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The Constraints in Sharia-Compliant Asset-Backed Securities Issuance at Islamic Banking Industries in Indonesia

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Abstract. *The paper examines the responses of Islamic bank executives in Indonesia on constraints precluding the Sharia-Compliant Asset-Backed Securities (SABS) issuance, especially from sharia and legal perspectives. This research uses socio-legal and inductive approaches, analyzed with content analysis. The research finds that, first, despite its necessity, the SABS concept brings risks and constraints in its implementation. Second, the constraints to SABS issuance include the difficulties in procuring assets. Third, the constraints in the legal aspect include the basis of bank authority to sell assets to SABS issuers, the types of assets, the transfer process to special purpose vehicles (SPV), the dubiety in the clauses managing bankruptcy remoteness and perfection of security interest, and the problems of accounting, asset bookkeeping, and taxation.*

Keywords: *securities, asset-backed security, Islamic bank, source of funding*

Abstrak. *Artikel ini menganalisis respon pelaku industry bank syariah di Indonesia terhadap kendala pada penerbitan Efek Beragun Aset Syariah (EBAS), dari perspektif syariah dan hukum. Penelitian ini menggunakan pendekatan sosio-hukum dan induktif, dengan analisis konten. Penelitian menemukan, pertama, sekalipun secara konsep dibutuhkan dan bermanfaat, EBAS berhadapan dengan potensi risiko dan hambatan dalam implementasinya. Kedua, kendala penerbitan EBAS antara lain kesulitan pengadaan aset. Ketiga, kendala aspek hukum meliputi dasar kewenangan bank untuk menjual aset kepada penerbit EBAS, jenis aset yang menjadi dasar penerbitan EBAS, proses pengalihan aset ke Special Purpose Vehicle (SPV), ketidak jelasan ketentuan bankcruptcy remoteness and perfection of security interest, serta masalah akuntansi, pencatatan aset, dan perpajakan.*

Kata kunci: *sekuritisasi, efek beragun aset, bank syariah, sumber pendanaan*

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Introduction

Indonesia's Islamic financial asset has not been developing significantly in the last five years. However, non-Islamic finance products still dominate Indonesia's finance market share by a 92% margin compared to their Islamic counterpart. The low performance of the Islamic finance industry in the national market share is due to several problems, such as the executives' lack of knowledge in Islamic finance, illiteracy, deprived quantity and quality of human resources, the low scale of product supply and demand, the liquidity restraint, the poor synergy, and harmony among the internal and external regulators.

The inconsequential scale of Sharia product supply and demand leads to challenges for the Islamic finance industry to procure fund sources. This problem further impacts the acceleration of Islamic financial products and precludes the fulfillment of consumers' needs. One prominent indicator is the insignificant participation of the Islamic finance industry (banks) in long-term investment plans such as housing and infrastructure financing.

The bank executives are highly committed to providing support in housing and infrastructure financing, but the mismatches between the period of funding and financing challenge them. Islamic banks procure funding sources mostly through short-term products such as deposits and savings with a maximum maturity of 1 year, whereas financing requires a longer period. For example, housing and infrastructure financing usually takes more than 15 years of a support plan.

The mismatches between the source of funding and financing/ investment will provoke two major risks: 1) the maturity gap, in that the source of funds differs from its use. From risk management assessment, this condition will induce the bank's high liquidity. 2) The repricing gap, in which fund sources' price (conventional: interest) differs from its use. As an illustration, the price for a one-month deposit is determined monthly, while housing financing is determined per semester or even annually. Those risks affect the portfolio allocation and the distribution of housing and infrastructure financing, despite the high potential and benefit of the demand for housing financing.

Even so, the marketplace offers a number of financial engineering methods to promote the increase of financial institutions' capital. The fund source can be obtained directly through public fund outsourcing or through various instruments in a capital market. Among the huge varieties of instruments or products, asset-backed security has not come to Islamic law (Sharia)-compliant

financial institutions' attention, specifically in the form of Sharia-Compliant Asset-Backed Securities (SABS). Asset-backed security has been widely practiced in many countries as a strategy to tackle the issue of liquidity shortage. This type of product offers an alternate bank liquidity fulfillment through the optimization of financial asset functions that the institutions have already possessed.

Drawing from the hypothesis, this research argues that the Islamic bank industry has faced several challenges in issuing SABS. These include (a) asset-backed securities transaction has not been offered as an alternate fund source in the Islamic bank industry as some Muslim jurists (*fuqahā'*) have differing opinions on the asset-backed securities practice and mechanism when judging it against the Sharia principles. (b) The regulators have not been able to make a collective decision about the execution of asset-backed securities, which further preclude the success of its implementation and even causes a decline of interest among industry executives in utilizing ABS to procure more resource fund. (c) Financial practitioners tend to be pragmatic in using products and contracts in that they resort to products and contracts that are simple and easily executed yet still offer positive returns rather than considering sophisticated products and contracts that offer a long-term impact.

