

Sharia Compliance of Sharia Asset-Backed Securities

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Abstract: To support the economic growth rate in Indonesia, the role of sharia financial institution is needed, one of which is Sharia Capital Market which has various products such as EBA or Asset-Backed Securities. Asset Backed Securities (EBA) is a form of sharia securitization that is present to address; Funding issues and sharia banking capital as a source of real sector financing. Securitization is essentially a well-known financial practice for collecting types of contractual debt such as housing loans, commercial loans, vehicle loans or credit card debt obligations, and incorporating those debts to bonds, through securities, or secured credit obligations Then sold to various investors, therefore it takes the principle of prudence in implementing it. The securitization of sharia assets is still relatively new developed in Indonesia. Therefore, in order to avoid doubts and irregularities that are not in accordance with the principles of sharia, it needs a strong legal foundation. The approach used in this research is analytical descriptive. The results conclude that there are several mechanisms in the process of securitization issuance that is contrary to Shariah compliance.

1 INTRODUCTION

Indonesia is one of the countries with the majority of the Muslim population, so Indonesia has a high potential for the development of Syariah Finance Industry. In addition, the global financial market trend is towards disintermediation. In other words, the role of the capital market is more dominant than the role of the banking system (financial intermediaries) in the allocation of financial resources. Therefore, the capital market will be the future for the economy and financial system for developed countries and countries that fall into the category of emerging markets such as Indonesia.

One of the capital market products is asset-backed securities. Currently, underwriting or securitization is financing methods are widely used in the business field. Basically, underwriting is a process whereby companies collect their hard-to-cash assets and issue billing rights to the pool of assets. When such assets are pledged, they can be traded in financial markets. Simply put, guarantees are a process whereby legal entities transform their tangible assets into financial assets.

The Financial Services Authority as the financial regulator, issues POJK No. 20 / POJK.04 / 2015 on Issuance and Requirements of Islamic Sharia EBA as of 10 November 2015 (Otoritas Jasa Keuangan

Republik Indonesia, 2015). This POJK is a refinement of Sharia capital market regulations to encourage the development of sharia capital market industry in Indonesia (Otoritas Jasa Keuangan, 2017). Asset Backed Securities (EBA) sharia is a form of shariah securitization that is present to address funding problems and capital of sharia banking as a source of real sector financing. The function of securitization through Asset-Based Securities is an effort to liquidate non-liquid assets, with the aforementioned efforts by the capital market to provide funding by disseminating securities for the ownership of certain assets.

The securitization of sharia assets is still relatively new developed in Indonesia. Therefore, in order to avoid doubts and irregularities that are not in accordance with the principles of sharia, it needs a strong legal basis.

According to (Cumming & Trainar, 2009), stated that “*Securitization is the open market selling of financial instrument backed by asset cash flow or asset value.*” According to (Ifham, 2017), it is different from conventional securitization. In the shariah securitization transaction scheme, the party conducting the securitization does not purchase receivables. Against transactions of transactions that are still receivable, there is no difference of opinion of scholars if the transaction uses akw hiwalah.

However, for transactions that are in the nature of trading receivables (*bay al-dayn*) there are differences of opinion among scholars.

This study will be focused to examines the sharia compliance of the capital market securitization of Asset-Based Securities (ABS) through policies, regulations and practices in the sharia capital market.

2 LITERATURE REVIEW

2.1 Sharia Investment

In the Islamic economic system, investment is a muamalah activity that is highly recommended, because by investing property owned to be productive and also bring benefits to others. The Qur'an explicitly prohibits the hoarding activity (*ikhhtinaz*) on the possessed property. Islam has an economic system organized in order to realize the welfare of human life both in meters and non-material. Sharia investment is an investment based on sharia principles, both in the real sector and in the financial sector. So that investment can not be separated from the principles of sharia.

In the Qur'an there are verses that indirectly instruct the Muslims to prepare for tomorrow better. Thus, the authors state that the concept of investment can not be separated from the Islamic Shari'a, where in the Qur'an surah an-nisa which means:

“And let those (executors and guardians) fear in justice as (if they (themselves) had left weak offspring behind and feared for them. So let them fear Allah and speak words of appropriate justice”.

The above verse commands us to do not leave *dhurriat dhi 'afa* (weak breeds), both morally and materially. As if to provide suggestions for always pay attention to well-being (in this case economically) and leave no economic difficulties, it seems that the Qur'an has long invited his people to always pay attention to the welfare that one way is to invest.

2.2 Sharia Compliance

Islamic law comes from the Qur'an and Sunnah, the principles of shari'a are all provisions that are based on the source of the law. To apply the principles contained in the shari'a, the technical rules are the same as in making legislation in general. The rule derives from the principles of shari'a made by the giver or lawmaker who specifically where the legal system of finance originates.

Sharia principles are the main reference for the National Sharia Council (DSN) in drafting fatwas related to shariah-based financial activities aimed at the Islamic finance industry. Not only that, the existence of sharia principles is used to accommodate the Sharia Supervisory Board in oversight to the sharia finance industry whether bank or non-bank. As every Islamic finance industry, both banks and non-banks are required to have a supervisory board, which automatically both the Islamic banking industry and non-bank finance are bound by the provisions of sharia rules as stipulated, this is called the compliance of sharia (Nurhisam, 2016)

2.3 Asset – Backed Securities

In finance literature, Asset-Backed Securitisation (ABS) is defined as a creative way of raising funds through the issuance of marketable securities backed by future cash flows from revenue-producing assets. As such, securitisation is the transformation of an illiquid asset into a security that is issued and more importantly it can be traded in a capital market. The term asset-backed security (ABS) is generally applied to issues backed by non-mortgage assets (Siew, S.M, 2004).

