



BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Tawarruq Concept Paper

Issued on: 15 April 2015

BNM/RH/CP 028-15	Islamic Banking and Takaful Department	Concept paper - <i>Tawarruq</i>
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As part of the objective to strengthen the Shariah-compliance practice among Islamic financial institutions (IFIs), Bank Negara Malaysia (the Bank) has embarked on an initiative to develop a Shariah-based regulatory framework. The Bank is issuing a series of policy documents on Shariah contracts to facilitate an end-to-end compliance with Shariah principles. These policy documents consist of two components; Shariah and operational requirements. The Shariah requirements highlight the salient features and optional practices of a valid Shariah contract to facilitate a sound and common understanding among IFIs. The operational requirements set out the regulatory expectations with respect to the governance and oversight, structuring, risk management, business and market conduct, and financial disclosure of a *tawarruq*-based contract.

This Concept Paper (CP) provides both the Shariah and the operational requirements of *tawarruq* contract. The Exposure Draft - *Tawarruq* (Shariah requirements and optional practices) was issued for consultation on 9 December 2013. This CP seeks feedback on Part A and Part C, as the Shariah requirements in Part B have been finalised. The Bank invites the IFIs and stakeholders to provide written feedback on this CP. In addition, respondents may wish to seek clarification on specific issues or areas, and highlight alternative proposals for consideration. The feedback must be supported with clear rationale, accompanying evidence or illustration, as appropriate to facilitate effective review of the feedback.

Responses shall be submitted to the Bank by **18 May 2015**.

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PART A OVERVIEW

1. Introduction

- 1.1 Compliance with Shariah requirement is a prerequisite in ensuring the legitimacy of Islamic financial products and services. In meeting this expectation, it is essential for an Islamic financial institution (IFI) to establish the necessary operational framework and infrastructure to ensure that the conduct of Islamic financial transactions is consistent with Shariah.
- 1.2 The Shariah contract-based regulatory policy is intended to ensure end-to-end compliance with Shariah and therefore, enhance the integrity and sustainability of the IFI.
- 1.3 The concept paper comprised of two components, namely the Shariah requirements and the operational requirements. The former highlights the salient features and essential conditions of a specific Shariah contract. The latter outlines the operational requirements consisting core principles of good governance and oversight, proper product structuring, effective risk management, sound financial disclosure and fair business and market conduct. These operational requirements aim to complement and promote sound application of the Shariah principles.
- 1.4 *Tawarruq* consists of two sale and purchase contracts where the first involves the sale of an asset to a purchaser on a deferred basis and the subsequent sale involves sale of the asset to a third party on a cash basis.

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2. Policy objectives

- 2.1 This policy document aims to:
- (a) provide reference on the Shariah rulings associated with *tawarruq*;
 - (b) set out key operational requirements with regard to the implementation of *tawarruq*; and
 - (c) promote end-to-end compliance with Shariah requirements which include adherence to sound banking practices and safeguarding customers' interest.

3. Scope of policy document

- 3.1 Part B provides mandatory Shariah requirements to ensure the validity of *tawarruq* and its optional practices.
- 3.2 Parts C provides operational requirements on governance and oversight, structuring, risk management, financial reporting and business and market conduct.

4. Applicability

- 4.1 This policy document is applicable to all IFIs as defined in paragraph 7.2. Notwithstanding this, licensed takaful operators under the Islamic Financial Services Act 2013 (IFSA) shall only apply Part B of this policy document.

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5. Legal provisions

- 5.1 The requirements in this policy document are:
- (a) specified pursuant to sections 29(1) and (2), 57(1), 135(1) and 277 of the IFSA; and
 - (b) specified pursuant to sections 41(1) and 126, and issued as a direction pursuant to section 129(3) of the Development Financial Institutions Act 2002 (DFIA).

6. Effective date

- 6.1 This policy document comes into effect immediately upon issuance. The IFIs are given a 6-months period from the effective date to fully comply with the requirements.

Question 1

Please highlight any significant operational consideration (with appropriate justification) that may impact the institution's readiness to comply with the policy document within the proposed period.

7. Interpretation

- 7.1 The terms and expressions used in this policy document shall have the same meanings assigned to them in the Financial Services Act 2013 (FSA), IFSA and DFIA, as the case may be, unless otherwise defined in this policy document.
- 7.2 For the purpose of this policy document:
- “S” denotes a standard, requirement or specification that must be complied with. Failure to comply may result in one or more enforcement actions; and
 - “G” denotes guidance which may consist information, advice or

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recommendation intended to promote common understanding and sound industry practices which are encouraged to be adopted;

“Islamic financial institution” or “IFI” means –

- (a) a licensed Islamic bank under the IFSA;
- (b) a licensed takaful operator under the IFSA;
- (c) a licensed bank and licensed investment bank under the FSA approved under section 15(1)(a) of the FSA to carry on Islamic banking business; and
- (d) a prescribed institution under the DFIA approved under section 129(1) of the DFIA to carry on Islamic banking business or Islamic financial business.

7.3 A glossary of terms used in this policy document is set out in Appendix 2.

8. Related Shariah rulings and policy documents

8.1 This policy document must be read together with but not limited to such Shariah rulings and policy documents as specified in Appendix 3.

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PART B SHARIAH REQUIREMENTS AND OPTIONAL PRACTICES

9. Definition

- S** 9.1 *Tawarruq* consists of two sale and purchase contracts where the first involves the sale of an asset to a purchaser on a deferred basis and the subsequent sale involves sale of the asset to a third party on a cash basis.

10. Nature

- S** 10.1 Each sale and purchase contract in a *tawarruq* is binding in nature. Therefore, each of the sale and purchase contract shall not be terminated unilaterally by any of the contracting parties.
- S** 10.2 The common inherent nature of each sale and purchase contract in the *tawarruq* is the transfer of ownership of the asset from the seller to the purchaser for a consideration.
- G** 10.3 Pursuant to paragraph 10.2, the sale and purchase contract in a *tawarruq* may take the form of *murabahah* or *musawamah*.

11. Contracting parties

- S** 11.1 The contracting parties in a *tawarruq* shall be the seller and the purchaser who enter into a sale and purchase contract.
- S** 11.2 In a *tawarruq*, the seller in the first sale and purchase contract shall not be the purchaser in the second sale and purchase contract.

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- S** 11.3 The contracting parties shall have the legal capacity¹ to enter into each sale and purchase contract in the *tawarruq*.
- G** 11.4 The contracting parties in each sale and purchase contract in the *tawarruq*:
- (i) may be a natural person or a legal entity; and
 - (ii) may enter into the sale and purchase contract through an agent.

12. Offer (*ijab*) and acceptance (*qabul*)

- S** 12.1 Each sale and purchase contract in the *tawarruq* shall be entered into through an offer and acceptance between the contracting parties.
- G** 12.2 The offer and acceptance may be expressed verbally, in writing or any other methods which could be evidenced by appropriate documentation or record.
- S** 12.3 Pursuant to paragraph 12.1, the offer and acceptance must be executed in the following manner:
- (i) the seller sells the asset to the purchaser by entering into a sale and purchase contract; and
 - (ii) subsequently, the purchaser enters into another sale and purchase contract of the asset with a third party.

