CHAPTER

4

GOOD FAITH AND FAIR DEALING IN ISLAMIC HIRE-PURCHASE

Hakimah Muhammad Zin and Faradina Ahmad

4.1 INTRODUCTION

Islamic hire-purchase (IHP) is an innovative financing method developed within the framework of Islamic finance based on the concept of *ijarah* (lease). This method has gained popularity in Malaysian Islamic financial institutions, particularly for vehicle and equipment financing. The practice of IHP must observe the elements of good faith and fair dealing, which are fundamental in Islamic finance. These principles ensure that all contractual obligations are fulfilled with honesty, fairness, and transparency. These elements are crucial in ensuring the integrity and ethical standards of the transaction. Under the Malaysian regulatory framework, Bank Negara Malaysia (BNM) has issued the *Ijarah* Policy Document (*Ijarah* PD) that shall apply to all *ijarah* (lease)-based facilities offered by Islamic financial institutions (IFIs) in Malaysia. The BNM *Ijarah* PD provides comprehensive guidelines for the implementation of *ijarah* as an Islamic leasing contract. The document aims to ensure that *ijarah* transactions are conducted in a manner that is consistent with Shariah principles, promoting fairness, transparency, and ethical practices. It plays a significant role in enhancing ethical practices in *ijarah* (lease)-based transactions through its provisions focusing on good faith and fair dealing.

This chapter is organised by firstly presenting an overview of Islamic hire-purchase in Section 4.2. Section 4.3 describes the principles of good faith and fair dealing in Islamic law, while Section 4.4 explains Bank Negara Malaysia regulation. Section 4.6 discusses good faith and fair dealing under the BNM *Ijarah* PD, and finally, Section 4.7 of this chapter provides the conclusion for the chapter.

4.2 AN OVERVIEW OF ISLAMIC HIRE-PURCHASE

Islamic hire-purchase also known as *al-Ijarah Thumma al-Bai'* (AITAB) refers to a lease contract ending with the transfer of ownership from the owner to the lessee through a sales contract once the lease period ends and the lessee has made full payment (Khir et al., 2008). This method is a contemporary innovation in Islamic financing, designed by Islamic banks based on the concept of leasing (*ijarah*) to align with modern financial requirements.

Islamic hire-purchase is a type of Islamic banking facility provided through an agreement known as an Islamic hire-purchase agreement. This facility allows customers to lease an asset from Islamic banks with the option to purchase it at the end of the lease period. Essentially, Islamic hire purchase is a financing arrangement that helps customers acquire assets. It is commonly used for vehicle financing, machinery and equipment financing, and real property financing. In Malaysia, where the high cost of living makes it difficult for many people to buy houses, land, or vehicles with cash, the IHP facility is particularly crucial (Abdullah, 2019; El-Din & Abdullah, 2007). Therefore, this financing option is a popular choice for vehicle financing and serves as a highly demanded alternative to interest-based conventional hire purchase facilities.

The financing structure of IHP involves both *ijarah* (lease) and *bai'* (sale) contracts. In this arrangement, an Islamic financial institution leases an asset to a customer for an agreed period and rental amount. At the end of the lease period, ownership of the asset is transferred to the lessee through a separate sales agreement, provided all payments have been made (Khir et al., 2008). In summary, the modus operandi of AITAB involves several essential stages:

(1) The customer identifies the desired asset and submits a financing application to the bank, agreeing to lease the asset once the bank purchases it.
(2) The bank acquires the asset by purchasing it from the supplier according to the customer's specifications.
(3) The bank leases the asset to the customer at an agreed-upon rental price, with an option for the customer to purchase the asset at the end of the lease term.
(4) After the lease term ends and all rental payments and contractual conditions are satisfied, the bank transfers ownership of the asset to the customer through a sales agreement.

Another common Islamic financing method used in Malaysia is *Bay' Bithaman Ajil* (BBA), which refers to a deferred payment sale. Under BBA, the bank sells the asset to the customer at an agreed profit margin, and the customer pays the price in instalments over a fixed period. Ownership is transferred immediately upon the sale. Unlike AITAB, which separates the lease and sale contracts into two different stages and completes the ownership transfer only after the lease period ends, BBA completes the sale contract at the beginning of the transaction. Although both structures aim to offer Shariah-compliant financing alternatives to conventional interest-based loans, AITAB follows the *ijarah* concept more directly by deferring ownership transfer and using a lease-based structure.

In Malaysia, Islamic hire purchase is governed by the same law as conventional hire-purchase agreements, the Hire Purchase Act 1967 (HPA 1967). However, unlike conventional hire-purchase, IHP operates based on Shariah principles, which emphasise ethical conduct and fairness. Moreover, IHP contracts avoid elements prohibited in Islamic finance, such as *riba* (interest) and *gharar* (excessive uncertainty), promoting a balanced, just, and socially responsible approach that aligns with both regulatory standards and Islamic values. In contrast, conventional hire-purchase under the HPA 1967 does not incorporate religious obligations and primarily addresses contractual and consumer protection aspects. It typically involves interest-based financing and allows for predetermined late payment