Restating the obvious that SABS issuance has met various constraints, this research aims to elaborate on the constraints faced by Indonesia's Islamic banks regarding SABS issuance through juridical and Sharia perspectives. Next, this research also tries to formulate potential solutions to those constraints to realize the successful implementation of SABS issuance by Islamic banks. In congruence with the research objectives, this research aims at finding out the types of underlying assets, structure/mechanism, and contracts to be used in asset securitization that are compliant with Sharia principles, as well as the legal challenges that may preclude the implementation of sharia-compliant ABS in Indonesia.

Furthermore, this research will focus solemnly on examining the responses of Islamic bank executives regarding the implementation of Sharia-compliant asset-backed securities (SABS) through the Sharia perspective and applicable legal system. The focus on Islamic banks is based on several considerations. First, Islamic banking is the pioneer in the development of Islamic finance in Indonesia. Second, banking has dominated the financial sector in Indonesia (approximately 80%). Third, Islamic banking mostly offers the currently existing long-term financing, especially for housing and infrastructure financing, which can take 20-25 years.

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Asset-backed securities are one of the financial products that have been widely used and have become the best practice in many countries. Financial institutions and even non-financial institutions have used asset-backed securities (ABS) as an instrument to procure funds from the domestic and international public. Many academics, researchers, and practitioners have individually or institutionally promoted empirical studies to scrutiny ABS. Most existing studies on ABS usually only discuss the advantages, objectives, and constraints. Most of them also mainly use conventional approaches to examine this topic. Thus the Sharia-compliant discussion is still scarce and only partially explored. New ABS studies have emerged since the subprime mortgage crisis in 2007 in the United States.

Upon reviewing a body of related literature, this research classifies four major clusters of studies concerning asset securitization. The first research cluster views asset securitization as a financial product that captures investors' interest (due to its cost efficiency and certainty) and the possibility of procuring cash funds quicker for originators (because of customers' long-term loans). However, this product is highly risky, as confirmed in the subprime mortgage case in the United States in 2007. The studies in this cluster mostly promote the necessity of more prudent risk management and mitigation for the implementation of asset securitization not only in the technical-mathematical aspect but also in cultural and religious aspects. Aside from that issue, the intermediary monitoring functions have undergone a series of changes because this financial product, in the form of asset securitization, can transcend multiple sectors not limited to banking. Consequently, the monitoring functions should also comply with other institutions' regulations and monitoring procedures. This view was explored by Omneya H Abdel Salam et al. (2017), Gary Gorton & Andrew Metrick (2013), Nicola Cetorelli & Stavros Peristiani (2012), Loutskina & Strahan (2009), and Steven l. Schwarcz (2009), as well as Alfredo Martin Oliver & Jesus Saurina (2007).

The second research cluster on asset securitization views asset securitization from Sharia or Islamic law perspectives. After reviewing the literature discussing asset securitization against Sharia principles, this research infers that in light of Sharia principles, asset securitization can become an alternative solution to the main cause of the global financial crisis in 2007, which is attributed to the subprime mortgage case in the United States. Raihana Hamzah (2016) and Hanim Kamil et al. (2010) acknowledge that the characteristics attributed to Sharia securitization that bases its operation on risk-sharing arrangements demonstrate more reliability in managing financial stability than the shifting risk concept, commonly operated by conventional securitization. As argued by Ayub (2007), Dualeh (2008), Daghi

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(2013), and Farhat (2013), Sharia-compliant asset securitization necessitates the availability of assets as the underlying of the security, as well as the attainability of contracts that are capable of representing the ownership of assets by the asset holders/sukuk and showing the proportional ownership of asset holders/Sukuk. Daghi (2013) and Farhat (2013) further assert that asset securitization from contracts originating from liabilities (*dā'in*)—such as trades, loans, and lease receivables are not allowed (read: *ḥarām*) because those types of transactions cannot fulfill the elements of value equality (*tamaththul*) and cash equivalents (*taqābudh)* that are postulated in *ṣarf* (the exchange of two currencies) contract. Based on his examination of asset securitization practices in Malaysia, Rosalan (2010) deems that the sharia-compliant Mortgage-backed Security (MBS) issued by Cagamas (government-operated SPV, as equivalent to SMF in Indonesia) demonstrates a better performance than the conventional MBS in terms of profitability and cost-effectiveness as it induces higher profitability and lower cost.

Similarly, Hanim Kamil (2010) expresses that asset securitization in the form of sukuk is proven more efficient in stabilizing a security market by using risk-sharing arrangements explained in the previous part of this research. Raihana Hamzah (2016) and Van Hilten (2014) discover that, ironically, this sharia-compliant asset securitization practice, especially in some issuance cases, still imitates non-Islamic products by adopting shifting risk arrangements from a company to investors. Van Hilten (2014) concludes that the tendency to adopt or imitate conventional asset securitization practice during Sharia-compliant asset securitization will cancel its' entire attempt to make the practice Sharia-compliant.