¹ *The legal capacity of a person, from Shariah perspective, is defined as capacity to assume rights and responsibilities; and the capacity to give legal effect to his action. Among the important conditions are that the person must be of sound mind and have the capacity to distinguish between what is beneficial or harmful to one's interests. Legal capacity of a legal entity is defined as the eligibility of an entity to acquire rights and assume responsibilities. In Malaysia, the legal capacity is governed by the Contracts Act 1950 and the Age of Majority Act 1971.*

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13. Asset

- S** 13.1 The asset to be traded in a *tawarruq* shall be either a tangible or an intangible asset that:
- (a) is recognised by Shariah, valuable, identifiable and deliverable; and
 - (b) is already in existence and owned by the seller in each respective sale and purchase contracts involved.
- G** 13.2 The asset may be divided or undivided.
- S** 13.3 Pursuant to paragraph 13.2, the undivided asset shall be apportioned based on practices which are recognised by the Shariah.
- S** 13.4 The following assets shall not be traded in a *tawarruq*:
- (a) gold, silver and currencies;
 - (b) assets to be constructed or under construction; and
 - (c) assets which are debt in nature.
- G** 13.5 The asset may be acquired by the seller through a purchase from a supplier, or through any other means of transfer of ownership which is in compliance with Shariah.
- S** 13.6 In the event where the asset is not present at the *majlis al-`aqd* (place of the contract session), the purchaser shall be given a specific description of the asset by the seller.
- S** 13.7 The transfer of ownership from the seller to the purchaser is effected upon entering into a valid sale and purchase contract even though there is no legal registration of the ownership.

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- S** 13.8 The purchaser shall take possession of the asset before he can sell the asset to a third party. Possession of the asset shall be either *haqiqi* (physical) or *hukmi* (constructive).
- S** 13.9 Possession of the asset shall take effect by the seller releasing the asset (*takhliyah*) to the purchaser through any mechanism permitted by Shariah including customary business practice (*`urf tijari*) so that the purchaser would have access to the asset (*tamkin*) and would have assumed its ownership risk.
- S** 13.10 The seller shall bear all liability for loss or damage of the asset before the purchaser takes possession of the asset.
- S** 13.11 Multiple *tawarruq* shall not be entered into simultaneously on the same asset.
- G** 13.12 A *tawarruq* may be entered into on a group of assets between the same contracting parties at the same time.
- S** 13.13 Any defect in the asset which occurred before entering into any sale and purchase contract in the *tawarruq* but is discovered by the purchaser after the execution of the contract shall entitle the purchaser to the *khiyar al-`ayb* (defect option).
- S** 13.14 Pursuant to paragraph 13.13, the purchaser has the right to:
- (a) terminate the sale and purchase contract;
 - (b) choose to continue with mutually agreed variation of the terms of the sale and purchase contract; or
 - (c) choose to continue with the sale and purchase contract as it is.
- S** 13.15 Any defect in the asset which is discovered and consented to by the purchaser at the time of entering into each sale and purchase contract in the *tawarruq* shall disqualify the purchaser from the entitlement to the

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khiyar al-`ayb (defect option) with respect to the defect.

- G** 13.16 The contracting parties may mutually agree to specify the period of the *khiyar al-`ayb* (defect option) at the time of entering into the sale and purchase contract.
- G** 13.17 Notwithstanding paragraph 13.13 the contracting parties may mutually agree to stipulate a condition to waive liability for any defect on the asset prior to entering into the sale and purchase contract.
- S** 13.18 Pursuant to paragraph 13.17, the waiving of liability shall be mutually agreed between the contracting parties.

14. Price

- S** 14.1 The price used in the *tawarruq* shall be determined and be mutually agreed by the contracting parties at the time of entering into each of the respective sale and purchase contract.
- S** 14.2 Where the selling price for any sale contract in the *tawarruq* is on a *murabahah* basis, it shall comply with all requirements relating to the price such as the disclosure of cost and profit under a *murabahah* sale.
- G** 14.3 The price of each sale and purchase contract in the *tawarruq* may be paid at any time after entering into a contract and in any form agreed by the contracting parties such as spot or deferred in the form of instalments or bullet payments.
- G** 14.4 The contracting parties may mutually agree to extend or reschedule the payment period of the remaining debt.

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- S** 14.5 Pursuant to paragraph 14.4, where the contracting parties extend or reschedule the payment period of the remaining debt, such new arrangement shall not lead to any increase in the amount of the remaining debt.
- G** 14.6 The contracting parties may mutually agree to settle the outstanding debt obligation by entering into a new contract that may result in a new debt obligation, the proceeds of which is to be used to settle the outstanding debt obligation.
- S** 14.7 Pursuant to paragraph 14.6, where a new contract which results in a new debt obligation is entered into to settle the outstanding debt by utilising the new proceeds, the new contract shall be entered into before maturity of the debt arising from the existing contract.

15. Requirements of the *tawarruq*

- S** 15.1 Each sale and purchase contract in the *tawarruq* shall satisfy all the necessary conditions of a valid sale and purchase contract under Shariah.
- S** 15.2 All sale and purchase contract in a *tawarruq* shall be executed by entering into separate and independent sale and purchase contracts.
- G** 15.3 The *tawarruq* may be incorporated in other legal documents such as:
- (a) a master agreement, provided that the master agreement does not carry the effect of the sale and purchase contract; or
 - (b) a stand-alone document.
- S** 15.4 The purchaser in each sale and purchase contract in a *tawarruq* shall have the right to take delivery of the asset.

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S 15.5 No sale and purchase contract in a *tawarruq* shall stipulate any terms and conditions that restrict the purchaser from taking delivery of the asset or create an obligation for the purchaser to sell the underlying asset.

S 15.6 Any amount of the deferred selling price including profit shall not be paid to the seller before entering into the sale and purchase contract.

16. Arrangement of *tawarruq* with *wakalah*

G 16.1 A *tawarruq* may be arranged together with a *wakalah* contract.

G 16.2 Any contracting party in a *tawarruq* may appoint an agent to execute the transaction on his behalf.

S 16.3 The *wakalah* contract shall be arranged in a separate contract from the sale and purchase contract in a *tawarruq*.

G 16.4 Pursuant to paragraph 16.3, the *wakalah* may be incorporated in other legal documents such as:

- (a) a master agreement, provided that the master agreement does not carry the effect of the *wakalah* contract; or
- (b) a stand-alone document.

S 16.5 Pursuant to paragraph 16.4, inclusion of the *wakalah* contract in the *tawarruq* shall not restrict the principal or his agent as purchaser from taking delivery of the asset.

S 16.6 Ownership of the asset shall be transferred from the seller to the purchaser (principal) even though the sale and purchase contract in the *tawarruq* is entered into through an agent on behalf of the purchaser.

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- S** 16.7 Roles and responsibilities of the agent shall be specified clearly in the *wakalah* contract.
- S** 16.8 The agent shall not be held liable except in the event of *ta`addi* (misconduct), *taqsir* (negligence) or *mukhalafah al-shurut* (breach of specified terms).
- S** 16.9 Pursuant to paragraph 16.8, the principal shall be held liable for the sale and purchase contract entered into by the agent in accordance with specified terms and conditions agreed upon under the *wakalah* agreement.
- G** 16.10 The name of the principal in the *wakalah* contract may be disclosed in documents related to the sale and purchase contract in the *tawarruq* between the third party and the principal which has been executed by the agent on behalf of the principal.
- G** 16.11 Notwithstanding paragraph 16.10, the agent and the principal may agree that only the name of the agent may be disclosed in all documents related to the sale and purchase contract between the third party and the agent.
- S** 16.12 In the event that the principal requires the purchasing agent to provide several quotations for the price of the asset, the principal shall clearly specify to the purchasing agent the preferred price quotation.
- G** 16.13 The purchasing agent may advance his own money by way of *qard* for partial or full payment of the purchase price of the asset to the third party.
- S** 16.14 Pursuant to paragraph 16.13, the amount advanced shall be reimbursed by the principal or shall be off-set from the selling price to be concluded with the purchasing agent.

