

*ISLAM, ACCOUNTING AND FINANCE*  
**CHALLENGES AND OPPORTUNITIES**  
**IN THE NEW DECADE**

Norhayati Mohd Alwi | Sherliza Puat Nelson



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ACCOUNTING AND FINANCE:  
CHALLENGES AND OPPORTUNITIES  
IN THE NEW DECADE**

**Editors:  
Norhayati Mohd Alwi  
Sherliza Puat Nelson**



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## CHAPTER 2

### ISLAMIC LETTER OF CREDIT (LC-i) IN MALAYSIA: THE UCP 600 AND THE ISSUE OF INTEREST

Sharifah Faigah Syed Alwi  
Uzaimah Ibrahim  
Mohd Fuad Sawari

#### 1. Introduction

Letters of credit are the product of the International Chamber of Commerce (ICC), which is a world business organisation based in Paris. According to Pang (2000), LC is a written undertaking issued by the issuing bank on the specific authorisation and instruction of its customer (applicant), who, normally, is the buyer/importer of the goods. Once the seller of the goods (beneficiary) named in the LC presents the stipulated documents evidencing shipment of the goods and those documents are in compliance with the terms and conditions as stipulated in the said LC, the issuing bank undertakes to make payment of a certain sum of money to him. Furthermore, the seller/exporter of the goods can expect the payment once he presents the stipulated documents and duly complies with the requisite terms and conditions of the LC since the undertaking is given by the issuing bank. The ICC rule that governs LC is the Uniform Customs and Practice for Documentary Credit, 2007 revision, ICC Publication no. 600, or, popularly known as UCP 600, which is the current edition (Teoh, 2008). Obviously, UCP 600 is designed by the ICC to govern the conventional LC. UCP is the most recognised rule for LC by the banking world because it provides a uniform mechanism for the use of LC through the involvement of commercial banks (Chatterjee, 2006).

As at February 2011, there are 17 Islamic banks in Malaysia according to the statistics released by Bank Negara Malaysia – the Central Bank of Malaysia (2010). The dire need of the market to trade finance has encouraged the Islamic banks in Malaysia to offer facilities and products, which relate to domestic and international trade. Islamic LC or Letter of credit-i (LC-i) is the most popular facility of Islamic trade finance and it is offered by all Islamic banks in Malaysia. The operational aspects of LC-i are very similar to the operations of LC in conventional banks and governed by the same UCP 600. Islamic banks in Malaysia offer LC based on Shariah contracts like *wakalah* (agency) and *murabahah* (cost-plus). The discussions in this paper will focus on one of the Shariah issues on the UCP 600, which governs LC offered by the Islamic banks in Malaysia. The paper will begin by presenting the operation of LC in Islamic banks in Malaysia. It will then elaborate upon the