Necessary Legal Reforms to Create Legal Basis for Effective Islamic Asset Securitization (*Ṣukūk*) in Indonesia

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The paper will start with the argument that Asset Securitization (ṣukūk) can be the main vehicle for the development of modern Islamic financial system. The effective Islamic ṣukūk will serve as a powerful tool to mobilize funds from the market which will certainly strengthen the operation of Islamic financial institution. However, creation of effective Islamic ṣukūk necessitates sufficient and sound legal system which is unfortunately the missing part of the endeavour. Indonesia has a sufficient legal stepping stone for the development of Islamic ṣukūk. However, due to its complex nature, some reforms need to be introduced to Indonesian legal system. In this context, the reforms will be proposed in the light of Indonesian legal system and the principles of Sharīʿah. The Paper will review existing laws and regulations related to Islamic banking and asset securitization; recent developments in Indonesian Islamic financial sector and existing practices of international Islamic ṣukūk.

1. Introduction

This paper aims to put an argument for the introduction of some legal reforms which can create a legal environment which is conducive to the issuance of Islamic asset securitization. The paper will elaborate on the reason why the asset securitization is the most appropriate financing for resource mobilization for Islamic institutions and why the existing legal regime in Indonesia is not fully equipped and needs some reforms to be introduced.

At the moment, the mobilization of resources in Indonesia is done through Islamic Bond, the terminology which is used in the lack of a better term. However, even though the Indonesian Islamic Bond has been sanctioned by the National Sharīʿah Board and is not regarded as a debt instrument, Indonesian laws have a different perspective on them.

This issue can potentially attract unnecessary debate, therefore it is prudent to approach the issue of resource mobilization through other methods. In this juncture, the assets securitization seems to be an optimal choice. Looking back at

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the successful issuance of conventional asset-backed securities between 1996-1997 in Indonesia, it is worth exploring the possibility of applying the techniques with some modifications for Islamic institutions.

2. The Importance of Asset Securitization

While mobilization of resources does not need to be conducted through securitization, it can be demonstrated that this vehicle is the most suitable one in case of developing Islamic financial instruments in conventional environments. One of the arguments for the suitability of the securitization is the clarity of the source of the stream of income.[1] The sub section below will explain the importance of asset securitization.

2.1 The Assets Securitization and Ideal Islamic Banking System

Islamic Banking is part of the broader concept of Islamic economics which aims at the introduction of value system and ethics of Islam into the economic sphere. Because of this ethical foundation, the concept of Islamic Banking for the follower of Islamic faith is more than merely a concept on how to do banking. It is the embodiment of the submission to Allah since following the Islamic precepts is a religious obligation. Based on this tenet, the Islamic Banking can be elaborated as a system of banking which provides just financing, is free from factors unlawful to Islam and offers benefits not only to the shareholder of the bank but also to the stakeholder of the bank.

Therefore, some basic characteristics can be drawn to identify an Islamic Banking. It is the element of justice which makes it prohibited for Islamic Banking to charge exorbitant profit. The distribution of profit depends on the magnitude of risk assumed, while the distribution of loss is based on the ability of one to bear such losses. Moreover, Islamic Banking is participatory in nature. An Islamic Bank is supposed to assume all normal risks of business that an entrepreneur/ a businessperson will assume. Profit or loss irrespective of its quantum should be shared between the bank and the customer. Return on the bank's investment is not normally the function of time and when the return is pre-determined, it is pre-determined in absolute terms and not affected by any delay or pre-payment.

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[1] The certainty of the source of income can be achieved through other Islamic method of financing, such as simple and straight forward *muḍārabah*. However, in the case of multiple investors and multiple investments, it is difficult to trace the source of income. While it is theoretically possible to do so through production of several books, namely one book for each category of investor, tracing the source of income for each investor can create administrative nightmare. The other example is *murābaḥah*. While the source of income in this type of financing is also certain, the use of *murābaḥah* itself has always attracted sarcastic criticism, being the mode of financing which is very similar in substance to conventional loan.