The asset securitization techniques even though it complex, has won a secured place in corporate financing and investment portfolios because it can, paradoxically, offer originators a cheaper source of funding and investors a superior return (Giddy I., 2000). These asset securitisation techniques are being embraced by a number of Asian countries seeking to promote home ownership, to finance infrastructure growth, and to develop their domestic markets, including Malaysia (Keng T. Y. and Ting K. H, 2004).

3 METHODOLOGY

This paper uses library/literatures based research methodology in order to explore sharia compliance of sharia asset-backed securities. Library/literatures based research methodology is a kind of qualitative research approach.

Qualitative research method is a method to investigate objects that can not be measured with numbers or other sizes that are exact. Qualitative research can also be interpreted as research that is descriptive and tend to use analysis with inductive approach.

4 RESULT AND DISCUSSION

Islamic guarantee, like any other agreement which includes all its activities, must be in accordance with the teachings of the Qur'an and Sunnah. It further includes all the words and deeds of the Companions, as well as the sayings and deeds of prominent people in the history of Islam who teach about them also should be referenced (Billah, 2010).

By exploration of literatures, it is found that asset backed structure is more compliant to shariah principles than another asset based i.e sukuk. This is due to the asset backed nature of Islamic financing and some shariah issues in the asset based structure (Abdullah, 2012).

According to a statement from (Cumming & Trainar, 2009), stated that “*Securitization is the open market selling of financial instrument backed by asset cash flow or asset value.*”

It is clear that the investor is a buyer of Asset Backed Securities as stipulated in the terms of the sale and purchase of Civil Code. The construction of this law is certainly different if it is related to the background of the engagement between the original debtor and the initial creditor. The agreement underlying the engagement between them must be based on an obligation or that we are familiar with the lending and borrowing agreement as stipulated in Article 1765 Civil Code. From the aspect of KIK-EBA's engagement, it turns out that it has been based on three types of engagement, namely trading agreement, exchange and lending and borrowing.

From the description of the practice of securitization of sharia assets abroad in the Middle East, Asia, Europe and North America can be identified some of the characteristics attached to the issuance of Islamic Sharia EBA abroad, namely the transfer of assets from the originator to SPV, assets transferred in the form of real assets and bills, the need for ratings for EBAs being issued, and the transfer of such assets in the form of true sale and sale with recourse. Some of these characteristics may not be applicable in a country whose understanding of fiqh muamalah is different from other countries. Therefore, to see if Islamic Sharia EBA can be adopted in Indonesia, it is necessary to understand the existing infrastructure in Indonesia, especially the regulation both conventional and syariah that regulates the EBA.

4.1 Sharia Compliance

As already mentioned, assets are pledged to the company to obtain financing through the issuance of a debt certificate. Thus when we discuss asset guarantees according to Islam, the two problems that arise are on the one hand related to the assurance process of the asset (the problems of *Bay Al Inah*) and related to debt guarantees (*Bay al-Dayn*).

4.2 Bay' al-'Inah

Assurance of the asset is done by *Bai al-Inah*, the investor sells the assets of the company and then sells the assets back to the same company with the price already raised to the investor will be executed on the next date. For example, a company has assets worth 1 billion which are then pledged to obtain financing. Assets will be sold to investors at a price of 1 Billion. Then the investors will sell the assets back to the company at a price of 1.5 billion (this is at a high price exceeding billion). This concept is used when the assets are pledged using murabahah agreement and *Al bai Baithaman Ajil*.

Bay al-Inah is not allowed in Islamic principles because of the difference between the original price sold by the firm to the investors and the price that the firm will sell to the investors and the price reissued by the investors to the firm brings usury and legalizes something which is not legal. According to the shari'ah college, such transactions are legitimate with external evidence that they are duly bound; things that are not in accordance with the law are considered important at least have been mentioned in the contract.

4.3 Bay'al-Dayn

When the company issues a guarantee or certificate to the investor, as a proof of a debt, sometimes this guarantee is traded in the secondary market, ie the investor sells the certificate to a third party. Since the certificate indicates a company's debt to investors, the trade of these certificates is called *Bay al-Dayn*.

Shari'a, in Indonesia, the sale and purchase of debts (*bay al dayn*) is not permitted. Therefore, in the scheme of establishment and issuance of syariah asset-backed securities must be made in such a way that there is no sale and purchase of receivables from the initial creditor to the party conducting the securitization.

According to Ibn Taymiyah and Ibnul Qayyim allow the transaction on condition there is no *riba* (at par). While jumhur ulama prohibit such transactions

because there is an element of risk the debtor can not pay (*gharar*). Shari'a, in Indonesia, the sale and purchase of debts (*bay al dayn*) is not permitted. Therefore, in the scheme of establishment and issuance of syariah asset-backed securities must be made in such a way that there is no sale and purchase of receivables from the initial creditor to the party conducting the securitization.

The Hanafi, Hanbali and Maliki schools agree that the debt should not be sold to non-debtors or all third parties because the sale of debt involves *gharar* elements and the sale of something the seller does not own.

5 CONCLUSION

The process of asset syariah securitization in general is not different from conventional asset securitization process. However, not all types of assets that are securitized conventionally can be securitized by sharia. This is because in the sharia transaction is forbidden the transfer of assets, payments, which contains elements of usury, gambling and *gharar*. In addition, not all types of assets can be traded.

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