Benchmark on Underlying Asset Value for Islamic Banking Product: A Practitioner's Perspective

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ABSTRACT

In current Islamic banking products particularly in financing facility, the purpose of financing could be for asset acquisition or to obtain cash. In addition, financing may be given on secured or clean basis. For financing with secured asset, normally the value of security asset will match the financing amount whereas for unsecured facility, the underlying asset is merely to facilitate the transaction in which the value may not match the financing amount. In other words, the contracting parties may enter into transaction using an asset in which the price may be higher or lower than the actual market value. Such arrangement may lead to the issue on the permissibility to transact asset at different price than the actual cost or market value. This paper discusses on the Shariah and operational concerns in relation to possible benchmark on underlying asset value for Islamic banking transaction. This article is based on qualitative research approach which is purely based on primary data gathered through library research and observation from practitioner perspective. The outcome from the literature review can be applied as the possible asset value benchmark.

Key Words: Benchmark, Underlying Asset Value, Islamic Banking product, Shariah

Introduction

Islamic banking products apply various Shariah contracts as its underlying structure to generate cash for customer and at the same time will create debt obligation on customer to pay to the bank. In concluding such transaction, the bank and customer may need to ascertain specific asset as the underlying asset for transaction.

In current Islamic banking products category particularly in financing facility, the purpose of financing could be for asset acquisition or to obtain cash. In addition, financing may be given on secured or clean basis. For financing with secured asset, normally the value of the asset will match the financing amount whereas for unsecured facility, the underlying asset is merely to facilitate the transaction in which the value may not match the financing amount. In other words, the contracting parties may enter into transaction using an asset in which the price may be higher or lower than the actual market value.

Such arrangement may lead to issue regarding the permissibility to transact asset at different price than the actual market value. This research will focus on the following areas of analysis which also part of the research question in general:

1. Transacting at Higher Cost or Market Value: A Shariah perspective;
2. Literature review on possible asset value benchmark; and

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3. Operationalisation of the asset value benchmark.

Research Methodology

The research is qualitative in nature whereby review and analysis will be carried out on primary and secondary texts in classical and contemporary *Fiqh* literature in understanding the subject and its related issues. It also involves investigative examination on relevant literature including fatwas, resolutions, standards and relevant documents such as guidelines issued in Malaysia by the regulators.

Transacting at Higher Cost or Market Value: A Shariah perspective

In Islam, generally there is no limit to profit. Having said that, numerous texts indicate that Islam places considerable stress on justice in the distribution of profits; whereas it does not strictly limit the rate of profits acquired, which vary according to factors of asset, place and period. Nevertheless, there are also discussions by the classical jurists with regard to fixing the profit to avoid profit maximization by seller.

A. Opinion which Prohibits Price Fixing at either Lower or Higher Than Market Price

Al-Shawkani views that it is prohibited to fix the price because of the possible element of oppression (*Zulm*) involved to the contracting parties. Everyone has right to their own asset, and fixing prices would hinder their freedom to dispose or transact with their asset. Al-Mawardi also rules that it is not permissible to fix the prices of essential foods, either at a higher or lower price than the market price. The main reason for such prohibition is in view of the spirit in the Quran in Surah al-Nisa` verse 16 as follows:

"O you who believe, do not wrongfully consume one another's property, but trade by mutual consent."

The above verse indicates that mutual consent (*Redha*) between the parties involved is the main criterion for the validity of a business transaction. According to the Hanafites, Malikites, Shafiites and Hanbalites, the authority's intervention in determining the price of transaction may conflicts the right of mutual consent (*Redha*) between the seller and the buyer in business transaction.

The above interpretation is also supported from the following Hadith where Rasulullah (Sallahu 'Alaih Wasallam) refused to fix pricing in business transaction upon request by several companions.

"The people said, "O Messenger of Allah, fix prices for us." Thereupon Rasulullah (Sallahu 'Alaih Wasallam) *said, "Verily, Allah is the one who fixes prices. Who withholds, who gives lavishly and provides, and I hope that when I meet Allah, none of you will have any claim on me for an injustice regarding blood or property"* (Narrated by Abu Daud, no 3451)

This Hadith explains about the ruling to restrict certain price that was prohibited during the time of Rasulullah (Sallahu 'Alaih Wasallam). The jurists view this ruling from the perspective of Maqasid or objective whereby the purpose of such restriction was to ensure fairness and to prevent injustice to the retailers in gaining reasonable profit as long as it is mutually agreed by the contracting parties.

