'a* board will generally be involved in settling the term sheet and in reviewing the penultimate draft of the transaction documents, although the level of a *Shari'a* scholar's or *Shari'a* board's involvement will vary from transaction to transaction. At present, one of the pressing issues facing the Islamic finance industry is the shortage of suitably qualified *Shari'a* scholars. As such, *Shari'a* scholars working in the industry are very busy and getting their attention can be difficult at times. Typically contact with the *Shari'a* scholars will be by way of telephone, fax and e-mail, however, some *Shari'a* scholars will also require face to face meetings.

Decisions of a *Shari'a* board, as to whether a particular transaction or product is *Shari'a*-compliant, are generally arrived at by consensus. The *Shari'a* board will then issue a pronouncement (*fatwa*) to confirm that that transaction or product is *Shari'a*-compliant. If a single scholar has been engaged to review a transaction or product, then he will issue a *fatwa* after he is satisfied that the proposed transaction or product complies with the requirements of *Shari'a* law.

4.5 Considerations involved in appointing a *Shari'a* scholar or board

As mentioned earlier, most jurisdictions have yet to develop a detailed regulatory framework governing the appointment of *Shari'a* boards or the qualifications required for someone to become a *Shari'a* scholar and some jurisdictions do not even require an institution offering *Shari'a*-compliant products to have a *Shari'a* board (or indeed engage any *Shari'a* scholars). Why then would an institution go to the trouble and expense of appointing a *Shari'a* scholar or a *Shari'a* board if it is not required to do so under the applicable regulatory regime? The answer is so it can have the necessary credibility with potential investors and customers. In practice an institution that wants to participate in the Islamic finance industry will only have that credibility if it has a *Shari'a* board.

A key consideration for an institution when appointing a *Shari'a* board is its composition. The composition of a *Shari'a* board will be a determining factor in whether or not that institution achieves acceptance among potential investors and customers as a credible provider of *Shari'a*-compliant products and services. As such, an institution should strive to appoint experienced scholars that are well known in the jurisdiction in which the institution operates as this will have a positive effect on the institution's credibility and business prospects.

Another important consideration when appointing a *Shari'a* board is to make sure that the composition of the *Shari'a* board is made up of *Shari'a* scholars who represent a range of Islamic schools of thought, as this will help reduce the risk of disagreements as to whether a particular product or transaction is *Shari'a*-compliant or not.

It should be noted that some Islamic finance transactions and products are approved by a single scholar. This generally happens in the case of private transactions where there are a limited number of parties or investors involved, and these parties or investors are willing to rely on the *fatwa* issued by a single scholar selected by them.

5. *SHARI'A* COMPLIANCE

5.1 General

A transaction or product will generally be treated as being *Shari'a*-compliant if a *Shari'a* scholar or *Shari'a* board issues a *fatwa* to confirm that in his/their opinion that transaction or product is *Shari'a*-compliant. However, a *fatwa* does not ensure that the relevant transaction or product will be accepted as *Shari'a*-compliant by every *Shari'a* scholar. In fact, there have been instances where one or more *Shari'a* scholars have disagreed with the view taken by an institution's *Shari'a* board. As mentioned earlier in this report, there are different schools of thought within Islamic jurisprudence and while all of them agree on the fundamental *Shari'a* principles, they can (and sometimes do) hold different views on their interpretation and application.

5.2 Steps involved in obtaining *Shari'a* approval

It is important to bear in mind that the steps for obtaining *Shari'a* approval will vary from institution to institution and quite possibly from transaction to transaction. For example, an Islamic bank or a conventional bank with an Islamic division or "window" will have a *Shari'a* board, whereas other institutions may not have a *Shari'a* board but may approach *Shari'a* scholars on a transaction-by-transaction basis or in relation to a particular product. Where an institution has a permanent *Shari'a* board the process for obtaining *Shari'a* approval (which will culminate in the issuance of a *fatwa*) is generally as follows:

(a) the relevant commercial department of the institution will discuss a proposed transaction or product with the institution's *Shari'a* co-ordinator (or the department that co-ordinates with the institution's *Shari'a* board);

(b) the *Shari'a* co-ordinator will provide feedback on the proposed transaction or product and, based on his experience, advise the relevant commercial department as to whether or not the *Shari'a* board is likely to grant *Shari'a* approval. In the event the *Shari'a* co-ordinator feels that the transaction or product will not receive *Shari'a* approval, he will suggest changes that should be made to improve its chances of receiving *Shari'a* approval;

(c) once any changes suggested by him have been made, the *Shari'a* co-ordinator will submit the necessary details of that transaction or product to the *Shari'a* board;

(d) the *Shari'a* board will consider the transaction or product and will either ask for changes to be made before approving it or they will approve it as submitted; and

(e) if satisfied, the *Shari'a* board will issue a *fatwa* confirming that that transaction or product is *Shari'a*-compliant.

Where an institution does not have a permanent *Shari'a* board it may appoint a temporary *Shari'a* board or a single *Shari'a* scholar (depending on the circumstances). The institution could liaise with the *Shari'a* board or *Shari'a* scholar directly with a view to obtaining *Shari'a* approval for the relevant transaction or product. Alternatively, the institution may engage an independent *Shari'a* consultant to liaise with the *Shari'a* board or *Shari'a* scholar with a view to obtaining *Shari'a* approval. The role undertaken by an independent *Shari'a* consultant is usually similar to that undertaken by an internal *Shari'a* co-ordinator.

6. *SHARI'A* LAW AND SECULAR LAW

6.1 Introduction

A question often raised when entering into contracts or financing transactions in the Middle East is to what extent would *Shari'a* law apply to contractual obligations. The answer varies from jurisdiction to jurisdiction as there is no overall consensus as to when and where *Shari'a* applies. It often depends on the religious and social structure of the society, the legal system, the provisions of the constitution and the civil code of each jurisdiction.