The third research cluster discussing asset securitization analyzes the potential implementation of asset securitization in specific sectors and entities in Indonesia as well as the implementation history in other countries. Through their publications, Santoso (2014) and Suselo (2013) argue that there is a high demand for asset securitization as an alternate source of funds in real sectors, UMKM (Micro, Small, and Medium Enterprises), and financing companies. Unfortunately, they cannot all be fulfilled due to internal and external constraints. Studies conducted by the Capital Market and Financial Institution Supervisory Agency (Bapepam LK) in 2010 and the Bank of Indonesia in 2003 indicate that some countries have implemented asset securitization practices with asset-based and asset-backed underlying. Asset securitization can only be implemented by using a Collective Investment Contract of Asset-Backed Securities (CIC-ABS) and establishing the company as an SPV. In an international context, asset securitization, as in secondary mortgages, has been growing rapidly in

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the United States since 1970 (Haffner, 2008). The products of ABS have been widely used in the U.K., some other European countries, Middle-East regions, and South East Asia.

The fourth research cluster examines asset securitization from Indonesia's legislation perspective. This research found that some publications by Remy (2005), Sunarto (2003), Wijaya (2008), Dewi (2010), and Rustam (2016) briefly discussed the legal scrutiny on the implementation of asset securitization. These publications mention that asset securitization has been backed up with a legal foundation but has not been properly executed as the challenges persist. More detailed guidelines governing the position of taxable and mortgaged assets are necessary to provide legal assurance for the stakeholders involved in the asset securitization procedures.

The four research clusters summarized from the literature reviews bear similarities and differences with this study's concentration. Through the interviews with Islamic bank executives, this research confirms the issue around the benefit, risk, cost, and circumspection aspects in relation to asset securitization through ABS. The literature also mentions the need for more prudent risk management and mitigation in asset securitization by considering the cultural and religious aspects. This research follows up specifically on the cultural and religious aspects by confirming Islamic bank executives' understanding, attitudes, and responses. The second research cluster concludes that sharia-compliant asset securitization that bases its operation on risk sharing principle and the clarity in asset underlying ownership of each transaction – as in sukuk, offers more advantages than conventional asset does. A conventional asset securitization that bases its operation on shifting risk principle and underlying assets in all account receivables, including uncertain income such as future cash flows, triggers instability in the finance system. The previous studies, however, have not managed to discuss the issue concerning *fiqh* institutions in Indonesia.

To bridge that gap, this research will scrutinize the sharia aspect of asset securitization through the Islamic law of economics affairs (*fiqh al-mu'āmalah*) by considering the arguments of several fatwa institutions, including the ones operating in Indonesia that the previous studies fail to cover. Besides, prior studies judge that asset securitization in the form of sukuk practice is ineffective since it imitates conventional product that adopts shifting risk from a company to investors. This study has several objectives. First, it will elaborate on the concept of asset securitization and the potentially applicable contracts that comply with Sharia principles. Second, it will analyze the legal constraints that come with the

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implementation of asset securitization in the form of SABS in Indonesia. For that, this study differs from the previous studies in the scope of Sharia theoretical review and practical aspects of law enforcement.

Methods

This research used a qualitative approach to understand a phenomenon experienced by the research subjects, for instance, through the behavior, perception, motivation, action, etc., holistically within the phenomenon's natural context and by employing natural methods and presenting the results through verbal description. It also used a socio-legal paradigm and inductive approach. The inductive approach was particularly selected to evaluate the responses of Islamic bank industry executives regarding asset securitization in the form of ABS by examining and analyzing a number of indicators displayed by industry executives on a certain product prior to its launch. The indicators that influence an industry executive's response to a new product usually encompass not only religious factors (including beliefs, behavior, and commitment) but also other factors such as comprehension and behavioral perception toward the product (asset securitization) itself (Moleong, 2016).

The socio-legal approach analyses data by referring to laws and regulations, Sharia provisions, literature written by experts, and the perceptions of Islamic bank executives on implementing those laws and legislations. The socio-legal approach also makes a comparative study on the implementation of laws related to asset securitization and its accordance with Indonesia's statutory provisions (civil law) of sharia principles, as well as on the perceptions of Islamic banking industry executives towards the existing legislations. Statutory provisions have regulated asset securitization procedures, but industry executives implementing it as a financial product have faced various obstacles, constraints, and misconceptions. Those issues have resulted in some discrepancies in its implementation and caused industry executives' reluctance to make new product transactions through asset securitization in the form of SABS.

Data were collected through literature reviews to examine the *fiqh al mu'āmalah*, laws and regulations, studies on securitization products, and comparative studies regarding the laws adopted by civil law, common law, and Islamic law, especially those related to the concept of securitization. Those data were used as the reference for primary and secondary sources and field research.

The perceptions of Islamic bank business executives or practitioners on asset securitization were gathered through in-depth interviews and questionnaires.

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The process of interviews and filling out the questionnaires were conducted by visiting the Islamic banking practitioners with prior email or personal message correspondence (using WhatsApp). The question lists were delivered to the Islamic banks where the research participants work and sent through emails in a manner agreed upon by both parties.

The interviews were conducted in nine Islamic banks starting from the end of November 2019 until February 2020. The Islamic banks who agreed to participate in this research are BMI (Bank Muamalat Indonesia), BSM (Bank Syariah Mandiri), BNI Syariah, BRI Syariah, BCA Syariah, CIMB Niaga Syariah (UUS), Maybank Syariah (UUS), Bank Permata Syariah (UUS), and Bank Danamon Syariah (UUS). Apart from the Islamic banks, this research also held some interview sessions with PT Sarana Multigriya Financial (PT. SMF) as a SABS issuer.