B. Opinion which Allows Price Fixing at either Lower or Higher Than Market Price

Determining the price is allowed in order to preserve the basis of justice between people and to avoid the element of injustice (*Zulm*) to public interest (*Maslahah Ammah*). In rebutting the view of majority scholars who opined that fixing price is prohibited, Ibn Taymiyyah disagreed with the majority and the reasoning given. He explained that the Hadith: "*Allah is the price fixer, the constrictor, the loosener…*" that was used by the jurists to indicate the prohibition of pricing is inaccurate and out of context. He justified that the Hadith was related to a specific event and moreover, the statement (*lafz*) used was not made in general statement (*lafz am*).

Yusuf al-Qaradawi in commenting this view explained that it is important to understand the *hadith* from its true context and spirit (*hikmah)* on such prohibition by Rasulullah (*Sallahu `Alayhi Wasallam*) at the time. If in different period the same event happens due to the same reason, similar ruling (*hukm)* can be applied. Otherwise, the *hukm* should not apply to different circumstances.

Establishing Possible Pricing Benchmark: A Literature Review

Generally, there are no limits to pricing from Islamic view. It is clear that it is allowed to transact an asset at a higher price without any limitation based on the parties' mutual agreement and willingness to enter into such transaction. This is also in accordance with the Hadith by Rasulullah (*Sallahu `Alayhi Wasallam*) and Islamic Legal Maxim which state as follows:

"Every transaction i.e buying/selling is based on mutual agreement" (Sunan Ibnu Majah, no. 2185)

This Hadith refers to the mutual agreement between both parties. The purchaser may purchase the asset above the actual market value with mutual consent by the parties. All transactions, in order to be valid and enforceable, must be based on free mutual consent of the contracting parties.

In addition, Yusuf al-Qaradawi mentioned that there is no evidence from the Qur'an or the Sunnah that limits pricing to one-third, one-fourth, or any other proportion. However, in the normal circumstances, from ethical and moral perspectives, the majority of the scholars are of the view that excessive pricing is not encouraged as it will cause the loss of Allah's blessings.

Numerous texts indicate that Islam places considerable stress on fairness in the distribution of profits; whereas it does not strictly limit the rate of pricing which vary according to factors of the underlying asset, place and period. There is evidence from the Sunnah that Rasulullah (*Sallahu `Alayhi Wasallam*) allowed profits of up to 100 percent, and some of the Companions earned more than 100 percent. It was reported in a Hadith as follows:

*"Verily, the Prophet (*peace be upon him*) gave 'Urwah a dinar to buy a goat, then (the wisdom) to buy two goats, and sold an amount of one dinar, and he came to meet him to bring a dinar and a goat, then he continued to pray in sales , that if he bought the land even sure it will make profit "* (Sahih al-Bukhari, no. 632)

The above hadith shows that how a *Sahabah* bought two goats with the price of one dinar, which means half a dinar, and then sell 100% of the offering price of 1 dinar as profit. This transaction was approved by the Rasulullah (*Sallahu `Alayhi Wasallam*). In another Hadith, it was reported that Zubayr ibn Awwam, one of the Prophet Muhammad's companions, bought a piece of land from a wealthy person in Madinah for 170,000 dinars; his son later sold it for 1,600,000 dinars; nine times more than the original price. Azmi Omar, et al in explaining this transaction provides an analogy of which if one dinar weighs 4.25 grams, and one gram of gold is equal to RM120 (estimated current value), then one dinar is equivalent to RM510. The estimated purchase cost of the land at today's value would be RM86.7 million, while the sale price was the equivalent of RM816 million (9.41 times the cost price).

However, Zaharuddin Rahman in his analysis mentioned that this Hadith is *Mawquf*. Although the Hadith is *Mawquf,* but the land was sold to other companions of Rasullulah (*Sallahu `Alaihi Wassallam*) such as Mu'awiyah, Abdullah bin Jaffar other companions who still live at that time in which the transaction was made during the period of Sayyidina Ali k.w. The scholars said that the agreement and acceptance by the companions during that time had made it Ijma` among the Sahabah (companions) which can be used as justification on its permissibility.