Shari'a law may apply directly as the governing law of a jurisdiction where there is no fully developed codified legal system, or indirectly through the application of statute law based fully or partially on *Shari'a* law, or as a source of law to fill legislative gaps.

The following overview highlights the contrasting approaches taken by the Kingdom of Saudi Arabia (**Saudi Arabia**) and the United Arab Emirates (the **UAE**) in their application of *Shari'a* law and its effect on contractual obligations. It also considers the approach of English courts to contracts governed by English law but which are also expressed to be subject to *Shari'a* law.

6.2 Contrasting the application of *Shari'a* law in the UAE legal system with the application of *Shari'a* law in the Saudi Arabian legal system

In Saudi Arabia there is no civil code, so *Shari'a* operates and applies directly as the governing law of the country in respect of both commercial and personal matters. No other law is applicable if contrary to *Shari'a*. The Basic Law of 1992 confirmed in Saudi Arabia that the *Qur'an* and *ahadith* are the sole sources of law and that all laws and regulations must conform to *Shari'a*. Therefore, no foreign judgement nor any constitutional provision contrary to Islamic principles can be enforced in Saudi Arabia.

Shari'a law in Saudi Arabia is supplemented by legislation enacted by the Saudi Arabian State and other legislative authorities. Such legislation takes various forms, the most common of which are royal orders, royal decrees, council of ministers' resolutions, ministerial resolutions and ministerial circulars which cover many fields including company law, the code of commerce and tender law. All such laws are ultimately subject to, and may not conflict with *Shari'a* and Saudi Arabian adjudicatory bodies are required to interpret enacted legislation accordingly.

In contrast, the UAE has adopted a civil code and civil legal system, where the Federal Law No. 5 of 1985 in respect of civil transactions (the **Civil Code**) is based on the French Civil Code and to some extent *Shari'a* law, and where *Shari'a* law applies mainly in the field of family law.

The constitutions of most Arab states refer to the *Shari'a* as either: a *primary* source of law or *the* source of law, the difference being that where the constitution describes the *Shari'a* as the source of legislation, the hierarchy implies that all the other laws and statutes must comply with the principles of the *Shari'a*.

In the UAE, the matter is ambiguous, because Article 7 of the UAE Constitution has *Shari'a* as a primary source of legislation, whereas Article 75 of the Law of the Union Supreme Court of 1973 provides that the Supreme Court shall first apply *Shari'a* and other laws in force if conforming to *Shari'a* principles. It may also apply custom, if custom does not conflict with *Shari'a*. Further, in contrast to the provisions of the Constitution, Article 1 of the Civil Code refers to *Shari'a* as the first source of law where there is a lack of any legislative provision and Article 27 provides that in the case of conflicts of laws, no law contrary to *Shari'a* can be applied and public policy[2] and morals are applicable. So in the UAE, there are constitutional provisions where *Shari'a* is recognised only as a source of law, while the Civil Code and the law of the Supreme Court establishing the highest court consider *Shari'a* as the source of law.

The extent of the application of *Shari'a* has been the subject of a number of cases heard by the highest court of appeal in the UAE, where the court ruled that *Shari'a* is the principal source of law, above all other laws, but it is for legislators to implement that when enacting new legislation.

6.3 The relevance of *Shari'a* law in the UAE to the enforcement of contracts which are expressed to be *Shari'a*-compliant and contrasting this with the approach taken in Saudi Arabia

The contradiction between the prohibition of interest under *Shari'a* law and "legalising" the charging and taking of interest under the Commercial Codes was brought to the attention of the UAE Supreme Federal Court in the decision of 6 September 1983.[3] The Federal Supreme Court held that *Shari'a* prohibited interest, but at the same time made exceptions to the prohibition by the application of other principles, including "*necessity permits what would be otherwise forbidden*" and argued that Islamic jurisprudence allows exceptions to a rule in the overwhelming interest of society, and thereby justified the taking and charging of interest on public interest grounds. Consequently, the Court held as constitutional Articles 76 and 77 of the Commercial Code, which allow the charging of interest. The Court also took the view that the judge must respect the will of the parties and may not ignore the agreement of the parties except in exceptional circumstances. For instance, if parties have agreed to charge interest in a contract, the court cannot set aside the agreement unless the rate of interest is in excess of the maximum legal rate.

Hence, in practice, although *Shari'a* is a source of law in the UAE, the UAE courts have very rarely relied on *Shari'a* as a basis for determining cases involving commercial transactions but have rather relied on published codes and decrees as primary sources of law to determine such cases, or even public policy grounds. However, if the UAE courts decided to apply *Shari'a* in respect of commercial transactions expressed to be *Shari'a*-compliant, it is possible that they could reach different interpretations as to whether the commercial contracts comply with *Shari'a* as this would be within the realms of their constitution.

Under Saudi Arabian law, any provision in an agreement for the payment of, whether directly or indirectly, or the bearing of the cost of any amount based upon, calculated by reference to or otherwise related to, interest (for these purposes, "interest" includes money deemed by Saudi Arabian adjudicatory bodies to be in the nature of interest) is not enforceable under Saudi Arabian law. Similarly, any other contractual provision which contravenes *Shari'a* will also be unenforceable in Saudi Arabia. However, the unenforceability of an interest provision does not affect the validity and enforceability of any obligation to pay the principal and it is worth mentioning that apart from the prohibition of interest, there are no civil or criminal penalties which attach to or result from the charging or payment of interest. Therefore, if a Saudi Arabian adjudicatory body considered a provision in a contract to be contrary to *Shari'a* principles (such as the payment of interest), then that provision would not be enforceable in Saudi Arabia.