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- S** 16.15 Where the *murabahah* sale in a *tawarruq* is executed by the agent on a date later than the date on which the fund is accepted from the principal, the following requirements shall be observed:
- (a) the fund must be held based on trust (*amanah*) by the agent; and
 - (b) both the agent and principal must ensure that funds accepted from the principal shall not be treated as *qard* to the agent prior to the execution of *tawarruq* between the agent and the principal.
- S** 16.16 Notwithstanding paragraph 16.15, in situations where the funds need to be treated as *qard* to the agent due to necessary and unavoidable incidental circumstances (*tabî*), such treatment is allowed.

17. Implementation of a dual-agency in a *tawarruq*

- G** 17.1 Dual-agency may be implemented in a *tawarruq*.
- G** 17.2 A dual-agency in a *tawarruq* arrangement may involve the following:
- (a) an action of one of the contracting parties who acts as an agent to purchase an asset on behalf of the other contracting party; and subsequently acts as an agent to sell the asset on behalf of the same contracting party to himself; or
 - (b) an action of one of the contracting parties who acts as an agent to purchase an asset from himself (agent) on behalf of the other contracting parties; and subsequently acts as an agent to sell the asset on behalf of the same contracting party to a third party.
- S** 17.3 Pursuant to paragraph 17.2, the execution of the sale and purchase transactions between the principal and the agent shall comply with the following requirements:
- (a) essential criteria or specification of the authorised task shall be agreed such as price, tenure, asset specification; and
 - (b) the transaction shall be in a proper sequence and supported by

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proper evidence.

- S** 17.4 In the event where:
- (a) the *murabahah* sale in the *tawarruq* is executed on a date later than the date on which the funds are accepted from the principal; and
 - (b) the profit of the *murabahah* sale is calculated from the day the funds are accepted,
- the selling price shall be made known to the principal.

18. Arrangement of *tawarruq* with *wa'd*

- G** 18.1 In a *tawarruq*, the purchaser may undertake to purchase the asset from the seller upon its acquisition from a third party.
- S** 18.2 Pursuant to paragraph 15.5 and 16.5, in a *tawarruq* there should not be any undertaking by the purchaser to sell the asset to a third party.
- S** 18.3 A *tawarruq* shall not contain any condition that requires the asset to be sold back to its original seller.

19. Arrangement of *tawarruq* with assurances

- G** 19.1 For the purpose of assurances, a *tawarruq* may be arranged with other Shariah contracts or concepts such as *kafalah*, *takaful*, *rahn* or *hamish jiddiyah* (security deposit).

(a) Assurance through *kafalah*

- G** 19.2 A *kafalah* (guarantee) may be arranged to guarantee the payment of the outstanding debt of the sale and purchase contract in a *tawarruq* in the event of default by the purchaser.

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(b) Assurance through *takaful*

- G** 19.3 The seller may require the purchaser to subscribe to a *takaful* coverage to secure the payment of the outstanding debt of the sale and purchase contract in a *tawarruq* for certain events such as death or total permanent disability of the purchaser.

(c) Assurance through *rahn*

- S** 19.4 Any *marhun* (collateral) pledged to secure the debt in the sale and purchase contract in a *tawarruq* shall be a Shariah-compliant asset.
- G** 19.5 Notwithstanding paragraph 19.4, an interest bearing debt based asset such as conventional fixed deposit certificate, may be used as collateral provided that the collateral is valued up to the principal amount.
- S** 19.6 The proceeds from the liquidation of the collateral shall be utilised only to recover the outstanding debt.
- G** 19.7 Notwithstanding paragraph 19.6, the contracting parties may agree to also utilise the proceeds to recover the actual costs pertaining to recovering of the debts.

(d) Assurance through *hamish jiddiyah*

- G** 19.8 The seller may require the purchaser to provide *hamish jiddiyah* (security deposit) to secure an undertaking to purchase the asset.
- G** 19.9 The security deposit may be used to compensate against actual loss incurred in the event the purchaser fails to purchase the asset from the seller.
- S** 19.10 Pursuant to paragraph 19.9, the excess portion of the security deposit after compensation against actual loss shall be returned to the purchaser.

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- S** 19.11 The seller shall not utilise the security deposit prior to the execution of the sale and purchase contract in a *tawarruq*.
- S** 19.12 The security deposit paid to the seller before entering into the sale and purchase contract shall not be treated as part of the selling price including profit.
- G** 19.13 Only upon entering into the sale and purchase contract, the security deposit may be treated as part of the payment of the agreed selling price for the sale and purchase contract.
- S** 19.14 The security deposit shall be returned to the purchaser if it is not treated as part of the payment of the selling price.

20. Arrangement of *ibra'* (rebate) in *tawarruq*

- G** 20.1 The seller may consider waiving part of the outstanding or remaining unpaid price of the sale and purchase contract in the *tawarruq* in the form of a discount to the purchaser upon pre-payment and/or early settlement.
- S** 20.2 Notwithstanding paragraph 20.1, an *ibra'* (rebate) clause shall be incorporated in the sale and purchase contract or other relevant document when it is imposed by the relevant authority.
- G** 20.3 In the event that the sale and purchase contract in the *tawarruq* contract involves payment of the deferred price in instalment, the seller may provide periodic *ibra'* (rebate) on the instalment amount based on a formula agreed by the contracting parties.

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21. Arrangement of *tawarruq* with *ta'widh* and/or *gharamah*

- G** 21.1 The contracting parties may agree to include a clause in any of the sale and purchase contracts in the *tawarruq* stipulating late payment charges as determined by the relevant authority.
- S** 21.2 Pursuant to paragraph 21.1, the late payment charges shall consist of:
- (a) *ta'widh* (compensation) for actual loss suffered by the seller, which may be recognised as income to the seller; and/or
 - (b) *gharamah* (penalty), which shall not be recognised as income. Instead, it shall be channelled to *baitulmal* and/or charitable bodies or purposes.

22. Dissolution of sale and purchase contract in *tawarruq*

- S** 22.1 The sale and purchase contract in a *tawarruq* is dissolved when:
- (a) the purchaser exercises the *khiyar al-'ayb* (defect option) to terminate the sale and purchase contract;
 - (b) any of the contracting parties exercises mutually agreed options to terminate the sale and purchase contract within the agreed time period;
 - (c) the contracting parties exercise the option to terminate the sale and purchase contract due to breach of the specified terms;
 - (d) both contracting parties mutually agree to terminate the sale and purchase contract.
- S** 22.2 Upon dissolution of any of the sale and purchase contracts in the *tawarruq* where the asset has not been sold to a third party, the asset shall be returned to the respective seller and the price paid shall be returned to the respective purchaser.

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- S** 22.3 Pursuant to paragraph 22.2, the dissolution of the sale and purchase contract shall be effective provided that the asset can be returned to the seller.