Results and Discussion

The Responses of Islamic Banks on the Sharia-Compliance of Asset-Backed Securitization

Based on the interviews with nine executives of Islamic banks concerning the sharia-compliance of securitization in the form of Asset-backed Securities, this research finds that seven respondents (Islamic banks) have reported some constraints, and one respondent (Islamic bank) has reported no constraints. One respondent claimed to have no knowledge about any constraint. This research concludes that the constraints regarding the implementation of SABS in Islamic banks consist of three issues, namely the issue regarding the assets underlying the SABS issuance, the permissibility contract, and the transaction scheme or structure that is used as a security assurance for Islamic banks as the originators. Each of those issues is further explained below.

Regarding Assets

The asset that underlies the transaction in ABS securitization is a crucial element because ABS issuance cannot happen without it. The most sensitive matter in this issue is that some assets deemed right for underlying assets of ABS in non-Islamic finance are not necessarily applicable to Islamic finance.

In compliance with Sharia principles, the type of asset allowed as an underlying for SABS must not be in the form of debt (*dayn).* The asset allowed is "an asset procured from financing or transactions on profit and loss sharing (*muḍārabah*) and joint venture/financing (*mushārakah*) contracts, as well as other

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types of contract in which the ownership still belongs to the originators". In sharia principles, unfortunately, "securitization cannot be carried out on sharia asset procured through debt (*dayn)* because it is regarded as *ṣharf* transaction (the exchange of two currencies) that does not meet the prerequisite of *tamaththul* elements (equivalent value) and *taqābudh* (cash)". One example of debt asset is "an asset that is procured through a trade (*bay')*, loan (*qarḍ)*, and lease (*ijārah* receivables)" (DSN-MUI Fatwa No. 120/2018).

The executive of Permata Bank Syariah explained that "*muḍārabah* financing in Permata Bank Syariah at the end of 2019 reached 55% of the total financing". A respondent from BNI Syariah revealed that "*murābaḥah* and *ijārah* financing was 90% of the total financing". Data from the Financial Services Authority (OJK) in June 2019 show that out of the outstanding value of house ownership credit (KPR iB) financing of IDR 81.22 trillion, *bai' al- murābaḥah* (deferred payment sale), *bay' al-istisnā* (purchase by order or manufacture), and *qarḍ* (benevolent loan) contracts take up 60% of it while *ijārah* (lease)*, mushārakah* (partnership), and *mushārakah mutanāqishah* (diminishing partnership) contracts take up the rest 40% (equal meaning).

Based on the interviews and the data acquired from the Financial Services Authority (OJK), this research concludes that most of the assets owned by the Islamic banks participating in this research do not meet the requirements for securitized assets in the Sharia provisions. As stated above, most of the assets owned by the banks are in the form of receivables (*dayn*), resulting from non-cash trade transactions with *murābaḥah* contracts or loan agreements (*qarḍ*). Another pressing problem in the asset to be used as an underlying in securitization is the legal challenges that the banks have often been facing despite having committed to *mushārakah* (partnership) contracts, especially *mushārakah mutanāqishah* (diminishing partnership), in which banks have ownership of the said assets. On top of that, there is an issue with the industry executives who tend to display subjectivity toward other parties and insecurity in the asset transfer process during the ABS securitization procedure.

Walsh explains that the types of assets that can be securitized in conventional ABS include "residential mortgage, commercial mortgage, auto loans and leases, consumer loans, trade receivable, corporate loans, and project finance loans." Quite differently, Indonesia's laws and legislations state that assets that can be securitized include "all financial assets mentioned in the investment portfolio of Collective Investment Contract of Asset-Backed Security (CIC-ABS) including a) bills resulting from commercial securities; b) credit card bills; c) future receivables; d) credit disbursements; e) debt securities guaranteed by the government; f) credit

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enhancement facilities; g) future cash flows or rights issues to future cash flows; h) future income or rights issues to future income; and/or i) all equivalent assets and other types of financial assets related to those financial assets." Similar definition has also been stated in the provisions of Article 2 Paragraph (1) of the Regulation of Bank of Indonesia No. 7/4/PBI/2005, stipulating that "the financial assets transferred for the purpose of asset securitization must be the financial assets in the form of loans, securities-induced account receivables, and other equivalent financial assets." In line with that, this research infers that assets or objects that can be used as the underlying in conventional ABS issuance include the various types of account receivables such as "account receivables that result from commercial securities, credit card bills, future receivables, credit disbursements including housing or apartment mortgages, debt securities guaranteed by the government, credit enhancement facilities/ cash flow, as well as all equivalent financial assets and other type of financial assets related to those financial assets."

The above-mentioned provision articulates that the types of assets that can be used as an underlying in securitization in conventional ABS vary, ranging from financial assets in the form of account receivables that result from currently effective securities to liabilities or future cash flows.