The strict enforcement of the prohibition on interest would make it impossible for a modern conventional banking industry to function in Saudi Arabia. In order to address this issue, the Saudi Government set up the Banking Disputes Settlement Committee under the aegis of the Saudi Arabian Monetary Agency (the **SAMA Committee**) and empowered it with resolving disputes of a

2 Article 3 of the Civil Code also stipulates that public policy rules are those which are not contrary to the basic principles of *Shari'a*.

3 The defendant company had borrowed money from a bank and claimed that *Shari'a* has prohibited interest. Therefore, the defendant had no obligation to pay the sums claimed by the Bank. The appellant contended that the court may apply *Shari'a* only in cases of absence of an express provision in the law as stated in the Commercial Code. Articles 76 and 77 of the Law of the Union Supreme Court of 1973 expressly permit charging interest.

banking nature between banks and their customers or between banks themselves. The SAMA Committee does not apply Islamic law principles in as strict a fashion as other courts and judicial committees of Saudi Arabia and upholds arrangements which it considers to be customary or internationally recognised banking practice. The SAMA Committee, in practice, upholds the payment of sums in the nature of interest in connection with credit facilities (which would include loan agreements) in certain circumstances. However, even in such circumstances, the amounts awarded may not constitute all interest payable under the terms of a loan agreement.

6.4 Highlighting the approach of the English courts when enforcing an English law governed contract which is also expressed to be subject to *Shari'a* law

The English courts recently had to consider the issue of the relevance of *Shari'a* law to a contract which was governed by English law but which was also expressed to be subject to *Shari'a* law.

In ***Shamil Bank of Bahrain EC v Bexmico Pharmaceuticals Ltd (No. 1)***[4]**,** the English courts were required to adjudicate on a dispute relating to agreements where the governing law provided that "*Subject to the principles of the glorious Shariah, this Agreement will be governed by and construed in accordance with the laws of England*". The defendant had argued that on a proper construction of the governing law clause, the agreements were only enforceable in so far as they were recognised by the *Shari'a* and English law, and contended that the agreements were in fact contrary to the *Shari'a*.

The trial judge gave summary judgement in favour of the plaintiff and held (*inter alia*) that:

- English law was the governing law because there could not be two separate systems of law governing the agreements;
- the parties had not chosen *Shari'a* law as the governing law because it was not the law of a country and there was no provision for the application of a non-national system of law such as *Shari'a* law; and
- it was highly improbable that the parties had intended that an English secular court should determine any dispute as to the nature or application of controversial religious principles.

The defendant appealed the summary judgement to the Court of Appeal who dismissed the appeal and upheld the original judgement. In dismissing the appeal, the Court of Appeal held that in interpreting the governing law clause, the court should avoid a construction which would defeat the commercial purpose of the agreements. It also held that there could not be two governing laws in respect of the agreements and that the Rome Convention 1980, scheduled to the Contracts (Applicable Law) Act 1990, only contemplated and sanctioned the choice of the law of a country.

[4] Case No.A3/2003/1952; [2004] EWCA Civ 19; [2004] 1 W.L.R. 1784.

7. ISLAMIC MICROFINANCE IN THE MIDDLE EAST (UNITED ARAB EMIRATES AND SAUDI ARABIA)

7.1 Introduction

The late Dr. Ahmad Elnaggar initiated the first modern experiment with Islamic banking in 1963, in Mit Ghamr, Egypt. The Mit Ghamr savings project, which would now be called a microfinance programme, was based on profit sharing and applying certain concepts of the modern microfinance movement. The Mit Ghamr project became the Nasser Social Bank in 1971. Despite this early initiative in Egypt, microfinance remains less developed in the Arab world than, for example, in Asia, Africa or Latin America and, although it seems to have taken hold in many Middle Eastern and North African (**MENA**) countries, it remains largely undeveloped in Saudi Arabia and in its infancy in the UAE.

The majority of microfinance surveys of the region mention Saudi Arabia only in passing and do not mention the UAE at all, and the few microfinance institutions (**MFIs**) and organisations that are present in the UAE seem to view the UAE as their MENA administrative hub or as a potential source of funds rather than as a location for implementing projects.

That said, the partnership between Grameen Bank and the Abdul Latif Jameel Group has served to introduce the Gulf Co-operation Council (**GCC**) countries to microfinance initiatives[5] and, since 2006, the UAE has staged several high profile microfinance conferences showcasing microfinance initially as an alternative business model, in which participants might like to engage, and subsequently as an alternative asset class, in which participants might like to invest. On 17 January 2008 Noor Islamic Bank announced its commitment to serving the "unbankable" segment of the UAE population and, on 20 January 2009 at the Arab Economic, Social and Development Summit in Kuwait City¸ the League of Arab States announced the formation of a US$2 billion fund run by the Arab Development Fund that is set to include a microfinance programme that is aimed at helping small businesses through the credit crunch, extending credit to cottage industries and reducing unemployment across the Arab world.[6]

7.2 Interest in Microfinance

(a) 5-6 November 2006 – First Dubai Microfinance Forum, Dubai

Under the patronage of the Al Qasimi family and supported by the Zayed Foundation, the Emirates Foundation and the Mohammed Bin Rashid Establishment for Young Business Leaders, the conference attracted delegates from and discussed microfinance activities across Egypt, Jordan, Kuwait, Palestine, Saudi Arabia, Sudan and Yemen. It dealt with involvement in microfinance on a primary, face-to-face, and secondary, wholesale, level.