Consequently, it is sufficient to say that, in economic sense, the Islamic Banking should avoid the potential huge divergence between real assets and real liabilities which may be translated into a Profit and Loss sharing banking with some elements of morality and justice.[2] It is true that in practice the Islamic Banking consists of Profit and Loss Sharing (PLS) and Non-PLS mode of financing in assets side. However, the heavy reliance on the Non-PLS mode often attracts sarcastic criticisms that most Islamic Finance techniques used at present bear no difference in substance to the conventional finance and that the superficial distinction of the Islamic and conventional finance is mainly centred in the use of Arabic names and in the disguised trade transactions for conventional transaction which are substantially similar to those of conventional finance. Even though this notion can be refuted by the development of myriad Sharīʿah justifications for a restricted scope of application of some conventional techniques, it is sufficient to say that efforts should be directed toward the revival of the early concept of double tier *muḍārabah* in Islamic Banking in order to minimize the effects of the above-mentioned sarcastic criticisms.[3]

In this context, the Assets Securitization can play a significant role through combination with project finance. Such connection will enable and encourage the creation of true double tier *muḍārabah* which was, so far, difficult to be implemented. This mechanism can create an internal system which allow the matching of different maturities of the first tier *muḍārabah* (the deposit) with the second tier *muḍārabah* (the investment).[4]

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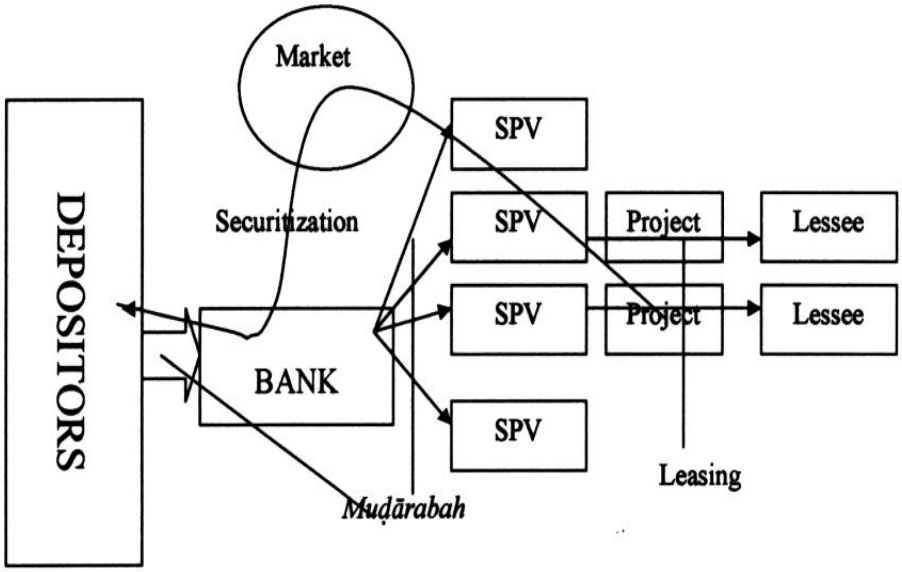
[2] Equality and Justice are the core principles of Islamic Economic System. These principles are manifested mainly in the form of prohibition of interest. However, the Islamic ban on interest does not mean that the capital is "free of charge" in an Islamic system. Islam recognizes capital as a factor of production but it does not allow this factor to make a prior or predetermined claim on the productive surplus in the form of interest. The permissible viable alternative is the profit-sharing system. The reason behind rendering profit-sharing admissible in Islam as opposed to interest is that in the case of the former it is only the profit-sharing ratio not the rate of return itself predetermined. Another rationale for Islamic finance is that wealth should be put into productive use in order that others may share in its benefits. It is therefore unjustified to charge an interest for the mere use of money. The owner of wealth should invest it in a productive and real transaction. However, profit-sharing is only one side of a coin. The other side is that losses should also be shared between the parties which can bear such losses, however, the inability to bear a loss will exonerate such obligation.

[3] It should be stressed out here that it might be unrealistic to eliminate completely the element of debt/non profit loss sharing in the Islamic banking system. However, the point that the author would like to make is that the double tier *muḍārabah* should form the dominant facet of Islamic Banking.