A Fatwa of DSN-MUI explains that the asset to be used for an underlying in sharia-compliant Asset-backed Securities in the form of a Participation Letter (ABS-PL) should be an asset that results from housing financing (KPR iB) that has met particular requirements. The requirements for the asset will become proof of ownership belonging to Islamic banks. The proof of ownership should be based on *mushārakah mutanāqishah* /MMQ (diminishing partnership)), *Ijārah Muntahiya bi al-Tamlīk*/IMBT (financial lease with purchase option)) contract and/or other types of contracts that position Islamic banks as asset owners. This is quite different from asset securitization in the form of CIC-ABS, where the assets can take form in a greater variation (not restricted to housing financing), where tangible assets (*al-a'yān*), benefits *(al-manāfi'/*usufructs*),* or services *(al-khadamāt/services)* are still allowed as long as they can fulfill the criteria of each type of those assets.

In response to the fatwa of DSN-MUI above, the Financial Services Authority (OJK) issued a legal basis for the implementation of SABS issuance by Islamic banks through POJK Number 11/POJK.03/2019 on the Circumspection Principles in Asset Securitization Activities for Commercial Banks which substantially regulates the asset criteria in SABS issuance. In the POJK Number 11/POJK.03/2019, it is explicitly stated that:

> (1) Banks, in carrying out Asset Securitization activities as referred to in Article 2, may only conduct Asset Securitization of the underlying financial assets or Islamic financial assets in the form of financial assets or Islamic financial assets consisting of credit or financing, account receivables resulting from securities or Islamic securities, future receivables and/or other equivalent financial assets or Islamic assets. (2) …"

Subsequent to the discussion above, it is clear that underlying asset has become an essential element in asset securitization when viewed from a Sharia perspective. Dualeh (1998) emphasizes that "there are 4 (four) main differences between conventional and sharia-compliant asset securitization, namely the acceptable forms according to Islamic principles, the acceptable transaction structures, the process of ownership transfer, and the forms of credit enhancement justified by Islamic principles". In another publication, Ayub (20100) and Jobs (2007) distinguish the characteristics of Sharia-compliant ABS from conventional ABS in that the assets in Sharia-compliant ABS must represent the ownership or participation of the party from whom the asset will be transferred.

Therefore, this research concludes that the basic difference between the assets in conventional and Sharia-compliant ABS lies in the prerequisites that require the assets to not originate from receivables/ *al-ḍa'īn*. This requirement is grounded on Islamic jurists' opinions that account payables (*bay' al-ḍa'īn*) is categorized as riba (usury) transaction. According to Sharia principles, the "transfer of assets and payments which contain the elements of usury, gambling and *gharar*" is forbidden.

About Contracts

A contract is the second most important element in SABS securitization. It is even often considered a crucial characteristic of every Islamic finance transaction. The type of contract for SABS issuance will be selected accordingly to the legal relationship among the parties involved in the transaction. The types of contract selected for the legal relationship between parties involved in SABS issuance are "'*akad wakālah bil ujrah* (deputyship fee contract), *kafālah bil ujrah* (guaranty fee contract), *bay' al-haqīqī* (true sale), *wa'd* (promise), *ijārah maushūfah fi al-dhimma* (a lease contract for the benefits of a good and/or service which at the time of the contract only states its characteristics and specifications (quantity and quality), *bay' al-yan al- maushūfah fi al-dzimmah* (sale and purchase of goods that do not exist but the specifications are explained and are the responsibility of the seller). The *wakālah bil ujrah* (deputyship fee) contract is particularly used in legal relationships

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between the investor and the issuer, the investors and the custodian bank, the investor and the trustee, as well as between the Investor and the Service Provider.

The *kafālah bil ujrah* (guarantee fee) contract is used in a legal relationship between the investor and the financing enhancer if the financing support makes a guarantee in the securitization process. The *"al-bay' al-haqīqī" (*true sale) contract is used between the issuer, as the investor's representative, and the originator during the transfer of asset ownership. Next, the *"wa'd"* is used in a legal relationship between the originator and Issuer, who acts as the Investor's representative in the securitization arrangement – in case of the absence of a Trustee – where the originator commits to sell their asset, and the issuer, as the investor's representative, commits to buying it" (Fatwah DSN-MUI No. 121/2018). Especially the matter regarding the *"bay' al-haqīqī"* (true sale) contract between the issuer who acts as the investor's representative and the originator in an asset transfer, the results of the interviews indicate the confirmation of some problems occurring in the majority of banks which participate in this research. Some of the problems related to the issue of the contract concern the concept of transfer of ownership from a SABS asset, as well as the follow-ups with the customers for the contract regarding MMQ financing.