(b) 13-17 April 2008 – International Islamic Finance Forum, Dubai

Professor Yunus, Nobel Peace Prize winner and founder and Managing Director of Grameen Bank, led a panel composed of Islamic finance professionals from all over the world in a discussion on how the global Islamic finance sector needs to undergo a paradigm shift towards poverty alleviation. The offering of microfinance products by UAE institutions was said to be an issue with which the UAE was not yet or was only beginning to be ready to deal. Wasim Saifi, CEO of UAE Islamic mortgage firm Tamweel, suggested that Islamic banks had yet to engage in microfinance "*because*

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[5] The six members of the Gulf Co-operation Council are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

[6] The 22 members of the League of Arab States are Algeria, Bahrain, Comoros, Djibouti, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Palestine, Qatar, Saudi Arabia, Somalia, Sudan, Syria, Tunisia, the United Arab Emirates and Yemen.

the pressures are still there to create the Islamic finance sector, and widening its scope [is] not part of the immediate focus." Ahmed Al Janahi, deputy group CEO of UAE-based Noor Islamic Bank, added that the 15 per cent. of the UAE finance market who would benefit from microfinance initiatives are deemed by most financial services providers to be too costly and "unbankable" and continued, "*we have spotted this at Noor Islamic Bank – we have been creating another bank in the main bank, with a different structure so we can break down the cost per product.*"

(c) 30 November 2008 – Arab Microfinance Investment Symposium, Dubai

Organised by Grameen-Jameel, a joint venture company focussed on poverty alleviation across the Arab world, and BlueOrchard, a microfinance investment manager based in Geneva, this conference presented microfinance as an alternative asset class in which investors could invest.

(d) 20 January 2009 – Arab Economic, Social and Development Summit, Kuwait City

Mohammed Al Sabah, Kuwait's foreign minister, announced the formation of a US$2 billion fund to include a microfinance programme aimed at helping small businesses through the credit crunch, extending credit to cottage industries and reducing unemployment across the Arab world.

7.3 Participants in Microfinance

(a) Arab Fund for Economic and Social Development (**AFESD**)

Set to run the US$2 billion fund announced at the recent Arab Economic, Social and Development Summit in Kuwait City, AFESD is an autonomous regional pan-Arab development finance organisation made up of the members of the League of Arab States.

The function of the AFESD is to assist the economic and social development of Arab countries through:

(i) financing development projects, with preference given to overall Arab development and to joint Arab projects;

(ii) encouraging the investment of private and public funds in Arab projects; and

(iii) providing technical assistance services for Arab economic and social development.

The AFESD seeks to assist member countries in eliminating development constraints, increasing absorptive capacity and achieving higher rates of growth, and to foster economic integration and co-operation among member countries.

(b) Arab Gulf Fund for United Nations Development Organisations (**AGFUND**)

Established in 1980 at the instigation of HRH Prince Talal Bin Abdul Aziz Al Saud and supported by the Arab Gulf States, AGFUND is a non-profit regional development institution concerned with the support of sustainable human development efforts targeting the neediest in developing countries, particularly women and children. It supports the developmental efforts of national, international and regional organisations, institutions and NGOs, especially those concerned with improving educational and health standards and combating poverty.

It has supported the establishment of banks for the poor across several Arab countries, including Al-Amal Micro-Credit Bank in the Republic of Yemen, the National Bank for Small Projects Funding in Jordan and Al-Rajaa Micro-Credit Bank in Lebanon. It has plans for similar programmes in Sudan, Morocco, Syria and Mauritania but is notably silent in relation to the GCC countries.

(c) Abdul Latif Jameel Company Community Service Programmes (**ALJCSP**)

(i) Productive Families Program (**PFP**)

Launched in 2004 by the Abdul Latif Jameel Company on the basis of a business plan developed by the Grameen Foundation and benefiting from the continued support of Grameen Bank advisers, the PFP aims to empower low-income women in Saudi Arabia to improve their lives and has piloted a "micro-retail" strategy that uses female loan officers to offer interest-free loans ranging from SR1,000 to SR5,000[7] to women to start their own household projects.

(ii) Bab Rizq Jameel Centres

Intended as the "first stop" for unemployed young Saudi males and females who are looking for a decent job, the Bab Rizq Jameel centres focus on job creation and, as part of this, offer:

(A) interest-free loans up to a maximum of SR150,000 to owners of new or existing projects of a service, industrial or production nature;

(B) interest-free loans to enable young Saudi males to acquire and run fully-equipped taxi cars or transport trucks, enabling them to repay the cost of the cars or trucks in instalments from their earnings and entitling them to ownership of the cars or trucks at the end of the instalment period; and

(C) office and retail facilities and franchise opportunities with international and local companies to those who desire to start their own small projects.

(d) Grameen-Jameel Pan-Arab Microfinance Ltd (**Grameen-Jameel**)

Launched in 2003 as "the first social business in the Arab world" and operational across, *inter alia*, Egypt, Jordan, Lebanon, Morocco, Palestine, Saudi Arabia, Sudan, Syria, Tunisia and Yemen, Grameen-Jameel is a partnership between the Bangladeshi Grameen Foundation and the Saudi Arabian Abdul Latif Jameel Group. It forms strategic partnerships with select MENA MFIs and works at increasing their capacity by providing financial support, technical assistance, training and access to translated resources on best practice microfinance. It hopes to enable MENA MFIs collectively to reach one million new borrowers by 2011 and aims at enabling these MFIs to increase the breadth and depth of their outreach and improve their financial and operational sustainability on a long-term basis.

(e) Microfinance Network of Arab Countries (**Sanabel**)

Established in 2002 as a membership-driven network of microfinance institutions in the Arab world, Sanabel currently has 64 members from 12 Arab countries who collectively serve over 80 per cent. of the total microfinance clients in the region. Sanabel works with MFIs to promote best practice microfinance across the Arab world through information exchange, training opportunities, research, and a transparency initiative (in partnership with the Microfinance Information Exchange).