[4] One factor that creates difficulty in matching the deposit *muḍārabah* and the investment *muḍārabah* is the illiquid nature of the *muḍārabah* investment. By using asset securitization, the *muḍārabah* investment is in fact, becomes liquid which make the

Below is the simplified diagram of the structure of the Islamic Banking which is based on the double tier *muḍārabah* model. (It is to be noted that the diagram is a very simplified one. The structure can be very complicated can consists of some hybrid structures or some enhancements).

Figure 1:Tthe double tier muḍārabah Islamic banking structure



The structure is based on two tier *muḍārabah* model, where the Depositors will place their fund as a *muḍārabah* deposit in the bank which in turn invests the fund through *muḍārabah* in several projects. Such *muḍārabah* is structured as a non recourse project finance transaction using leasing as a main vehicle where the repayment of the financing was convened only to actual revenues generated by the project. Then, each individual project is securitized and sold back to the bank. Because all projects are converted into marketable quasi equity security, the risk of maturity mismatch between the first tier *muḍārabah* and the second tier *muḍārabah* can be avoided.

2.2 The Assets Securitization as an Alternative Method for Resource Mobilization

In the absence of Sharīʿah money and capital market, the only available option for resource mobilization is to utilize the existing conventional infrastructure as long as such an infrastructure is not against the principles of Islamic Sharīʿah. For

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redemption of the deposit *muḍārabah* much easier even in the case of the maturity mismatch between the deposit and investment *muḍārabah*.

that purpose, the capital market is the most appropriate solution to this problem. As long as the means of mobilizing the capital is Sharīʿah compatible, the structure is acceptable. The recent Indonesian experience with the issuance of Islamic bonds (in the form of *muḍārabah* or *ijārah* bonds) proved the point. However, this success is not without legal problems. While the trading of debt is not permitted by Sharīʿah. The legal status of Islamic Bonds is still a debt.

It is without doubt that the conventional instruments which are most compatible with Islamic Sharīʿah is the equity instrument. However, for any institution considering to issue a debt-like instruments, changing its issuance into equity or giving up its equity position is not always desirable as it can dilute their interest or simply too expensive. Therefore, the desired alternative is to find a quasi equity instrument which behaves like a debt however has all necessary characteristics which can qualify it as an equity. In this juncture, the viable alternative to this is an instrument which is created through securitizing the assets of such an institution or any subsidiary thereof.

3. Indonesian Present Legal Environment

Indonesia has, for quite some time, laws related to Sharīʿah Banking. Indonesian laws have adopted dual banking system through the promulgation of Law No 10 year 1998 concerning amendments to the banking law[5] which forms a legal basis for the development of Islamic Banking in Indonesia and through the law No 23 year 1999[6] concerning Bank Indonesia which paved the way for the creation of the Sharīʿah based regulatory and supervisory frameworks. The attempt to create a Sharīʿah environment was quite promising and Bank Indonesia has been very active in this regard. Soon after the promulgation of the Law No 10 year 1998 which gives Bank Indonesia the power to supervise and regulate the banking sector in Indonesia,[7] it promulgated several Bank Indonesia Regulations (Peraturan Bank Indonesia) which are intended to regulate the Islamic Banking. The regulatory regimes are quite comprehensive. They cover almost every facet of administrative aspects of Islamic Banking.

However, it is not the case for other financial institutions. Other Sharīʿah financial institutions or instruments such as asset securitization do not enjoy the same privileges as Islamic banks do. Other Sharīʿah financial institutions or

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[5] State Gazette No 182 year 1998

[6] State Gazette No 66 year 1999

[7] See Article 24-35 of Law No 23 year 1999. It is to be noted that under the previous banking regime in Indonesia, despite the fact that BI sets and administers the operative rules and regulations related to banking operations, it was the Ministry of Finance that had the ability to enforce the rules, through its authority to issue and revoke banking licenses. See Anwar Nasution, "An Evaluation of the Banking Sector Reforms in Indonesia, 1983-1993," Asia Pacific Development Journal 1 (June 1994) at 78.

instruments have to rely on laws for conventional system. Unfortunately, the law is not always very compatible with Sharīʿah.