23. Completion of *tawarruq*

- S** 23.1 The sale and purchase contract in a *tawarruq* ends upon fulfilment of the obligations of the contracting parties which include the following:
- (a) full settlement of the selling price;
 - (b) transfer of the obligation to pay the selling price to a third party through *hiwalah al-dayn*;
 - (c) waiving of the right to receive the remaining or outstanding selling price through an *ibra'* (rebate) by the seller; or
 - (d) full *muqassah* (set-off) of debt obligations between the contracting parties.
- S** 23.2 Upon completion of the *tawarruq* the contracting parties are free from any contractual obligations.

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PART C OPERATIONAL REQUIREMENTS

Part C emphasises the need to put in place effective policies and procedures to facilitate governance and oversight function, structuring, risk management, financial disclosure and business and market conduct of *tawarruq*. The policy intent of these operational requirements is to provide adequate safeguards for stakeholders' interests, promote cohesive implementation of business and risk management strategies and drive the development of the necessary systems, processes and control measures while preserving compliance with Shariah. In the case of *tawarruq*, when any of the sale and purchase contract is conducted under *murabahah*, the IFI will also comply with the requirements of the policy on *Murabahah*.

24. Governance and oversight

Principle 1: The IFI shall establish a comprehensive governance and oversight framework to ensure that a *tawarruq* transaction is conducted based on sound practices and complies with Shariah requirements.

- S** 24.1 This policy document complements the *Guidelines on Corporate Governance for Licensed Islamic Banks* and *Guidelines on Corporate Governance for Development Financial Institutions*.
- S** 24.2 While the broad governance and oversight principles can be applied, specific requirements are needed to manage the distinct risks and the unique nature of a *tawarruq*. The IFI shall have sufficient understanding of its risk profile and availability of resources with the appropriate knowledge and skill set.

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Board of Directors

- S** 24.3 The board of directors (the Board) shall establish a sound governance structure to facilitate an effective oversight function on the management and implementation of the *tawarruq*. The adequacy of the governance structure shall commensurate with the nature, scale, complexity and risk profile of the *tawarruq*.
- S** 24.4 The roles and responsibilities of the Board in respect of the *tawarruq* shall include the following:
- (a) setting the IFI's business strategy and risk appetite with regard to the application of the *tawarruq*;
 - (b) approving and overseeing policies and procedures for effective risk management to ensure compliance with the relevant law and regulations;
 - (c) establishing appropriate systems to implement the *tawarruq* in compliance with Shariah;
 - (d) ensuring that the IFI has adequate and qualified personnel with sufficient knowledge and competency on the concept, application and risks associated with the *tawarruq*; and
 - (e) ensuring that independent reviews are conducted regularly to assess compliance with the policy documents issued by the Bank and internal policies established by the IFI.

Shariah Committee

- S** 24.5 The Shariah committee (SC) shall perform the following to ensure that all activities of the *tawarruq* undertaken by the IFI are conducted in line with Shariah requirements:
- (a) endorse that the Shariah requirements are appropriately applied in the relevant policies and procedures governing the *tawarruq*; and
 - (b) deliberate and endorse that the terms and conditions stipulated in the legal documentations and other documents such as information published for promotional materials, product manuals or other publications are in compliance with Shariah;

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- (c) assess the work carried out by Shariah review and Shariah audit, identify issues and propose appropriate corrective measures; and
- (d) advise and provide clarification on relevant Shariah rulings, decisions or guidelines on Shariah matters issued by the Bank and, if relevant, any other authorities.

Senior management

- S** 24.6 The roles and responsibilities of the senior management with regards to the *tawarruq* shall include the following:
- (a) developing and implementing business strategies, internal control and risk management requirements in line with the IFI's business objectives;
 - (b) establishing policies, processes and procedures with regard to proper management of the *tawarruq*;
 - (c) implementing relevant internal systems, infrastructure and adequate mechanisms to identify, measure, control and monitor risk inherent in the *tawarruq*;
 - (d) identifying, assigning and training key personnel with the appropriate skill and ensuring that the roles and responsibilities are properly delegated to the relevant functions to undertake the different activities under the *tawarruq* e.g. asset purchase and asset sale;
 - (e) undertaking regular reviews and monitoring of compliance with the approved policies; and
 - (f) ensuring timely disclosure of relevant information to the Board and the SC.

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25. Structuring

Principle 2: The IFI shall ensure that the structuring and implementation of a *tawarruq* is supported by comprehensive policies and procedures, processes, adequate infrastructure and robust documentation.

(a) Shariah compliance

- S** 25.1 The IFI shall be responsible for ensuring:
- (a) the overall operations of the *tawarruq* are in compliance with Shariah requirements;
 - (b) the product structure, strategies, terms of agreement and policies, processes and procedures are endorsed by the SC; and
 - (c) the opinion of the Shariah Advisory Council (SAC) of the Bank is sought to resolve issues pertaining to Shariah matters as outlined in the *Shariah Governance Framework for Islamic Financial Institutions*.
- S** 25.2 The IFI shall establish an effective management system that is supported by adequate policies and procedures and competent personnel to ensure that the *tawarruq* continuously adhere to Shariah requirements.

(b) Purpose

- S** 25.3 The purpose of the *tawarruq* shall be clearly outlined between the IFI and its customers e.g. for the purpose of deposit taking, provision of finance or derivatives.

(c) Contracting parties

- S** 25.4 The contracting parties in the *tawarruq* contract shall involve at least three parties which consist the customer, the IFI and the asset broker or asset exchange (e.g. Bursa Suq Al-Sila’).

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- S** 25.5 The contracting parties shall be clearly identified as the seller or purchaser in each sale and purchase contract in line with the purpose of the *tawarruq*. The IFI shall also identify the agent of any of the contracting parties.
- S** 25.6 The IFI shall clearly specify the roles and responsibilities of the contracting parties and if applicable, the agent, in each sale and purchase contract based on the purpose of the *tawarruq*.

(d) Assets

- S** 25.7 The IFI shall specify the asset(s) used in the *tawarruq*. In addition to the requirements of paragraph 13, the asset must meet the following criteria:
- (a) have monetary value that would be objectively valued in the open market or a value that could be reasonably realised by an independent third party;
 - (b) have met the acceptable contract grade or specification as adopted by leading commodity exchanges if they are traded commodities;
 - (c) in good condition prior to the completion of both sale and purchase transactions e.g. have not expired if the asset is perishable; and
 - (d) do not include assets with no active markets or intangible assets recognised under applicable Malaysian Financial Reporting Standards (MFRS) e.g. brand, patents and intellectual property.

Illustration 1: Valid assets for *tawarruq*

- (a) Consumer goods which are valued at available market prices.
- (b) Airtime coupons which are valued at available market prices.
- (c) Crude palm oil (CPO) which meets the acceptable trading grade determined by Bursa Suq Al-Sila'.
- (d) Consumer goods with an expiration period provided that each sale and purchase contract is completed before the consumer goods expire.

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- S** 25.8 Where the asset(s) is undivided², the IFI shall ensure the following:
- (a) ownership of such asset can be legally enforceable and executable;
 - (b) ownership can be identified on a proportionate basis; and
 - (c) asset selection is consistent with specification/description agreed between the contracting parties.

Illustration 2: Undivided assets

Crude palm oil (CPO) is stored in 10,000 tonnes storage tanks. Each trading transaction is carried out per 1,000 tonnes. In the case of 2 different purchase transactions of 1,000 tonnes and 4,000 tonnes each, the asset broker records the proportion of the CPO in the storage tank to identify the ownership of the respective purchasers. The asset broker is not required to physically divide the CPO into separate storage tanks for the purposes of identifying asset ownership of the respective purchasers.

Question 2

Please comment on the adequacy of the requirements under Assets.