(f) Noor Islamic Bank PJSC

[7] SR means Saudi Riyal.

On 20 January 2008, Noor Islamic Bank PJSC announced its intention to establish a company with Emirates Post Holding Group offering *Shari'a*-compliant financial services to the low income and unbanked segment of the UAE population, combining Noor Islamic Bank's "expertise in the provision of *Shari'a*-compliant financial services" with Emirates Post's "country-wide reach and brand reputation" to offer a comprehensive basket of financial products and services developed for and tailored to the needs of this segment.

(g) Saudi Credit Bank / Ministry of Finance

Established in 1971 with the aim of helping Saudi citizens with limited financial resources overcome their financial difficulties, the Saudi Credit Bank (**SCB**) extends interest free loans for marriage, home repair, vocational pursuits, and other social endeavours, including family loans, up to a maximum of SR20,000 to Saudi citizens:

(i) who are in actual need of the loan;

(ii) whose annual income does not exceed SR36,000; and

(iii) who do not have any loans or any type of amount outstanding from the SCB,

in return for a sufficient mortgage or acceptable surety from a creditworthy individual or firm.

The vocational loan programme aims at encouraging qualified Saudi professionals and technicians to pursue specialised, professional and technical vocations by themselves and for their own interest. It offers interest free loans up to a maximum of SR200,000 to Saudi citizens wishing to expand and develop their own workshops:

(i) who are at least 21 years old;

(ii) who are graduates of a university or college or of a vocational or technical institute or centre;

(iii) who are engaged in a profession that serves a large sector of society or enhances one of the national economy's sectors; and

(iv) who have practised in their profession for at least one year.

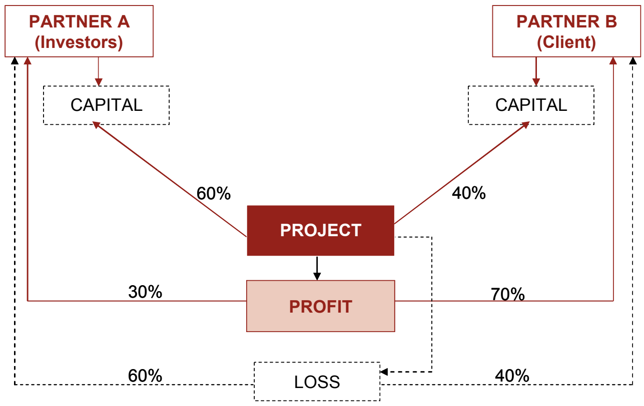
7.4 *Shari'a*-Compliant Financing Products and Structures

A number of *Shari'a*-compliant financing products and structures which are commonly used in the mainstream Islamic finance industry could also be used in the provision of *Shari'a*-compliant microfinance products and services and we have Set out below brief descriptions of these. We understand that MFIs in a number of Muslim countries (such as Afghanistan, Bangladesh, Indonesia, Malaysia, Sudan, Syria and Yemen) already use one or more of these products and structures.

(a) Profit Sharing

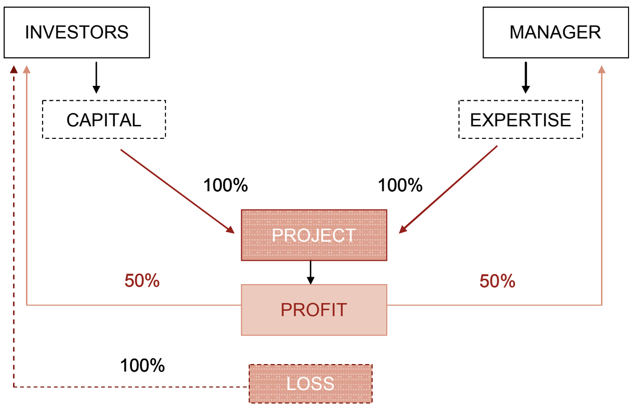
(i) *Musharaka* (partnership)

Musharaka involves investors injecting equity into a business venture and sharing any profits and losses from that venture according to predetermined ratios. Each partner retains (though is not obliged to exercise) management rights in the venture, must receive accounting and other information on business activity, must authorise the raising of capital from any new partners and may receive a salary in return for participating. This is not a popular structure, however, in the context of microfinance as the thorough reporting and transparency requirements surrounding the just distribution of any profit and loss can result in substantial operating burdens and costs on small enterprises unaccustomed to formal accounting.



(ii) *Mudaraba* (trust financing)

Mudaraba involves an investor or investors providing funding for a business venture and a manager with fiduciary responsibilities providing managerial or market specific expertise (and sometimes additional funding). Investors retain ownership of the assets but have no management rights. The investor(s) and the manager share any profits according to predetermined ratios. The investor(s) share any losses according to their respective funding contributions. As with the *musharaka*, however, this is not a popular structure in the context of microfinance as the thorough reporting and transparency requirements surrounding the just distribution of any profit and loss can result in substantial operating burdens and costs on small enterprises unaccustomed to formal accounting.