3.1 Laws related to Assets Securitization

Despite the fact that the Asset Securitization is one of the most important mechanisms for finance, Indonesia has not passed any comprehensive law for asset securitization. There is however, an attempt by the Government of Indonesia to create such a law.[8] Unfortunately, the draft law, if not modified, will have some issues with its compatibility with Islamic principles. The provision of the draft law which may have difficulty with Sharīʿah is the one which clearly states that the securitization can only be conducted over debts.[9]

However, despite the non existence on the laws in the level of statute, the law was implemented in the level of regulations in the Capital Market field. The Indonesian capital markets are regulated by the Ministry of Finance through the Indonesian Capital Market Supervisory Agency (BAPEPAM). Under the Capital Market Law of 1995, BAPEPAM sets policy guidelines and regulations and is responsible for the day-to-day supervision of the capital markets. In essence, it has the power to interpret laws and legislation on matters within its jurisdiction, and to establish rules and issue independent decrees to that effect.

In regard to assets securitization, BAPEPAM has issued regulations No IX.K.1 on Asset Backed Securities. It governs the elements of a typical asset securitization. However, it still has some characteristic which is not favourable to the issuance of Islamic asset securitization, the explanation of which will be given in the subsequent sections.

3.2 The Legal Issue of Sale of Debts

The most important aspect of the asset securitization is that the sale of debt should be done as a “true sale” transaction to achieve the bankruptcy remoteness of the transferred assets.[10] The requirement of the Indonesian law is quite simple, namely that the transfer should be made through *cessie* and the only requirement is notification to the debtors.[11] While it seems simple, some non legal issues will arise. The originator most of the time is hesitant to inform the debtor for various reasons. However, while the requirement of notice may create difficulties, there is more pressing issue in relation to the rights attached to assets transferred. While Indonesian law has pronounced that all rights associated with the debts are

[8] At present, Draft Law concerning Asset Securitization is being considered in the concerned ministries of the Republic of Indonesia.

[9] See Article 3 of the Draft Law on Assets Securitization. This will create difficulties for Islamic Financial Institution as Sharīʿah prohibits selling debts at discount

[10] It is possible to have asset securitization without sale of assets which is known as synthetic securitization. However, it is beyond the scope of this paper.

[11] Article 613 of Indonesian Civil Code.

transferred along with the transfer of debts,[12] it is not clear if the assets transferred are not in the form of debts. The same difficulties also arise in regard to debts which are the result of leasing or *muḍārabah* transactions, in the absence of any collateral being placed in the leasing or *muḍārabah* objects.

3.3 Laws Related to Leasing

Special mention should be made to leasing as this is the closest mode of financing to *ijārah*. Leasing is even often, if not always, equated to *ijārah*. Unfortunately, the leasing law in Indonesia is still underdeveloped. Leasing is still governed through the Presidential Decree No 61 year 1988 which was originally only intended to stipulate permitted activities to be carried out by a financial institution.[13] At the outset, this decree does not pose any legal hurdle for application of leasing according to Sharīʿah principles. However, the implementing regulation on leasing activities contains a requirement which may contradict the Sharīʿah principles. The Decree of the Minister of Finance No Kep.Men.Keu.RI.No1169/KMK.01/1991 put an obligation for the parties to a leasing agreement to put a clause which determines the liability[14] of a lessee in the event of non functionality of the object of the lease agreement.[15] The point of the above example is that while the decree neither permit nor forbid that those activities be carried out through Islamic means, this decree cannot be considered as the legal basis for Islamic leasing. Moreover, the fact that this Presidential Decree was based on the laws which do no recognize the principles of Sharīʿah[16] can further support the above argument.

3.4 Laws Related to *Muḍārabah*

Muḍārabah is also an instrument whose regulation is still uncharted. The tendency of equating *muḍārabah* transactions with share cropping transactions can only make the matter worst. The *muḍārabah* transaction entails more than simply sharing revenue. The heart of *muḍārabah* is the transfer of asset in trust, namely,

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[12] Article 1533 of Indonesian Civil Code.

[13] Article 2 stipulates the activities which are Leasing, Venture Capital, Trading in Commercial Papers, Factoring, Credit Card and Consumer Finance.

[14] It is true that the contract can determine that the liability being 0%. However it is clear that this regulation is not intended to be the basis of Islamic Leasing.