- (a) What other intangible asset that could be used in a *tawarruq*?
- (b) Please provide views on the proposal to use undivided assets in a *tawarruq* contract, such as land and property?
- (c) Please comment on whether asset with no active market should be allowed in a *tawarruq*? Please provide your justification and the issues that might arise in complying with this requirement.

² An undivided asset refers to an asset represented by a single physical form of which rights of ownership to such an asset may be held by a single or multiple owners who share in the rights, benefits and obligations of such an asset proportionally to their percentage of ownership.

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(e) Price

- S** 25.9 The selling price of the sale and purchase contract with deferred payment must be in the form of *murabahah*.
- S** 25.10 In order to ensure genuine selling price, the cost in the selling price of the asset of each sale and purchase contract shall be based on the quoted price or observable price in the designated markets of a similar asset.

Illustration 3: Valid cost in selling price

- (a) The cost of CPO per tonne is based on the quoted market price of leading commodity exchanges (e.g. Bursa Suq Al-Sila’).
- (b) The cost of airtime coupons of a telecommunication service provider shall reflect prevalent market prices.

- S** 25.11 In respect of *murabahah*, the profit in the selling price shall be specified either:
- (a) in absolute terms; or
- (b) in percentage terms in relation to the cost and/or number of days of deferred payment.
- S** 25.12 Pursuant to paragraph 17.4 the profit in the selling price shall be specified in absolute terms.

Illustration 4: Profit under *murabahah*

- (a) Absolute terms – A customer is given a financing of RM100,000 repayable over a period of 1 year. The agreed profit is RM6,500. Therefore, the agreed selling price is RM106,500.
- (b) Percentage terms – A customer makes a term deposit placement of RM100,000 for a period of 180 days. The agreed profit is 3.6% per annum. The agreed selling price is RM101,775 (RM100,000 X 3.5% X 180/365).

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Question 3

What controls should be in place to ensure that the price of the asset commensurate with the cash requirement and would be easily validated.

(f) Arrangement with *wakalah* and dual-agency

- S** 25.13 The IFI shall clearly specify the terms and structure of the arrangement with *wakalah* and/or dual-agency in the *tawarruq*. In this regard, the IFI shall assess the need for *wakalah* and/or dual agency, including further sub-agency arrangements to ensure that such application will effectively achieve the purpose specified in paragraph 25.3.
- S** 25.14 Where the agent is tasked to conduct a *murabahah* sale, it is the responsibility of the IFI to ensure timely execution.
- S** 25.15 In the event that the *murabahah* sale is not executed on the same day, the IFI shall comply with the requirements of trust (*amanah*). Pursuant to paragraph 16.16, the following events shall constitute incidental circumstances, that may cause the delay in the execution of a *murabahah* sale, that can warrant the treatment of *qard*:
- (a) normal close of business/operation including public holidays and other state holidays; and
 - (b) unexpected disruptions to operation e.g. system breakdown, force majeure.

Question 4

What are the challenges to ensure compliance with the above requirement? What approach does your institution would take to ensure compliance with the above requirement?

- S** 25.16 Where the agent has been requested to provide quotations, the IFI shall clearly outline the following:
- (a) minimum number of quotations to be provided;

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- (b) sources of quotation; and
- (c) time period for customer to respond and any time bound on the quotations, if applicable.

(g) Arrangement with *wa'd* (undertaking) and assurances

- S** 25.17 The IFI shall clearly specify the purpose and terms of the *wa'd* (undertaking) and assurances including the purpose and rights and obligation of the contracting parties associated with *tawarruq*. For example, where the seller requires placement of *hamish jiddiyah* (security deposit) for the purpose of securing firm commitment from the purchaser to perform the purchase of the asset, the seller has the right to recourse losses from the purchaser if the purchaser fails to perform the purchase undertaking.
- S** 25.18 The amount of outstanding debt shall mean the outstanding selling price less any *ibra'* (rebate).
- S** 25.19 IFI must outline the right to recover losses arising from the breach of *wa'd* (undertaking) or upon trigger event which warrant for assurances to be invoked. In respect of default arising from non-repayment of outstanding debt, the IFI that is the seller shall comply with the Guidelines on Late Payment Charges for Islamic Financial Institutions. Whilst, in the event where the customer is the purchaser and fails to perform the purchase undertaking, the actual loss must be determined based on costs which are directly attributable to non-purchase such as legal costs, storage cost and the shortfall in the disposed price compared to the purchase price (if any). The actual costs shall not include indirect costs such as allocated overhead costs or salary or opportunity costs such as cost of funds.
- S** 25.20 The amount of security deposit shall be determined and mutually agreed by the contracting parties. Prior to the execution of the sale and purchase contract, the security deposit shall clearly be distinguished from the

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selling price.

Illustration 5: Invalid payment of profit from security deposit

Bank ABC accepts deposit placement from a customer. As part of its marketing strategy it would like to pay advance profit to its customer. Bank ABC does this by making a security deposit with the customer on the day (1 January 2014) of deposit acceptance. However the actual sale and purchase transaction is performed at a later date (3 January 2014). Bank ABC is NOT allowed to declare the security deposit as partial payment of profit because the sale and purchase transaction has not been executed.

(h) Arrangement of *ibra'* (rebate)

- S** 25.21 The IFI shall clearly outline the applicability of *ibra'* (rebate) for pre-payment or early settlement including partial payment or settlement in the documentation.

Illustration 6: *ibra'* (rebate) on early settlement

- (a) A customer makes a 12-month term deposit placement under *tawarruq*. In the 6th month the customer withdraws the entire deposit. The withdrawal constitutes early settlement of the outstanding debt by the IFI. Hence, the customer must provide rebate to the IFI.
- (b) A customer is given a house financing repayable over a 30-year period. The customer fully settles the outstanding debt in the 12th year. The IFI must provide rebate to the customer.

- S** 25.22 The *ibra'* (rebate) clause must be incorporated in each of the sale and purchase contract that allows for pre-payment and/or early settlement.

- S** 25.23 In respect of financing products, the IFI shall comply with the *Guidelines*

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on *ibra'* (rebate) for Sale-based Financing.

- S** 25.24 *ibra'* (rebate) is defined as the amount of deferred profit³ at the point of settlement of the selling price. The IFI is prohibited to impose any penalty charges on customers for requiring early settlement during a specified time period. The formula for *ibra'* (rebate) shall be as follows:
- = Deferred profit at point of settlement of the selling price
- = Profit X $\frac{\text{Number of days remaining to original deferred payment period}}{\text{Number of days of the original deferred payment period}}$

Illustration 7: Calculation of *ibra'* (rebate)

- (a) Selling price: RM100,000 + profit RM3,000
Repayment period: 180 days
Early settlement: 60th day

$$ibra' = RM3,000 \times \frac{(180 - 60)}{180}$$

$$= RM2,000$$
- (b) Selling price: RM100,000 + profit 4.5% per annum
Repayment period: 365 days
Early settlement: 300th day

$$ibra' = (RM100,000 \times 4.5\%) \times \frac{(365 - 300)}{365}$$

$$= RM801$$

Question 5

Please comment on the proposed requirements under *ibra'*.

- (a) Please provide views on the proposed conditions where *ibra'* (rebate) shall be granted?
- (b) Do you agree with the proposed formula?

³ Deferred profit is equated to 'unaccrued/unearned profit' under applicable Malaysian Financial Reporting Standards (MFRS).