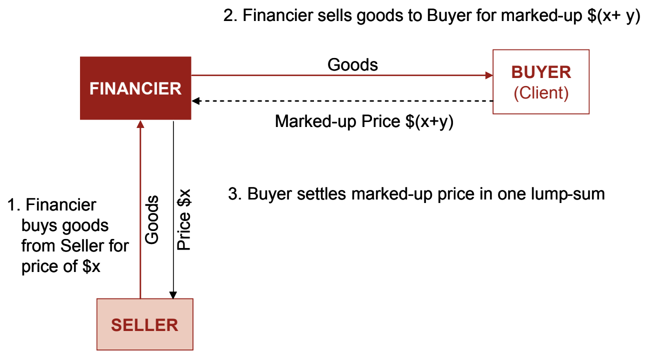
(b) Contracts of exchange

(i) *Murabaha* (cost-plus mark-up)

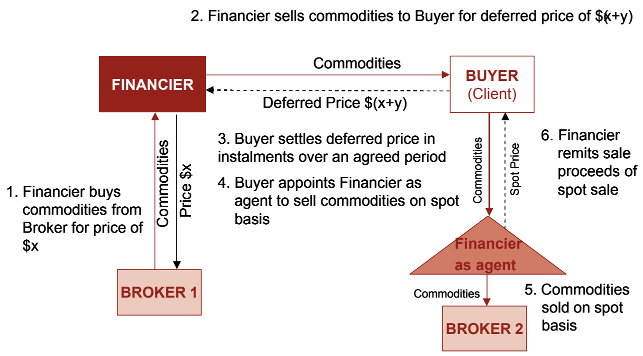
Murabaha involves a finance party purchasing tangible assets from a seller and selling them to a buyer at a predetermined profit margin. In the context of trade finance, the buyer will settle the marked-up purchase price by way of immediate lump sum payment. In the context of consumer finance, the buyer will settle the marked-up purchase price by way of deferred instalments. Using a *tawarruq* structure and an asset for which there is a highly liquid market, the buyer will settle the marked-up purchase price by way of deferred instalments but will also appoint the finance party as its agent to on-sell the assets on a spot basis and remit to the buyer the proceeds of any such sale.

Murabaha is the most popular and flexible *Shari'a*-compliant structure and is used in microfinance initiatives across Afghanistan, Bangladesh, Indonesia, Sudan, Syria and Yemen. However, it is costly to implement and a growing number of *Shari'a* scholars do not approve of it, especially in *tawarruq* structure, on the basis that it is merely disguised lending where the participants have no interest in actually acquiring the underlying commodities. This applies all the more in the context of providing microfinance to start-ups and small companies whose businesses do not involve the sale and purchase of commodities and which do not have sufficient surplus funds to be credibly investing in commodities.

Simple *Murabaha*

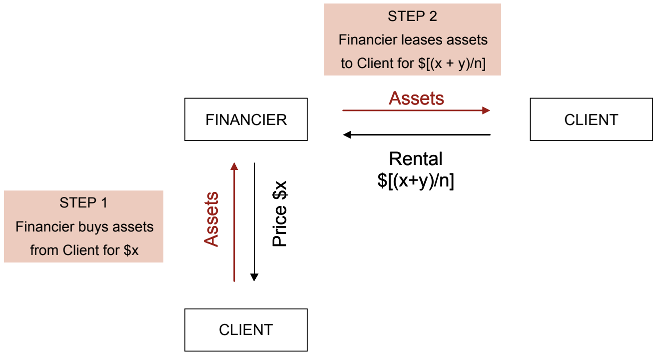


Commodity *Murabaha*



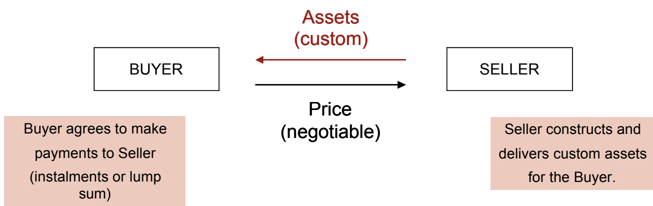
(ii) *Ijara* (sale and leaseback)

Ijara involves making available a known benefit arising from the use, possession and/or occupation of a specified asset in return for a payment. In the context of consumer financing, a finance party will purchase an asset from a client and lease it back to the client at a predetermined rate at predetermined intervals over a predetermined period of time. The finance party is responsible for maintaining and insuring the asset (though may engage another (often the client) as its servicing agent) and the asset must exist for the duration of the lease. The financier may grant the client a sale undertaking and the client grant the financier a purchase undertaking, giving the client the option to purchase the lease assets for a pre-agreed residual sum at the end of or during the lease. It is also possible to structure the lease so that the leased asset is simply transferred to the client at the end of the lease.



(iii) *Istisna'a* (construction / manufacturing)

Istisna'a involves the construction or manufacture and deferred delivery of specified made-to-order assets of predetermined quality and quantity in return for instalment or lump sum on delivery payments. The manufacturer must procure his own goods but, unless those goods do not conform with the contracted terms, the contract is irrevocable after the commencement of manufacture.



(iv) *Salam* (future delivery)

Salam involves one party making an upfront payment to another party for the future delivery of assets of predetermined quality and quantity. The contract is irrevocable after the payment of the purchase price. Although not accepted in many jurisdictions, in a parallel *salam* structure, the finance party will enter into a parallel but unrelated contract to on-sell the assets on delivery at a profit. However, *salam* is costly to implement and, in the context of forward crop-financing in agrarian societies such as, for example, the Sudan, it covers little more than production costs and it is the financiers rather than the clients that realise any potential gains at (post harvest-season and post asset-delivery) market maturity.

8. ISLAMIC MICROFINANCE IN SOUTH ASIA AND SOUTHEAST ASIA

8.1 Introduction

One of the earliest microfinance programmes originated in Bangladesh with the experience of the Grameen Bank initiated by Nobel Prize winner Mohammed Yunus. A 1998 World Bank study showed that in Bangladesh, Grameen Bank's clients were escaping poverty at the rate of 10,000 per month. However, the interest element in the Grameen model makes it unsuitable for replication in an Islamic environment hence the need for Islamic microfinance.