Some contemporary scholars, like Wahbah al-Zuhayli mentioned that the pricing which generate profit should not exceed one-third, based on the hadith,"*Al-thuluth kathir*", which means "One-third is a lot," a comment made by Rasullulah (*Sallahu `Alaihi Wassallam*) when Sa`d ibn Abi Waqqas wanted to make a bequest (*Wasiyyah).* This statement can be supported by the legacy of Sa`ad Ibn Abi Waqas who wanted to leave his assets as alms as in the following hadith:

"One day, Rasulullah (Sallahu 'Alaih Wasallam) visited Sa`ad bin Abi Waqas who was ill. Sa`ad expressed to Rasulullah (Sallahu 'Alaih Wasallam) his feelings that his illness was entering the last phase and that death was near. He asked for Rasulullah's (Sallahu 'Alaih Wasallam) opinion on giving his assets away as alms for he had only one daughter to inherit his wealth. Therefore, he wished to give as alms 2/3 of his property. However, Rasulullah (Sallahu 'Alaih Wasallam) stated his objections. Then Sa`ad asked whether he could give away 1/2 of his property. Rasulullah (Sallahu 'Alaih Wasallam) still said no. Rasulullah (Sallahu 'Alaih Wasallam) then said: 1/3 (of Sa`ad's property to give away as alms) is enough, that too is still too much. Verily, to leave your heir wealthy is far better than to leave you heir impoverished and dependant on other people's charity" (Hadith narrated by Bukhari and Muslim)

Based on the Hadith regarding Wasiyyah, 1/3 or 33.33% "is enough" and can be used as a guideline for the basis of formulating the pricing benchmark. The question is whether this benchmark is suitable to be used because it relates to the bequest of property and giving of alms. Even so, it cannot be denied that it can be used as a benchmark to set the upper limit of a mixture because an amount exceeding the percentage set will be considered excessive.

The best example of its application can be seen from the following view from Malikites as extracted from Al-Mausu`ah al- Fiqhiyyah. The one-third benchmark is used to determine the defection of certain items. If the defect is less than one-third, the item is not considered as a defect item.

"Malikites said that a defect of subject matter in sale has three kinds: one: Fruit - al-Tin, dates, grapes, walnuts, almonds and apples; the defect amounts is above one-third. If the defect is less than one-third, no effect on the buyer on the matter (sale). If it reaches one- third, the subject matter is regarded as defect. The one-third is used because it can differentiate between large and small amount, as stated in the Hadith of Rasulullah on Wasiyyah that: «one-third and one-third is already too much"

Furthermore, another aspect that needs to be elaborated is whether transaction above the norm market pricing would contain the element of *Ghabn (deception). Ghabn* means inequality in the value of two items exchanged in an exchange contract. In this case, the element which needs to be avoided is *Ghabn al-Fahisy* (exorbitant deception) which is the difference in value falls outside the range of what people are accustomed to, or what exceeds the experts' valuation of a particular asset or commodity. In determining *Ghabn al-Fahisy*, the Islamic scholars have provided two different views. According to Malikites, they were of the view that any excess beyond 1/3 of the cost price is considered as *Ghabn al-Fahisy*. According to *Majallah al-Ahkam al-`Adliyyah* (article no 165) which is based on the views of Hanafites, prescribes the financial ratio of *Ghabn al-Fahisy* as follows:

i. Commercial: 5% from the prevalent price.
ii. Animal: 10% from the prevalent price.
iii. Real estate: 20% from the prevalent price.

On the other hand, Hanbalites are more flexible in determining the standard for *Ghabn al-Fahisy* where it will depend on the *`Urf* (custom). The Shafiites regard *Ghabn al-Fahisy* as situations where it cannot be accepted by market practice/custom *(`Urf*). From the above explanation, Shamsiah Mohamad in her analysis is more inclined to accept view from Hanbalites since it is more flexible and practical to be used in current situation. Moreover, there is no explicit *Nas* from al-Quran or Hadith which states the standard of *Ghabn al-Fahisy*. Therefore, anything which is not stated by *Nas*, it must be referred to the application of *`Urf* or custom.