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(i) Arrangement of *tawarruq* with *ta'widh* and/or *gharamah*

- S** 25.25 The IFI must satisfy the requirements set out in the Guidelines on Late Payment Charges for Islamic Financial Institutions with regard to the application of *ta'widh* and/or *gharamah* in *tawarruq*.

26. Risk management

Principle 3: The IFI shall implement a sound and an integrated risk management system to effectively manage risks throughout the life cycle of the *tawarruq*.

- G** 26.1 The *tawarruq* may expose the IFI to various types of risks, such as commodities, market, liquidity, credit and operational risks. These risks, which appear at various stages of transactions, may change in nature that may necessitate a comprehensive and sound risk management infrastructure, reporting and control framework.
- S** 26.2 The IFI shall establish comprehensive risk management policies and procedures, systems and internal control to address risks in line with its risk appetite, throughout the life cycle of the *tawarruq* and shall include the following:
- (a) the identification and monitoring of risks including risk exposure to inventories arising from the acquisition and holding of asset prior to the execution of the sale contract;
 - (b) the formulation of appropriate pricing methodology of the asset including establishing controls to ensure quotations are obtained in an independent objective manner;
 - (c) the establishment of risk exposure limits including trading or concentration limits on approved asset, asset trader and/or asset exchange, where necessary in line with the IFI's risk appetite;
 - (d) the risk mitigation techniques including establishing;
 - (i) appropriate eligibility criteria and review process in identifying

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a list of approved asset, asset trader and/or asset exchange to be used in a *tawarruq*;

- (ii) clear segregation of roles and duties to be performed under dual-agency e.g. designating separate personnel to perform each role or applying appropriate technology that will independently execute dual agency roles e.g. short messaging systems (sms) or telephone calls; and
 - (iii) contingency plan that is feasible to facilitate the execution of the *tawarruq* in a timely manner e.g. inadequate supply of asset; and
- (e) the monitoring and reporting mechanism.

Illustration 8: Risk exposure to inventories

Bank ABC purchased asset from Asset Trader Y on 3 March 2014. Bank ABC subsequently executes the second sale and purchase contract with Asset Trader Z on 7 March 2014, which is 4 days after the initial sale and purchase contract. Prior to completion of the second sale and purchase contract, Bank ABC is exposed to inventory risk.

- S** 26.3 The IFI shall ensure that the appointment or selection of asset trader and/or asset exchange is subject to comprehensive risk assessment and satisfy itself that the arrangement does not impair the IFI's ability to monitor and control its activities and adhere to Shariah and regulatory requirements. When establishing the appropriate selection criteria to identify the approved asset trader and/or asset exchange, the IFI shall consider the following:
- (a) the financial soundness of the asset trader and/or asset exchange including financial performance, volume of trades and number of customers;
 - (b) the operational capability including adequate systems, trading capacity, delivery capacity, asset type, quality specification; and
 - (c) the availability of Shariah compliance oversight function. If such

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function is not available, the IFI must duly inform its SC for endorsement.

- S** 26.4 As part of monitoring the individual arrangement with the asset trader and/or asset exchange the IFI must:
- (a) establish controls to ensure service delivery in a manner expected in accordance with Shariah and regulatory requirements e.g. risk of delivery, performance reliability and processing capacity; and
 - (b) maintain continuous and effective engagement with the asset trader/asset exchange to ensure ongoing ability to meet the requirements of Shariah and regulators;
- S** 26.5 Internally, the IFI shall clearly specify and communicate the policies and procedures and limits to all its relevant functions.
- S** 26.6 The IFI shall establish a systematic process to review and update its policies, procedures, internal limits and shall ensure consistency with the risk appetite of the IFI and any material changes within the industry.

Question 6

Please comment on the adequacy of the requirements under Risk management.

- (a) Do your institution's risk management policies and procedures currently include the establishment of trading/concentration limits? Please elaborate your rationale for not having the policy.
- (b) Please provide comments on risks mitigation measures taken to manage daily risks on risk exposure to inventories?
- (c) Please provide your views on whether IFIs should be restricted from engaging with an asset trader/asset exchange which does not have a Shariah compliance oversight function?

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27. Business and market conduct

Principle 4: The IFI shall undertake *tawarruq* in a fair and transparent manner in line with the Shariah to protect stakeholder's interest.

- S** 27.1 The IFI shall give due regard to the interests of consumers in its policies and procedures to ensure that the *tawarruq* is conducted in a fair, transparent, responsible and professional manner.
- S** 27.2 The IFI shall ensure the accuracy of description, nature and feature of the *tawarruq* and other Shariah contracts or concepts applicable to the particular purpose and product structure.

Illustration 9: Inaccurate description

- (a) Promoting the use of *hamish jiddiyah* (security deposit) to offer “advance profit” to customers.
- (b) Quoting only profit rate and not identifying the selling price in the documents.

(a) Fair dealings

- S** 27.3 The IFIs' internal policies and procedures on business and market conduct for the *tawarruq* shall reflect fair dealing, including:
- (a) the information provided shall be accurate and clear;
- (b) the fees and charges (if any); and
- (c) reasonable care is taken to ensure suitability of advice and recommendations, if any.

(b) Disclosure of information

- S** 27.4 The IFI shall educate and facilitate the customer's understanding on the concept of *tawarruq* contract. For this purpose, the IFI is required to develop and implement appropriate marketing approach to ensure that the customer receives clear and adequate explanation on the following:

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- (a) nature and feature of a *tawarruq*;
- (b) terms in a *tawarruq* e.g. selling price, *ibra'* (rebate), asset, *etc.*;
- (c) the processes involved in a *tawarruq* which may differ from other Shariah contracts used in a similar type of product.

Question 7

- (a) What are the measures that your institution would employ to satisfy the requirements under paragraph 27.4?
- (b) What are the challenges to satisfy the above requirements?

S 27.5 At the pre-contractual stage, the IFI shall provide adequate and relevant information to the customers in the marketing or promotional materials, product disclosure sheet and any other relevant materials with regard to the *tawarruq*. The information shall include:

- (a) name of the product and the objective/ purpose of the *tawarruq*;
- (b) overview of the product structure and a description of the salient features including the nature of the Shariah contract applied and the roles and responsibilities of the contracting parties;
- (c) a description of the approved asset, price and disclosure of cost and profit margin where *murabahah* is applied;
- (d) key terms and conditions of the contract including arrangement with other Shariah contracts or concepts such as *kafalah* (guarantee), *takaful*, *rahn*, *hamish jiddiyyah* (security deposit) including rights and obligations of the contracting parties;
- (e) fees and charges including *ibra'* (rebate), late payment charges, if applicable; and
- (f) illustration of computation of profit, *ibra'* (rebate), late payment charges based on adopted pricing methodology.

In relation to the product disclosure sheet, the IFI is also required to observe the minimum information to be disclosed in the product disclosure sheet as prescribed in the *Guidelines on Product Transparency and Disclosure*.

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- S** 27.6 At the point of entering into the contract, salient features of the *tawarruq* shall be disclosed in the legal documentation to facilitate the customer's understanding of the terms and conditions of the contract.