In some Anglo-Saxon countries that recognize a trust system, the ownership of trust property belongs to two parties, namely the trustee and the beneficiary. A trustee is the legal owner, while a beneficiary is the beneficial owner. In this system, asset securitization is carried out this way, "the party who initially owns the settlement (the settlor) can immediately hand over the ownership of the settlement to another party (trustee) for the benefit of the beneficiary without the need for a new/ separate institution to handle the asset transfer" (Widjaya, 2008, 97). When an asset securitization product applies this concept of trust, the investor, as the party purchasing the receivables, will act as the settlor. Since the beginning of the deal, the settlor relies on the trust and transfers the ownership of the assets to the investor through the capacity of the trustee/ legal owner, whose assets are put directly on behalf of the investor/ customer. As a trustee, the customer can manage, maintain and control the settlement. In short, the investor can directly act as a trustee or party who manages a number of assets/ receivables received from the originator and can also directly act as the legal owner. Therefore, it can be said that in an Anglo-Saxon community, when a true sale is carried out, the transferred asset will immediately be under the legal ownership of investors (customers), and the party who manages and control the asset directly also acts as the settlor/ trustee.

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In countries where the concept of trust is not widely recognized, a special agency that acts as a legal owner handles the ownership transfer process. From then on, the asset owner can "exploit" the asset on their behalf through capital market instruments by issuing securities. This institution is often called a Special Purpose Vehicle (SPV) or conduit. Indonesia's legal system, similar to Continental European law, does not recognize dual ownership that consists of a legal owner and an equitable owner because this legal system does not separate law and equity. Indonesia's legal system adheres to an indivisible unitary ownership (*onsplitbaarheid*). In the Civil Law system, ownership is an invisible unit (unitary conception); therefore, sharing ownership is prohibited and conceptually impossible. However, the Common Law system recognizes a concept of ownership fragmentation (Sunarto, 2003, 176).

In accordance with Indonesia's legal system, the concept of ownership transfer in the context of asset securitization is carried out through a true sale to the issuer as a legal entity, not directly to investors who act as settlors. However, the settlors, using a trust as the groundwork, will transfer the ownership of the asset to investors within the capacity of a trustee/ legal owner whose assets are then named on behalf of the investor/ customer.

Another debate related to the issue of true sale is about the implementation of the concept of benefit (*manāfi'*) and services (*al-khadamāt*) on objects as in CIC-SABS objects, where arguments question whether *manāfi'* and *khadamāt* can be transferred as goods (*a'yān*) at the time of actual sale. Aside from that, the research participants were also questioned about the problems related to the *mushārakah mutanāqishah* (diminishing partnership) financing contracts. They were debating whether the ABS owner is willing to share the results, whether they are aware of their commitment to the ownership with the customer, and whether implementing *shuf'ah* (preemption rights of stockholder) in MMQ products are truly regulated by Islamic banks.

About Structure/ Scheme

The third issue in the ABS securitization process concerning Sharia principles is the structure or scheme of the transaction used. The two most commonly used structures in ABS transactions are pass-through/ true sale (sell out/ handover) or pay-through/ with recourse (payment line). On the one hand, pass-through or true sale structure in ABS issuance offers an advantage in that since the ABS held by the investors represents ownership over a batch of undivided account receivables that belong to the investor, the receivables become fully owned by the

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investor, including the credit risk. Therefore, receivables are no longer recorded in the originator's balance sheet even though the originator receives a fee for the administration service they provide (service fee). On the other hand, pass-through/ true sale has a drawback: the securitized housing financing asset will be removed from the Islamic bank's list of assets. Thus, it reduces the number of assets owned by the bank – which can further reduce the Financing to Deposit Ratio (FDR) and increase the estimation of Non-Performing Financing (NPF). Quite contrary, in the transaction scheme using pay through/ with recourse, the assets still belong to the originator and are recorded as the originator's assets. From a legal perspective, this transaction only acknowledges the economic benefits of the account receivables but not the ownership transfer of account receivables.

During the interviews, research respondents were asked about the advantages of pass-through/ true sale (sell out/ handover) and pay-through/ with recourse (payment line) as the structures/ schemes of transactions they used. They reported that every transaction scheme, including the pay-through/ with recourse transaction (payment line), has both advantages and drawbacks. The pay-through transaction is advantageous in that the assets still belong to the originator, and thus it neither reduces the number of assets nor affects the FDR. However, this transaction scheme is disadvantageous in that in the event of default, either due to customer default or a decline in the quality of the underlying asset, the bank will be the only party to assume the responsibility and thus will be exposed to financing risk.

When asked about their preferences between the pass-through/ true sale and pay-through/ with the recourse transaction scheme, most respondents opted for the pass-through/ true sale scheme. In addition to the reasonings above, they argue that the pass-through/ true sale scheme has become the trend in the ABS practice in several countries, such as the United States, the United Kingdom, some European countries, South Korea, and Malaysia.

The Responses of Islamic Banks on the Legal and Regulatory Aspects of Asset Securitization in the Form of ABS

Through the interviews, the executives of Islamic banks indicate some problems in the general implementation of asset-backed security securitization from legal and regulatory aspects. Drawing on the narrative recounted by the executives of Islamic banks, this research concludes that the commonly occurring legal problems include: the issue of the bank's authority to sell an asset to a prospective ABS buyer, the issue around asset transfer that has a possibility of

violating sharia principles, the issue around the unclarity in asset bookkeeping, and the confusion in the taxation matter due to the issue financing asset ownership, as well as the legal consequences that entail the legal relationship between the originator, investment manager, custodian bank, and investor.