Nevertheless, in deciding the `Urf of particular transaction, it must always adhere to requirements that have to be fulfilled for `Urf to become valid. The most important aspect is that it must not contravene to Shariah requirements and also clear stipulation made in the agreement. The `Urf must represent common and recurrent phenomena. For custom to be authoritative, it must also be dominant, in the sense that it is observed in all or most of the cases to which it can apply. If it is observed in some cases but not in others, it is not authoritative.

From the discussion with regard to *Ghabn al-Fahish*, Shamsiah Mohamad views that there is very clear distinction between *Ghabn* and also Ribn (profit). The latter refers to any increment in the form of profit to the capital cost due to an agreed transaction and not related to *Taghrir* (cheating). If *Ghabn al-Fahisy* is due to *Taghrir* (cheating), the losing-party may decide to terminate (*fasakh*) the contract.

From Shariah point of view, there are no limits to profits as long as the profit is charged not due to cheating and the contract is concluded based on mutual agreement. This is because, *Ghabn al-Fahisy* without element of *Taghir* should not be subject to *Fasakh* since the party that incur loss does not mindful enough, ignorance and neglect to understand the current market price. By right, the party should enquire the relevant parties before entering into contract.

Besides analysing the literature reviews of scholars and primary sources, the author also refer to the Shariah resolutions resolved by the regular of Malaysia in relation to Islamic banking and finance namely the BNM and Securities Commission. From the review conducted, as to date, BNM has not issued a specific pricing benchmark to determine the allowable maximum profit or value for Islamic transaction when dealing with particular asset as underlying asset of transaction. However, it is worthnoting that the author managed to analyse the resolutions made by Shariah Advisory Council (SAC) of BNM in which there are several resolutions that can be used as reference. Nonetheless, the resolution is merely on one Shariah concept namely *Bai` al-`Inah* (sale and buy-back) in which may not be applicable to other Shariah contracts.

In the early Shariah resolution of SAC of BNM with regard to *Bai` al-`Inah*, it was resolved that in concluding *Bai` al-`Inah* transaction, the price and asset for transaction must be actual and according to reasonable price or based on market value. The extract of the resolution no 23 (refer item vi) as follows:

> Antara ciri-ciri yang perlu ada dalam satu urusniaga *Bai' Al-Inah* adalah seperti berikut:-
>
> (i) Pembiayaan *Bai' Al-Inah* perlu mempunyai dua kontrak yang jelas, iaitu kontrak penjualan harta oleh penjual/pemilik kepada pembeli dan kontrak penjualan semula harta tersebut kepada pemilik asal.
>
> (ii) Pembayaran harga dalam salah satu urus niaga atau kontrak mestilah dilakukan secara tunai bagi mengelakkan penjualan/pembelian hutang dengan hutang.
>
> (iii) Barangan yang digunakan dalam urusniaga jual dan beli balik bukan barangan ribawi;
>
> (iv) Kedua-dua urusniaga ini mestilah melibatkan penyerahan hakmilik yang sah dari sudut *syara'* dan diterimapakai berdasarkan adat perniagaan semasa *('uruf tijari)*.
>
> (v) Pembiayaan *Bai' Al-Inah* yang dijalankan ini mestilah memenuhi syarat-syarat *Bai' Al-Inah* yang diterima oleh Mazhab Syafie.
>
> (vi) Penentuan harga dan harta yang terlibat dalam kontrak juga mestilah dengan sebenar dan berdasarkan harga yang munasabah atau berdasarkan pasaran.
>
> (vii) Kontrak pertama mestilah diselesaikan terlebih dahulu (ditandatangani oleh kedua-dua belah pihak) sebelum memasuki kontrak yang kedua. Ini bertujuan mengelakkan isu penjualan harta yang belum dimiliki dalam kontrak kedua.