Islamic microfinance represents the confluence of two rapidly growing industries: microfinance and Islamic finance. Presently, the supply of Islamic microfinance is concentrated in a few countries, with Indonesia, Bangladesh and Afghanistan ranking in the top three. According to the 2008 Consultative Group to Assist the Poor (**CGAP**) survey, Islamic microfinance accounts for about 0.5 per cent. of global microfinance despite a global Muslim population of about 1.2 billion.

This section sets out an overview of Islamic microfinance in South Asia and Southeast Asia by looking at the experience of Islamic microfinance in Pakistan, Bangladesh, Indonesia and Malaysia.

8.2 Islamic microfinance in Pakistan

Pakistan and Bangladesh account for an estimated 122 million Muslims living in poverty, or about 10 per cent. of the world's Muslim population.

Pakistan is among the few countries in the world which has a separate legal and regulatory framework for microfinance banks. The framework allows microfinance and commercial banks to extend a range of microfinance services to poor and low income people through various arrangements.

Consequently, the State Bank of Pakistan has formulated guidelines for provision of Islamic microfinance produces and services. These guidelines are intended to increase the scope of microfinance services and products consistent with *Shari'a* principles, and specify the four types of institutional arrangements eligible in offering Islamic microfinance.

Apart from the banks, the other notable Islamic microfinance institutions (**IMFIs**) in Pakistan are *Akhuwat* and Islamic Relief.

Pakistan has developed a unique mosque-centered structure. In the case of *Akhuwat*, Islamic microfinance is dispensed by small interest-free charitable loans (*qard al-hasan*) with an administration fee of 5 per cent. in a spirit of Islamic brotherhood. There is no funding from international donors or financial institutions. All activities revolve around the mosques and involve close interaction with the community. There are no independent officers and loans are disbursed and recovered in the mosque. It uses collateral-free group and individual financing based on mutual guarantees. Anecdotal evidence suggests that the fact that loans are disbursed in a mosque, also attaches a religious sanctity to the oath of returning it on time.

Islamic Relief disburses *murabaha*-based financings to individuals based on a combination of personal guarantors, group savings accounts, co-signers and community recommendations to ensure repayment. These guarantee mechanisms are highly efficient and repayment levels are in the range of 95-99 per cent. *Murabaha* financings are typically delivered to borrowers' business premises. Islamic Relief is continually working in partnership to establish new lending programmes based on Islamic models of microfinance and expand existing programmes in the wider community. In a recent pilot project, HSBC Amanah collaborated with Islamic Relief by providing funding towards Islamic Relief's microfinance projects in Rawalpindi, Pakistan. HSBC Amanah also assists in developing the *Shari'a* structure for financing models and contracts, and providing Islamic finance training to Islamic Relief staff. Islamic Relief will, in turn, manage microfinance projects, identify and screen beneficiaries, set out eligibility criteria and provide financial and social reports to HSBC Amanah.

8.3 Islamic microfinance in Bangladesh

As one of the first countries to adopt microfinance, Bangladesh was also one of the first to introduce Islamic microfinance, which currently accounts for about 1 per cent. of the country's microfinance, and currently has the highest outreach level globally. Available evidence reports Islamic microfinance instruments used by the IMFIs in Bangladesh are predominantly *murabaha* and deferred sale contracts (*bai mu'ajjal*) based on group lending principles. Islamic microfinance has thus evolved in this manner from *qard al-hasan* structures.

Generally, cash credit is not extended in compliance with the "materiality" principle hence sale on credit is implemented through *bai mu'ajjal* and *murabaha*. Mark-up rates range between 12-15 per cent. with a compounding annualised implicit interest rate of 24-25 per cent. Islamic microfinance programmes largely depend on IMFIs' members' savings and funds from Palli Karma-Sahayak Foundation (PKSF).

In a study by Mannan (2007) in Bangladesh, conventional microfinance institutions are based on implicit assumptions of social class conflict and tend to empower women, whereas IMFIs empower families by ensuring joint liability of husband and wife by lending to families or groups of families. Leading Islamic microfinance organisations in Bangladesh include Islami Bank Bangladesh, Social and Investment Bank Bangladesh, Al-Fallah and Rescue.

8.4 Islamic microfinance in Indonesia

Indonesia currently has the greatest diversity of both conventional and Islamic microfinance. It possesses one of the most differentiated microfinance infrastructures, comprising some 6,000 formal and 48,000 semi-formal registered microfinance units serving about 45 million depositors and 32 million borrowers. A majority of microfinance institutions in Indonesia are found in rural and semi-urban areas.

Currently, Indonesia maintains a dual conventional/Islamic microbanking system, which includes both conventional rural banks (Bank Perkreditan Rakyat or **BPRs**) and *Shari'a*-compliant rural banks (Bank Perkreditan Rakyat Syariah or **BPRSs**). Each BPRS has a *Shari'a* board to monitor the conformity of products to Islamic principles. In contrast with many single-product Islamic microfinance programmes in other countries, the financing portfolios of Indonesian IMFIs are reasonably balanced with an array of products based on *murabaha*, *musharaka*, *mudaraba*, *ijara* and *qard al-hasan*.

In addition to BPRs and BPRSs, co-operative institutions are also involved in Islamic microfinance activities, for example, Baitul Maal Wat Tamwil (**BMT**). BMTs are grass-roots developments programmes supported by funds from Islamic community members. BMTs usually operate on the principle of profit-loss sharing instead of charging interest rates, and use Islamic moral values and group solidarity to encourage repayment of loans. *Zakah* (a type of religious tax payable by Muslims on their net worth) funds also form an integral part of BMTs.