The explanation of each problem can be found in the following discussion

1) The bank's authority to sell/ transfer assets to prospective ABS buyers

Many industry executives have questioned the basis on which bank authority conducts financing asset transfers to other parties. It is commonly understood that each securitization process always begins with internal activities carried out by the originator as the party who owns receivables or rights. These assets exist as the result of agreements made by the parties involved in the process. In relation to a bank, the agreement should be viewed as an agreement or a contract between a bank and its customers, either in the form of a house ownership credit (KPR) contract or other financing agreements. Generally, that type of contract will be a standard agreement.

Each bank financing agreement generally contains a clause that explains the rights over transferring liabilities, receivables, and rights to other parties. According to that clause, the bank juridically has the right to transfer the financing asset they own to another party, as explained in Article 1320 jo. Article 1338 jis. Article 1317 KUH Perdata (Civil Code) regulates the validity of an agreement and how an agreement that is made legally acts as law for those who make them and allows someone to bind themselves to it for the benefit of third parties.

Notwithstanding the lucid regulations, in reality, many Islamic banks often leave out the said transfer clause or include it but ignore the arrangements for the transfer process of the rights or portion that they own to other parties as applied in *mushārakah* or *mudārabah* contracts. Rudi (BMI) stated that "the absence of the clause regulating the transfer of rights leaves no room for dispute". He further explained that the receivables in *mushārakah mutanāqishah* (diminishing partnership) are categorized as unpaid shared profit. At the same time, *ijārah muntahiya bi al-tamlīk* (a lease contract that ends with the lessee's acquisition of ownership of the asset), is regarded as an unpaid overdue lease. Since the transfer process for the rights owned by the bank to another party does not allow any changes of clauses on the customer's side, it implies that the bank is obliged or not to notify the customer at the time of making the transfer. Notification becomes mandatory in the event that changes are made, but otherwise, it becomes

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unnecessary. The *'illah* in notifying the customer is due to the anticipation of changes that may affect customers, so the absence of changes that potentially affect customers cancels the need for providing customers with a notification.

The MMQ contract does not contain a clause that allows the bank to transfer the ownership of their portion to other parties. Subsequently, the clause that states, *"the customer agrees to the bank to transfer their portion to another party"* does not exist. The existing clause mentions that the bank may transfer the receivables in the event of the subrogation of account receivable transfer. It is quite controversial because, in the capacity of MMQ, the portion cannot be regarded as a receivable but rather as a right that belongs to the bank and proportionally belongs to the customer. For that reason, if the clause is changed into "transfers customer's liability", the joint portion has become positioned as a receivable.

2) The consequences that entail asset transfer potentially put the bank in a potential judgment against some violations of Sharia principles

Based on Sharia principles, ownership can be transferred from one person to the other as long as the transaction scheme/ structure is carried out in accordance with Sharia principles. Ownership can be transferred by using the *hiwālah* contract. The *hiwālah* contract has two categories, namely *hiwālah dayn* and *hiwālah haqq*. While *hiwālah dayn* can be defined as the process of transferring liabilities or an obligation to pay off debts from one party to another, *hiwālah haqq* can be defined as the process of transferring ownership over account receivables or the receivables themselves from one party to another. At some point, *hiwālah dayn* and *hiwālah haqq* are similar, depending on which perspective one category is viewed. *Hiwalāh dayn* is used to view the notion as the process of transferring liabilities, while *hiwalāh haqq* is used to view the notion as the process of transferring receivables. Stating the obvious, Sharia principles allow the transfer of ownership or receivables from one person to another using the *hiwālah* contract or true direct sale (*bay' al-haqīqī*). However, It should be noted that the transfer process using the *hiwālah* system should follow the terms and conditions that apply, one of which is that every party involved in the process should own liabilities or receivables before the procedure. Unfortunately, the practices in reality often deviate from the main principle. Therefore, many industry executives opt for actual sale transactions (*bay' al-haqīqī)* because it is a safe option that complies with Sharia principles.

The Civil Code recognizes several methods of rights transfer according to the type of objects to be handed over. Generally, objects can be categorized into

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three types: movable, immovable, and intangible assets (receivables-on-behalf-of/ ROBO). According to the types of objects and the process or the method of submission, objects can be divided into three categories. Explanations of each category are as follows:

a. The transfer of movable objects or assets is carried out by handing over the ownership of the said object. It signifies that the ownership over the object or asset changes, except for the transfer of intangible objects.
b. The transfer of immovable objects is carried out through a transfer of title recorded on a deed made by and in the presence of the Land Deed Official (the PPAT).
c. The transfer of tangible assets (receivables-on-behalf-of/ROBO) is carried out by drawing up a deed notified to the debtor (*cessie*).