[15] According to Sharīʿah, the leasee to an *ijāra* contract cannot be held responsible for the damage or any loss due to the non functionality of the object of the lease.

[16] This Presidential decree was based on the Constitution, the Commercial Code, Civil Code, Law No 12 year 1967 concerning Cooperatives and Law No 14 year 1967 concerning Banking. See the Recital of the Presidential Decree No 61 year 1988. It is to be noted that the Commercial Code and the Civil Code were initially intended for the European and were the codification of living values of the Netherlands/western society. Prior to Indonesian independence, the Islamic majority native Indonesians were subject to *Adat* law which consists of among other Islamic law.

the transfer of assets into the ownership realm of the *muḍārib* for the benefit of the investor. The *muḍārib* owns the assets and is not merely the custodian of the assets. Indonesian laws unfortunately cannot protect adequately the parties to the *muḍārabah* transaction as the nature of the transaction is not within the ambit of its legal foundation. As transfer of ownership in the *muḍārabah* transaction resembles the common law trust,[17] Indonesia as a country following civil law system do not recognized dual ownership[18] in equity and at law. Unfortunately, such split in ownership is the essential facet of *muḍārabah* transaction which has not been covered by Indonesian law and cannot be governed by conventional Civil law principles.[19] It is however possible to cover the profit sharing aspects of *muḍārabah* transaction through the freedom of contract principle.[20]

4. Indonesian Existing Practise And International Experience

4.1 Islamic Bonds

Current *sukūk* in Indonesia are always manifested in the form of bond which is legally a debt instrument.[21] While the Sharīʿah pronouncement on the Sharīʿah bond stated otherwise, the legal fact on the matter is that the legal opinion always stated the Sharīʿah bond as a debt instrument.[22] This creates a dilemmatic legal problem. On the one hand, Sharīʿah prohibits selling a debt instrument not at the face value and on the other hand, the nature of the bond and market necessity requires that the bond is to be freely traded, namely at discount or at premium. It is true even in the case of *ijārah* bond where the bonds represent not the ownership of the asset but on the rental claims associated with the lease of the underlying assets.

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[17] Some Islamic Financial Institution even used the terminology "trust financing" to denote the mechanism contemplated in classical *muḍārabah*.

[18] It is true that the notion of ownership in *muḍārabah* transaction is not exactly the same as the notion of ownership in common law trust. However, it is safe to say that both are similar. Therefore it is appropriate to take the example of the dual ownership of the common law system to highlight the problem associated with the implementation of *Muḍārabah* under legal regime following Civil Law system.

[19] The consequences which may arise are related to the status of the *muḍārabah* object in case of insolvency of the *muḍārib*, the liability of the *muḍārib* and the rights of the investor. As the explanation will make this paper unnecessarily long, the writer will not make elaboration on this issue.

[20] Both Common and Civil laws share this principle.

[21] In order to not creating unnecessary controversy, this paper will not name any specific case of Sharīʿah bonds for the following reasons: (a) It is not the aim of this paper to criticize the practice, (b) the Author do not have all documents pertaining to each single Islamic bonds issuance in Indonesia, and (c) the Author does not wish to make any generalization on the issuance of Islamic bonds.

[22] See The Legal Opinions issued in conjunction with the issuance of the Islamic Bonds.

However, even if the *ijārah* bond can be manifested in the ownership of the underlying assets and not merely in the rights to receive rental payment, another issue will arise, namely the liability of the owner of the assets. As an owner of an asset, the investor will be exposed to numerous risks which may result in the Sharīʿah bonds being less attractive than its conventional counterpart for rational investors.

4.2 The Practise of Assets Securitization

Another possible vehicle under Indonesian law is the issuance of asset backed securities. The Capital Market authority has since 1997 issued regulation on asset backed securitization. However, it is doubtful whether the vehicle can be used as a vehicle for Islamic *ṣukūk*. Asset securitization in Indonesia is done through a vehicle named Kontrak Investasi Kolektif or Collective Investment Contract (CIC) between the portfolio manager and the custody bank on behalf of the investors. This arrangement seems to attempt to mimic a trust special-purpose vehicle (SPV) for achieving the bankruptcy remoteness. In this arrangement, the investment manager has the task of managing the portfolio while a custodian bank becomes a collective depository of the securities.