(c) Documentation

- S** 27.7 The IFI shall develop comprehensive and legally enforceable documentations for the *tawarruq* which are in compliance with Shariah and regulatory requirement.
- S** 27.8 These documents shall specify the agreed terms and conditions on asset acquisition, asset sale and other terms of the *tawarruq* according to the purpose of the *tawarruq* e.g. financing, deposit placement, derivative instrument. At minimum, the legal documentation shall clearly stipulate the following:
- (a) the purpose of the *tawarruq*;
 - (b) the contractual relationship between the various contracting parties;
 - (c) the rights, roles and responsibilities of the contracting parties to the *tawarruq*;
 - (d) a description and quantity of asset to be sold or acquired including asset code, contract grade and expiration date, if applicable;
 - (e) the selling or purchase price including breakdown of cost and profit, if *murabahah* is adopted;
 - (f) the proposed supplier of the asset and delivery details;
 - (g) the settlement terms of the selling or purchase price,
 - (h) the arrangement with other Shariah contracts or concepts such as *kafalah* (guarantee), *takaful*, *rahn*, *hamish jiddiyyah* (security deposit) including rights and obligations of the contracting parties; and
 - (i) the terms, fees and charges including *ibra'* (rebate) and where applicable, the late payment charges to be borne by the relevant contracting parties.

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- S** 27.9 The IFI shall ensure that the following is documented in writing and executed by the contracting parties at each leg of the sale and purchase transaction:
- (a) legal documentation evidencing the sale and purchase contract;
 - (b) legal documentation evidencing the asset ownership; and
 - (c) where applicable, legal documentation evidencing appointment of an agent and sub-agent if applicable.
- For avoidance of doubt, where the IFI is performing a dual-agency role, performance of each role must be evidenced by adequate documentation.
- S** 27.10 The use of Arabic terminology in the documents shall be sufficiently clarified and translated to enhance understanding of the contracting parties.
- S** 27.11 Where there is an arrangement of *tawarruq* with other Shariah contracts, the IFI shall ensure that the documentation involved is separated and executed in a sequence that is consistent with Shariah requirements.

28. Financial disclosure

Principle 5: The IFI shall provide adequate disclosure and transparency to facilitate stakeholders understanding and assessment of the *tawarruq*.

- S** 28.1 The IFI shall maintain adequate accounting and other records that sufficiently enable the preparation and reporting of a true and fair view financial statements in a timely basis.
- S** 28.2 Requirements stipulated in the *Financial Reporting for Islamic Banking Institutions, Guidelines on Financial Reporting for Development Financial Institutions, Capital Adequacy Framework for Islamic Banks – Disclosure Requirements (Pillar 3)* issued by the Bank and all applicable MFRS shall be observed by the IFI.

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- S** 28.3 The IFI shall ensure that the accounting records reflect the different processes involved in the entire cycle of the *tawarruq* e.g. asset purchase, asset sale, *amanah* and/or *qard* where applicable.
- S** 28.4 The IFI shall separately disclose the amount outstanding held under *amanah* and/or *qard* in the relevant notes to the accounts of the financial statements.
- S** 28.5 As part of its risk disclosure, where the use of *tawarruq* contract is significant as a percentage of either the total financing or total deposit of the IFI, a disclosure of concentration risk exposure to approved asset, asset trader/exchange shall be made in the financial statements.

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APPENDICES

Appendix 1 Legitimacy of *tawarruq*

The legitimacy of the *tawarruq* arrangement is derived from the Quran and founded on the Sunnah of Prophet Muhammad (peace be upon him).

The Quran

The following verse of the Quran implies the general permissibility of sales contract including *tawarruq*:

وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرِّبَا

“...whereas Allah SWT has permitted trading and forbidden usury...” (*Surah al-Baqarah, verse 275*)

The Sunnah of Prophet Muhammad (peace be upon him)

There is no direct juristic authority from the Sunnah of the Prophet (peace be upon him) regarding the legitimacy of the *tawarruq*. It is deemed permissible based on the general permissibility of sales in Islamic law.

Appendix 2 Glossary

Terms	Definition
<i>Amanah</i>	Trusteeship
<i>Gharamah</i>	Penalty
<i>Hamish jiddiyyah</i>	A security deposit placed to secure the undertaking to purchase an asset before execution of the sale and purchase agreement contract
<i>Hiwalah al-dayn</i>	Assignment/transfer of debt from the liability of the original debtor to the liability of a third person so that the original debtor becomes free of liability
<i>Ibra'</i>	Rebate
<i>Kafalah</i>	A contract of conjoining guarantor's liability to the guaranteed party's liability in a way that the obligation of the guaranteed party is established as a joint liability of the guarantor and guaranteed person
<i>Khiyar al-`ayb</i>	Option arising from a defect; the option of dissolving or continuing the contract upon discovery of a defect in the asset purchased
<i>Majlis al-`aqd</i>	Place of the contract session
<i>Marhun</i>	Collateral
<i>Mukhalafah al-shurut</i>	Breach of terms and conditions
<i>Muqassah</i>	Offsetting
<i>Murabahah</i>	A sale and purchase of an asset where the acquisition cost and the mark-up are disclosed to the purchaser
<i>Musawamah</i>	Sale contract without the disclosure of the asset cost price and profit margin to the purchaser
<i>Qabd haqiqi</i>	Physical possession. It refers to a state where a person has actual possession and the rights to control

	an asset
<i>Qabd hukmi</i>	Constructive possession. It refers to a state where a person does not have actual possession but has the legal rights to control an asset
<i>Qard</i>	Loan contract
<i>Rahn</i>	Pledge
<i>Ta`addi</i>	Misconduct
<i>Takaful</i>	An arrangement based on mutual assistance under which <i>takaful</i> participants agree to contribute to a common fund providing for mutual financial benefits payable to the <i>takaful</i> participants or their beneficiaries upon the occurrence of pre-agreed events
<i>Takhliyah</i>	Relinquishing or abandoning the rights of ownership
<i>Tamkin</i>	Enabling the person who has the ownership of an asset transferred to him to make full use and assume liability of the asset
<i>Taqsir</i>	Negligence
<i>Tawarruq</i>	Two sale and purchase contracts where the first involves the sale of an asset to a purchaser on a deferred basis and the subsequent sale involves sale of the asset to a third party on a cash basis
<i>Ta`widh</i>	Compensation
<i>`Urf tijari</i>	Common business practice which is accepted by the community and does not contradict Shariah rulings
<i>Wa`d</i>	An expression of commitment given by one party to another to perform certain action(s) in the future
<i>Wakalah</i>	A contract in which a party mandates another party as his agent to perform a particular task in matters that may be delegated voluntarily or with imposition of fee

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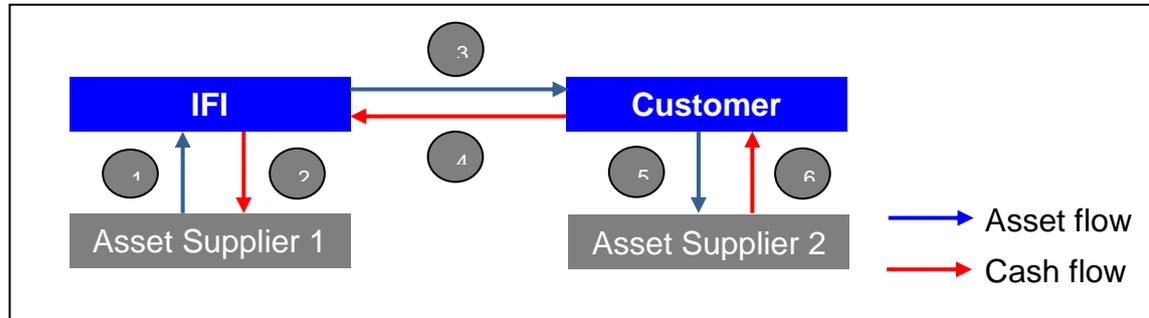
Appendix 3 Related legal instruments and policy documents