From the above resolution, the SAC of BNM has made it clear that in entering into *Bai` al-`Inah* transaction, the price and asset must be reasonable in accordance to the market value. Nonetheless, from the author observation, subsequent SAC of BNM resolution with regard to the same subject matter has delisted several requirements including the condition on price and asset value. The extract of resolution no 72 can be referred as below:

MPS pada mesyuarat ke-16 bertarikh 11 November 2000 dan mesyuarat ke-82 bertarikh 17 Februari 2009 telah memutuskan bahawa akad *bai` `inah* hendaklah menepati syarat-syarat sah seperti yang berikut:

i. Mempunyai dua akad jual beli yang jelas dan berasingan iaitu akad pembelian dan akad penjualan;

ii. Tidak terdapat syarat pembelian semula aset dalam akad;

iii. Masa bagi pemeteraian setiap akad adalah berbeza;

iv. Turutan pemeteraian setiap akad adalah betul iaitu akad jual beli pertama hendaklah disempurnakan terlebih dahulu sebelum akad jual beli yang kedua dimeterai; dan

v. Berlaku pemindahan hak milik aset serta wujud penguasaan ke atas aset (*qabd*) yang sah berdasarkan Syarak dan amalan perniagaan semasa (*`urf tijari*).

Further analysis has concluded that the latest resolution shall supersede the previous resolution in which the condition to ensure reasonableness of *Bai` al-`Inah* transaction price and also the asset according to market value is no longer required. This can be evidenced from the statement in the preamble section of the latest SAC resolution (2nd edition) as follow:

"…This edition supersedes the Shariah Resolutions in Islamic Finance (First Edition) which was published in 2007 and the Summary of National Shariah Advisory Council Decisions for Islamic Banking and Takaful (Summary of SAC Decisions) which was released in 2002. Accordingly, all new Islamic financial products that will be offered by Islamic financial institutions or any existing products to be offered to new customers must comply with the rulings of this Shariah Resolutions in Islamic Finance (Second Edition)…"

As for Securities Commission (SC), the SAC of SC has made resolution particularly in relation to Islamic Capital Market instrument such as Sukuk which involved underlying asset as subject matter of transaction. The SAC of SC has resolved on the requirement of Asset pricing which applicable to all Sukuk which to be structured in Malaysia. It is stated under section 26.10 and 26.11 of Guidelines on Islamic Capital Market Products and Services (Revised: 8 February 2024) that:

Asset pricing requirements

26.10 The purchase price of an identified asset under sukuk issuance structured based on any Shariah principles must not exceed 1.51 times of—
(a) the fair value of the asset; or
(b) any other appropriate value of such asset.

26.11 The asset pricing requirements under paragraph 26.10 are not applicable to sukuk which are structured based on any Shariah principles that do not involve the sale and purchase of identified assets including but not limited to sukuk ijarah that involves the lease and lease-back of the identified assets.

From the above requirement, for Sukuk structure which involves sale and purchase transaction such as *Bai` Bithaman Ajil, Murabahah, Istisna`* and *Ijarah Muntahiah Bi Tamlik*, the purchase price must not exceed 1.51 times the market value of the asset or if it cannot be ascertained, a fair value or any other acceptable value should be applied. Notwithstanding, the author observed that the requirement does not provide proper Shariah justification or *Takyif Fiqhi* on the basis of the benchmark of 1.51 times.

On separate matter, it is also important to highlight that the requirement of asset pricing has exempted transaction under Sukuk Ijarah which does not involve sale and purchase of asset. It means that, if the Sukuk only involve merely Ijarah transaction, the asset pricing requirement is not applicable in determining the rental structure.

Operationalisation of the Asset Value Benchmark

From Islamic banking product perspective, in deciding the asset value benchmark, it is also important to understand the nature and operation of product structure. For Islamic banking product, they are structured according to application of diverse Shariah contract categories namely fee-based, sale-based, lease-based or equity-based contracts. For that reason, the pricing benchmark should also take into account the nature of each of Shariah contracts since the pricing benchmark may not be relevant for certain type of Shariah contracts.

In other words, the pricing benchmark should be operationally feasible and should not just be a benchmark applicable to all products regardless of Shariah contracts. In addition, the benchmark must also be clearly defined its applicability to avoid confusion to practitioner. This is because there are two scenarios in banking product of which the benchmark can be practiced. The first scenario is in terms of determining the maximum profit where the bank may charge customer. This is where the bank will incorporate the profit margin chargeable on customer.

The second scenario is related to the underlying asset for transaction in deriving the financing amount. For Shariah contracts that use particular asset as the underlying asset for transaction such as Ijarah Muntahiyah bi al-Tamlik (lease with transfer of ownership) or lease and lease-back arrangement, the benchmark can be applied as reference to assess the reasonable value of asset that can be used for transaction. This is due to the fact that in certain circumstances, the financing amount may not reasonably match with the actual asset value. Having said that, normally customer is aware of such arrangement although it may open for severe risk. However, as the Islamic banking structure is merely to facilitate financing arrangement, customer would only concern about the financing amount and also the profit rate chargeable to them.