Originators sell their receivables together with the attached security to the CIC. The CIC investment manager responsible for the portfolio, in turn, issues asset-backed securities for investors. The funds raised are transferred to the originators as contracted and the servicing of the receivables is a function that is normally contracted back to the originators.

4.3 International Practises Related to Islamic *Ṣukūk*

It is important to see international practices related to *ṣukūk*. While the issuance of *ṣukūk* took different forms and methods, there is one similarity among all the issuances of *sukūks*,[23] namely the use of trust structure, in the sense that there is always involvement of the splitting of ownership of the underlying assets into legal and equitable ownerships. This is the answer to the prohibition of the sale of debts under Sharīʿah which result in the certificate issued or traded represent an ownership over a real asset. In the case of the famous first Malaysian *ṣukūk*, the traded certificates represent the equitable ownership on the real estate parcel while in the case of Islamic Development Bank (IDB) *ṣukūk*, the traded certificates represent the equitable ownership on the pool of assets which consist of mainly real ownership.

In order to satisfy the Sharīʿah requirement, the underlying transactions are always in the form of leasing. It is because, leasing is the closest mode of financing acceptable to Sharīʿah which involve real ownership over a real assets. Such requirements resulted in all transactions structured to involve leasing of real assets,

[23] Except for straight forward *muḍārabah* or *muqāḍarah* bonds.

regardless of whether the intention of the would-be investor are in the ownership of the associated real estate. Another development is in the IDB *ṣukūk*. It is no longer necessary to have the pool of assets consist of only leasing assets. The issuance of *ṣukūk* will be still acceptable of Sharīʿah if the initial composition of the portfolio consist of 51% leasing and at any time not reaching below 25% of the portfolio.

While the *ṣukūk* structure is always done through a complex structured finance transaction, one fact can be rooted out from the complex structure that the foundation of the structure lies in the ability to split the ownership of the underlying assets into legal and equitable ownership.

5. Analysis on Indonesia Current Laws

5.1 Analysis of the Legal Aspects of Islamic Bonds

The only justification for the Islamic Bonds in Indonesia to be issued in the way they were issued is that the Indonesian Capital Market Agency still requires uniform format in issuing bonds. Therefore, the approach taken was adhering with all requirements regarding forms while maintaining the substance of the matter in conformity with Sharīʿah.

However, this approach is not without problem. This approach creates inconsistencies, especially related to the treatment of the bonds under Indonesian law. Indonesian law still view bonds as a debt instrument. Despite some quarters argue that allowing Sharīʿah bonds has resulted in the broadening of the definition of bonds, Indonesian laws still regards Sharīʿah bonds as a debt instrument. The paradox of this treatment is that as trading in debt instrument not in its par value is unlawful in the view of Sharīʿah, the issuance of Sharīʿah bonds is just to allow such trading in debt.

5.2 Assets Securitization and Its Sharīʿah Compliance

While majority of Sharīʿah scholars prohibit trading of debts, the rulings on the trading on debt-like instrument or non-debt instrument which behaves like debt do not enjoy the same consensus.[24] Moreover, trading on proof of participation (whether in the form of shares of a company or unit trust) in a portfolio which consists of mainly debts might be considered at the trading in debts. This fact can potentially create difficulties in using asset securitization as a basis of Islamic *ṣukūk* in Indonesia. The Indonesian draft law on asset securitization requires that the asset to be securitized is in the form of debt.[25] Fortunately, in the existing

[24] The ruling regarding IDB's *ṣukūk* permit the trading of a certificate which represents ownership over portfolio of assets consisting both real assets and debts. The caveat is that the initial composition of the portfolio should be 51 % of real assets and in any case should never reach below 25% of real asset.

[25] Article 3 of the Draft Law on Assets Securitization.

regulations of BAPEPAM, there is no express requirement that the portfolio of the Collective Investment Contract consist of only debts. According to paragraph b of the Regulation IX.K.1, it is possible to have non-debt financial assets in the portfolio. However, while a lease rental payment can be categorized as a financial asset, it is not clear whether an asset which is subject to lease can be categorized as a financial asset.