Another type of institution providing Islamic microfinance is pawnshops. There are approximately 744 branches and 14 regional head offices, all of which are state-owned and run by Perum Pegadaian (**PP**). In 2001, PP established a Sharia Pawn Service Unit Division for implementing pawning practices based on *Shari'a* pursuant to Article 7 of Government Regulation No. 103 of 2000. Through the Sharia Pawn Service Unit Division, pawnshops provide fast loans based on collateral in the form of physical assets (e.g. jewellery, precious metals, electronic devices etc.) and which do not require complex procedures to operate. During the lending period, pawnshops provide a place for safekeeping the pledged assets and, in turn, charge the borrowers a fee for costs related to their maintenance and safekeeping. Upon maturity, pawnshops have the right to sell or auction the pledged assets upon giving notice to the borrowers, unless the borrowers repay the debt and reclaim the pledged assets. These *Shari'a*-compliant pawning practices are regulated and governed by *Fatwa* (Edict) No. 25/DSN-MUI/III/2002 and *Fatwa* (Edict) No. 26/DSN-MUI/III/2002 issued by the National Sharia Board of the Indonesian Ulemas Council.

Essentially, Islamic microfinance programmes in Indonesia serve two broad categories of clients: (i) clients with existing businesses and successful operations for at least two years; and (ii) new entrepreneurs without prior business experience. The vast majority of clients fall within the first category and are usually financed through Islamic financial products such as *murabaha*, *musharaka* and *mudaraba* involving some form of profit-sharing. A small minority of clients fall within the second category and are usually financed through soft loans (*qard al-hasan*) without any interest charge or profit-sharing.

8.5 Islamic microfinance in Malaysia

With its rather developed Islamic banking system and capital markets, Malaysia has established several organisations under the aegis of government agencies to provide microfinance to small- and medium-sized enterprises using a wide range of Islamic financial products.

In addition to financial institutions, efforts have also been made to diversify sources of loans for micro-enterprises and the poor, which includes Amanah Ikhtiar Malaysia (**AIM**) and Islamic pawn-broking (*Ar Rahnu*). AIM was established in 1987 with the objective of helping hardcore poor households. Islamic microfinance schemes employed by AIM are akin to the Grameen Bank Model, except that loans are provided without interest. Nonetheless, borrowers are required to pay service charges, usually charged below prevailing market rates. It was reported that since its inception, AIM has disbursed more than RM2.3 billion[8] in loans to its clients.

The inclusion of *Shari'a* regulation in the banking system in 1983 has led to the establishment of *Ar Rahnu* in 1993. *Ar Rahnu* offers short term interest-free loans that require collateral which is valued at current prevailing prices. During the lending period, the lender will charge a fee for safekeeping the collateral. At the end of the period, financing must be repaid and the collateral reclaimed. In the event that the loan is not repaid within the agreed duration (unless extensions are granted), the lender reserves the right to seize and auction the collateral to recover its financing costs with any remaining balance returned to the borrower.

[8] RM means Malaysian Ringgit.

9. DEFAULTING ON PERSONAL DEBT IN THE UNITED ARAB EMIRATES AND SAUDI ARABIA

9.1 UAE

Enforcement of a right in the UAE must be by way of court proceedings. Therefore, a creditor must apply to the court to seek a judgement to enforce its rights against the debtor. The creditor must obtain a final judgement for its debt against the debtor. Once a judgement has become final and non-appealable, a judgement creditor may enforce the judgement by placing the judgement with the Execution Department at the court. The debtor is then notified that execution has been commenced and is requested to pay the debt within 15 days.

If the debtor does not fulfil his/her due debts within the above mentioned period, the execution judge may order the seizure of assets which are owned by the debtor and then order the sale of the seized assets to pay off the debtor's obligations.

If the executed debt is over AED1,000[9], or is a financial fine or alimony, the execution judge also has the power to order the imprisonment of the debtor upon a request from the creditor, if the debtor has refrained from making payment and is proved as capable of paying the debt. Imprisonment of the debtor does not extinguish the right of the creditor to the repayment of the debt.

However, an order to imprison the debtor will not be issued in the following cases:

- if the debtor is under the age of 18 or over the age of 70;
- if the debtor has a child under the age of 15 and his/her spouse is dead or imprisoned;
- if the debtor can provide a bank guarantee or a guarantor capable and acceptable to the judge, to repay the debt at set times and disclose his/her funds that could be subject to execution and sufficient to repay the debt;
- if the debtor is pregnant, the imprisonment can be deferred to a year after giving birth;
- if the debtor is suffering from a medically proven permanent disease and cannot endure imprisonment, and if suffering from a temporary illness, the imprisonment can be deferred until after recovery; and
- the debt is less than AED1,000 unless the sum was a financial fine or decided alimony.

The term for imprisonment cannot exceed a month, however, it can be renewed 90 days after release if the debtor continues to fail to repay the debt.

In addition, where the creditor, even prior to raising a case of merits, has serious reasons to fear that the debtor will escape, and the debt is more than AED10,000 (or alimony), the creditor can require the judge to issue an order to prevent the debtor from travelling in the following cases:

- if the debt is known, due and not tied to conditions; or
- if the debt is an undecided amount, the judge will temporarily evaluate it if the request is supported by written evidence and the creditor provides bail that guarantees the debtor reimbursement for all damages suffered as a result of being prevented from travelling if it transpires that the creditor's allegation was false.

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[9] AED means United Arab Emirates Dirham.

9.2 Saudi Arabia

In Saudi Arabia there is no regulation or decree regulating the enforcement of personal debts. However, our understanding is that as a matter of practice enforcement is by way of court order, decision of the SAMA Committee or, where a promissory note has been issued evidencing the debt, judgement of the Negotiable Instruments Committee of the Saudi Arabian Monetary Agency. Following the grant of a court order requiring payment of the debt, the creditor may take the court order to the police station in the locality of the debtor for enforcement. The police have wide discretion in relation to enforcement of orders including imprisonment of debtors.

10. CONTRIBUTORS

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