From the author's observation and experience, the benchmark is only suitable to be applied to the second scenario. The first scenario should not be subject to this benchmark because it is impractical in the sense that in determining profit chargeable on customer, the bank has its own prerogative but always subject to the regulatory requirement at all time. Furthermore, each bank may have their own way to decide the profit rate so as to be competitive in the market. It is also noted that all banks are subject to several BNM's policy with regard to charging profit to customer such as the Reference Rate Framework Policy, Responsible Finance Policy, Imposition of Fees and Charges Policy and so forth.

From the perspective of time value of money, it refers to the difference in value of money received in cash vis-à-vis the value of money received on deferred basis in future. In the context of Islamic banking product, normally the transaction incorporated with profit margin is payable on deferred. For that reason, this transaction has higher price since it is calculated after taking into account the time

value of money. There were also discussions by jurists such as al-Kasani and al-Sarakhsi that allow higher deferred price as compared to spot price, indicating that time factor may be taken into consideration in determining the selling price.

Notwithstanding, the second scenario on benchmark for asset value transaction may also lead to several operational matters which require further deliberation. Particularly, the areas that need to be taken into consideration in implementing the benchmark are as follows:

1. In assessing the value of underlying asset, there must be reliable valuer in which the bank can use as reference before deciding particular asset as reasonable for transaction. This may also lead to another issue relating to extra cost and also the competency and capability of the party to value the underlying asset. Furthermore, this may extend the process and also create another operational requirement which the bank needs to perform before entering into transaction with customer. In addition, certain underlying asset such as brand, pattern and right or intellectual property may require professional valuer in that subject expert in valuing such asset.
2. If the practice is to use audited account or management report, as far as accounting is concerned, asset under financial reporting is subject to yearly depreciation in which the actual value may not be similar to the real market value. In short, net book value is not necessarily the same as market value.

Conclusion and Proposed Benchmark

From the foregoing deliberations in all sections of this paper, it can be summarized as follows:

1. The issue of benchmark on underlying asset value is mainly centered on the discussion regarding *Ghabn al-Fahish*. In this regard, the Shafiites and Hanbalites have considered *`Urf* as the basis to determine the standard for Ghabn al-Fahish. Hanbalites is more flexible in determining the standard for *Ghabn al-Fahish* where it will depend on the *`Urf*. The Shafiites regard *Ghabn al-Fahish* as situations where it cannot be accepted by market practice/custom *(`Urf*). This approach is more flexible as opposed to approach with specific benchmark for Ghabn Fahish such as Malikites (benchmark of 1/3) and Hanafites (benchmark according to category of item).
2. In the context of Islamic banking product, it must not lead to *Ghabn al-Fahish* of which the transactional value is unacceptable by *`Urf*. Selling an asset valued way below the market price would be unacceptable by `Uruf. For instance, selling an item valued RM100 for excessive price of RM1 million is considered something illogic and beyond reasonable price from the view of a normal person and custom. This is consistent with Shafiites view. Hence, to avoid Ghabn al-Fahish, the benchmark of 9 times to determine the reasonable and acceptable pricing may be applied as compared to other possible benchmark like 33.3% (Hadith on wasiyyah).

3. For transaction where profit margin is embedded, since the transaction involves bank's profit element, the determining factor of the transaction price would be the industry/market practice (*'Urf Tijāri*). This is in line with Hanbalites view. Therefore, the bank can decide the reasonable pricing for this transaction by comparing with other banks' profit rate in order to remain competitive. Since this transaction will be in accordance with the `Urf, the rate will not excessively beyond the rate that normally offered by other banks. For instance, if the profit rates offered by banks are within 4%-6%, it would be unusual and not competitive for the bank to offer rate higher than the market rate.
4. It is worthnoting that Islamic banking transaction is not merely focused on conclusion of `Aqd (contract) without taking into consideration other aspect which may tarnish and deem the transaction as mockery. As Islam upholds the spirit of justice and equality at all time, the application of proper benchmark for underlying asset value for Islamic banking product would ensure the sustainability of regulatory policy, economic resilience and safeguard the public interest.

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