The second issue is whether the transfer of the assets will attract moral hazard problem. While in the conventional asset securitization the only moral hazard problem is the possibility of the originator applying different treatments between the sold assets under servicing agreement and the unsold assets, the problem will add with the requirements for operation and maintenance of the lease assets if the whole asset and not only the lease payment is transferred to the portfolio.

The third issue is related to the CIC model required under existing BAPEPAM regulation. Even though has been used several times, the effectiveness of the CIC model remains questionable. The major issue is whether the CIC which does not have separate legal personality, can legally enter into contracts with other parties, such as investors and servicers, in the same way that a trustee can.

The bankruptcy remoteness of the CIC scheme is still untested. The CIC is basically an SPV which insulates the securitized assets from the insolvency of the originator. While in the conventional asset securitization, the SPV exists solely to sell and hold the securitized assets and may not have obligations other than to those to be paid with the securitized assets, in the Sharīʿah asset securitization, the SPV might have additional obligations as the SPV will hold the real assets and not merely claims.

5.3 Transferring Equitable Ownership

As a civil law country, Indonesian law has the principle of the unity of ownership. Therefore, it is difficult to assign and transfer only the part of the interest, namely equitable interest on the ownership of the income generating assets. While many problems can be sufficiently averted by simply splitting and securitizing the equitable ownership of the asset, the nature of Indonesian law does not permit such separation. Therefore some reforms are to be made into Indonesian law to allow such separation.

5.4 Problems with Non Straight Forward Debt

While Indonesian law has a provision related to the rights attached to a debt, the lack of laws related to leasing pose another problem. The provisions of Article 1533 of Indonesian Civil Code only extend to the security attached to a debt. In the case of transferring lease payment, the relationship between the lease payment and the lease assets is not very clear. The lease payment is not automatically secured by

the lease assets as the obligor of the lease payment and the owner of the lease asset are always different.

Another issue is related to the lease asset itself. While Sharīʿah compatible lease is limited to operating lease and not extended to financial lease. There is a problem of the ability to assign future debts. Under *ijārah*, the payment of the rental is given for the enjoyment of the lease assets. Therefore, each payment of rental is considered a separate payment for the enjoyment of the lease asset and not an instalment of an existing debt. This will create problem of notification and transfer as the notification has to be done for each and every rental payment.[26]

6. Proposal for Reform

Generally, Indonesia lacks the legal framework for complex financial innovations. The development of the Indonesian *ṣukūk*, in particular, is hampered, as explained in previous sections, by various shortcomings in the legal system. These include the difficulty of assigning and transferring the part of the interest on ownership, namely equitable ownership of the income generating assets and the lack of legal protection for the holders of non-straight forward debt.

This issue necessitates a legal framework which can accommodate the splitting of ownership of a real asset into equitable and legal ownerships. However, as the separation will affect the fundamental nature of Indonesian legal tradition, some reform should be introduced. The reform is needed in regard to the unitary principles in property ownership, in the sense that the ownership is no longer unitary if viewed or dealt with in different realms. In this juncture, the principle of equity of the Common law system may be introduced so that the separation of the property ownership does not alienate the rights of the legal owner of a property. Therefore, it is suggested that the equitable ownership be recognized in the same way as the common law jurisdiction perceived ownership over property.

Such reform will benefit the development of Islamic financial institution in the sense that it will eliminate paradox resulting from different view point of laws and Sharīʿah over the same matter.

In concrete term, the splitting the ownership will resolve all problems associated with the issuance of asset backed securities. Firstly, it will enable the recognition of *muḍārabah* transactions; Secondly, it will avoid resorting in the debt issuance for resource mobilization; Thirdly, it will ease the creation of bankruptcy remote vehicle; Fourthly, it will avoid moral hazard of the originator and the liability of the investor pertaining to the asset; Lastly, it will ease the problem with dealing with future debts; and finally it will avert the problems associated with the rigidity of property ownership principles in general.

[26] Article 613 of the Indonesian Civil Code.

Finally, it is to be mentioned that the reform proposed herewith is by no means a complete proposal. It is just considered as a first step and intended to make it possible for the current legal system to align with the Sharīʿah requirements.

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COMMENTS

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