In the Civil Code, the method of obtaining property rights is explained in the regulation of Article 584 KUHPerdata by transferring the ownership of rights based on a civil occurrence/ *rechtstitel*. The civil occurrence referred to in that article is a sale and purchase agreement (Article 1457 KUPper). Specifically, on the issue concerning an asset that takes the form of receivables/ rights, Article 613 (1) KUHPerdata (the Civil Code) stipulates that the transfer is carried out through a deed, either through an underhand or authentic deed, which is also known as "*cessie*". There are two legal relationships in trading, namely the relationship between the receivables seller (cedent) and receivables buyer (*cessionaris*), and the relationship between the cessionaris and debtor (*cessus*). The trade (sale and purchase process) transfers the title to the receivables to the buyer. Referring to the provision of Article 613 paragraph (2), the Civil Code requires the debtor to be notified about the receivable transfer. The notification (the acknowledgment from the debtor) creates a legal binding between the buyer and the debtor of the receivables, so the debtor is bound to make a payment to the receivable buyer. It can be concluded that the Civil Code does not prohibit the transfer of rights/ receivables to another party as long as the procedure follows the provisions of the applicable regulations.

Another problem around asset transfer is an issue regarding "*khiyār 'ayb*". This term relates to the failure of the asset transfer procedure to meet the criteria determined by the issuer, which results in shifting the obligation to the bank, as the originator, for the transfer period. On one side, the issuer wants the period to last until the completion of ABS, which aligns with the PBI provision in 2005.

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On the other side, however, the bank wants the period to be over within the first 3-6 months as soon as possible. To tackle this issue, the latest Financial Services Authority Regulation (the PJOK) explicitly states that the period must last for 60 days at the latest. On top of that, the maximum amount of assets to be exchanged has been determined to be a maximum of 10%.

3) Problems related to accounting reporting and asset bookkeeping

The asset transfer from the originator is carried out through pay-though or with recourse and pass-through or true sale. First, in a pay-through or recourse transfer method, the originator still assumes the risk of default and bookkeeping, so this concept does not meet the requirements for securitization transactions. Second, in a pass-through or a true sale transfer, the receivables are transferred through a trade-off system from the originator to the investors represented by an SPV or a trustee. Owing to the trade-off, the rights have been transferred, and thus the investor, instead of the originator, assumes the bookkeeping responsibility.

4) The unclarity in the taxation matter due to the issue in the ownership of financing assets

In Indonesia's legal system, ABS is subjected to corporate tax and, therefore, is required to fulfill tax obligations, such as signing up for a Taxpayer Identification Number (NPWP) and paying monthly and annual tax bills. ABS's obligation regarding tax fulfillment is managed under a set of legislation, including Corporate Income Tax (PPh Badan), Income Tax (PPh), and VAT (PPn).

After reviewing the legal aspects in several countries, this research summarizes that the problems regarding ABS issuance include (1) the set of assets that underlie the ABS issuance; (2) asset transfer; (3) SPV; (4) bankruptcy remoteness; perfection of security interest; transaction support (the issuer, trustee, custodian bank, and credit support), taxation aspect, and the governing law.

The legal problems concerning the ABS securitization process revealed by the industry executives participating in this research demonstrate some similarities with the ABS issuance in some countries. They have also faced bankruptcy remoteness, the perfection of security interests, and the governing law.

In general, there are three steps needed to bring forth a right (perfection) over a "security interest", namely: (1) control over collateral; (2) an obligation to register; or (3) a notification to third parties. Perfection of the security interest is

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crucial in securitization transactions to ensure that in the event that a financial asset/ receivable is transferred to the buyer, all the collaterals attributed to the receivable provide a guarantee to the buyer for the fulfillment of the debtor's obligations for the receivables claimed against them.

Conclusions

Drawing on the responses from the executives of the Islamic bank industry in Indonesia, this research summarizes three major problems regarding ABS issuance. The problems include the basis on which the ABS is issued, the contracts used, and the scheme or transaction structures selected. Since most Islamic banks own assets in receivables (*ḍā'in*), they cannot be used for the underlying asset for ABS issuance. Most of the contracts used in trading are in cash, not *shirkah* contracts. The majority of Islamic bank industry executives prefer to use pass-through/ true sale transaction structure/scheme to pay through/ with recourse transaction structure.

Legally, the constraints in the SABS issuance stem from the dubiety of the bank's authority to sell an asset to a potential ABS, the consequences entailing asset transfer that potentially violate Sharia principles, the asset bookkeeping and accounting recording, the confusion in the taxation issue regarding the ownership of financing assets, as well as the legal consequences that entail the legal relationship between the originator, investment manager, custodian bank, and the investor. Other constraints concerning the legal aspect are related to (1) the set of assets on which the ABS is issued; (2) the transfer of assets; (3) SPV; (4) bankruptcy remoteness; (5) perfection of security interest; and (6) transaction supports (the issuer, trustee, custodian bank, and credit supports).

Optimal development of SABS products requires a set of well-structured policies, relentless endorsement, and incentives from regulators, especially for Islamic banks that use *shirkah* contracts (*mushārakah* and *mudārabah*) in housing financing (House Ownership Credit/ KPR iB). In addition to that, it is necessary to improve the regulation flexibility, particularly the ones concerning Risk Weighted Assets (RWA), Minimum Capital Adequacy Requirement (KPMM), as well as Financing to Deposit Ratio (FDR) for the Islamic banks that become the SABS originators. The legal aspect is another aspect that helps promote asset securitization development through SABS. Therefore, further studies are needed to investigate the points and instances considered burdensome for Islamic banks when pursuing an interest in SABS issuance.

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