- (i) any Shariah Advisory Council (SAC) rulings published by the Bank⁴;
- (ii) *Murabahah* (BNM/RH/STD 028-4);
- (iii) Shariah Governance Framework for Islamic Financial Institutions (BNM/RH/GL 012-3);
- (iv) Guidelines on Corporate Governance for Licensed Islamic Bank (GP1-i) (BNM/RH/GL 002-1);
- (v) Guidelines on Corporate Governance for Development Financial Institutions (BNM/RH/GL 005-14);
- (vi) Guidelines on Risk Governance (BNM/RH/GL 013-5);
- (vii) Capital Adequacy Framework for Islamic Bank – Disclosure Requirements (BNM/RH/GL 007-18);
- (viii) Capital Framework for Development Financial Institutions (BNM/RH/GL 005-7);
- (ix) Guidelines on Product Transparency and Disclosure (BNM/RH/GL 000-3);
- (x) Guidelines on Financial Reporting for Islamic Banking Institutions (BNM/RH/GL 002-23);
- (xi) Guidelines on Financial Reporting for Development Financial Institutions (BNM/RH/GL 005-16);
- (xii) Guidelines on *Ibra'* (Rebate) for Sale-based Financing (BNM/RH/GL 012-5);
- (xiii) Guidelines on Late Payment Charges for Islamic Financial Institutions (BNM/RH/GL 012-6); and
- (xiv) Guidelines on Responsible Financing (BNM/RH/GL 000-5).
- (xv) Guidelines on Personal Financing (BNM/RH/GL 008-19)

⁴ Including Shariah resolutions in Islamic Finance, standards, circulars or any directive pertaining to Shariah matter issued by the Bank.

Appendix 4 Product structures

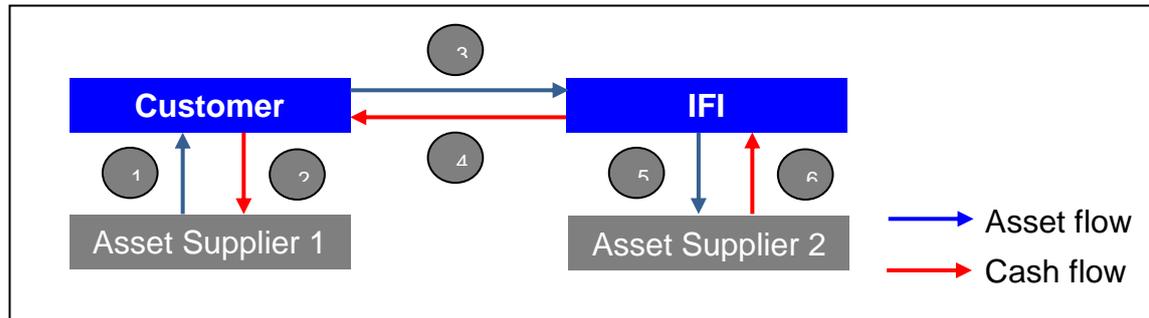
Example 1: Financing



A customer requires financing of RM100,000 from the IFI. Upon this request, the IFI executes the *tawarruq* arrangement.

1. The IFI purchases the asset with selling price of RM100,000 from Asset Supplier 1.
2. The IFI pays cash to Asset Supplier 1.
3. Subsequently, the IFI sells the asset to the customer at an agreed selling price of RM120,000 (RM100,000 + profit RM20,000).
4. The customer makes deferred payments through monthly instalments for a period of 5 years.
5. Subsequently, the customer appoints the IFI as its agent to sell the asset to Asset Supplier 2 on spot at selling price of RM100,000.
6. The customer obtains a cash of RM100,000 required for the financing.

Example 2: Deposit

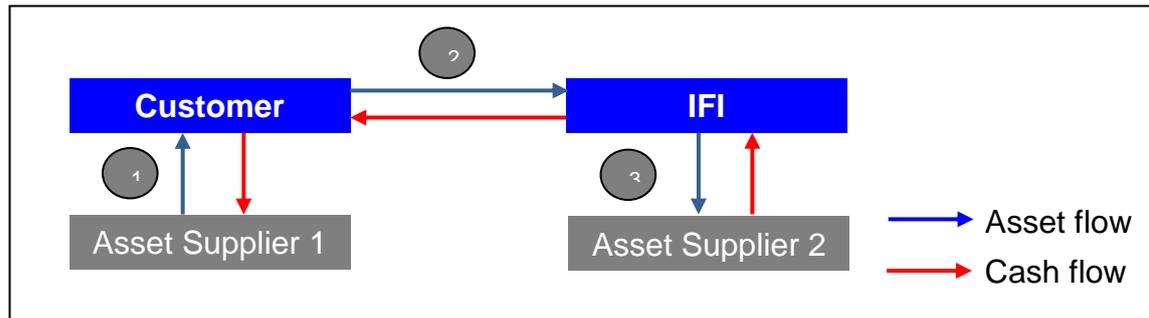


A customer makes a fixed deposit placement of RM100,000 with the IFI for a 90-day period. Upon this request, the IFI executes the *tawarruq* arrangement.

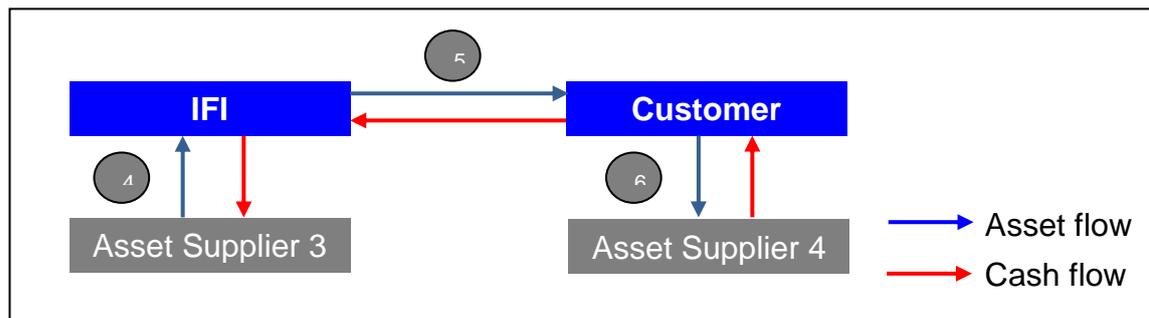
1. The customer appoints the IFI as its agent to purchase the asset from Asset Supplier 1 with selling price of RM100,000.
2. The IFI uses the cash deposit placed by customer to pay for the purchase.
3. Subsequently, the customer appoints the IFI as its agent to sell the asset to the IFI itself at an agreed selling price of RM100,863 (RM100,000 + profit RM863 i.e. 3.5% per annum)
4. The IFI makes deferred lump sum payment to customer upon maturity of the deposit placement.
5. Subsequently, the IFI sells the asset to Asset Supplier 2 on spot at selling price of RM100,000.
6. The IFI obtains cash of RM100,000 as per the deposit placement.

Example 3: Islamic profit rate swap

A customer has an obligation to pay a variable amount of RM2 million + KLIBOR payable every quarter for a 2-year period. The customer wishes to pay an equivalent of fixed quarterly payments. The IFI arranges an Islamic profit rate swap for the customer to swap the variable payments with a fixed rate for the next 2 years at 3.5% per annum.

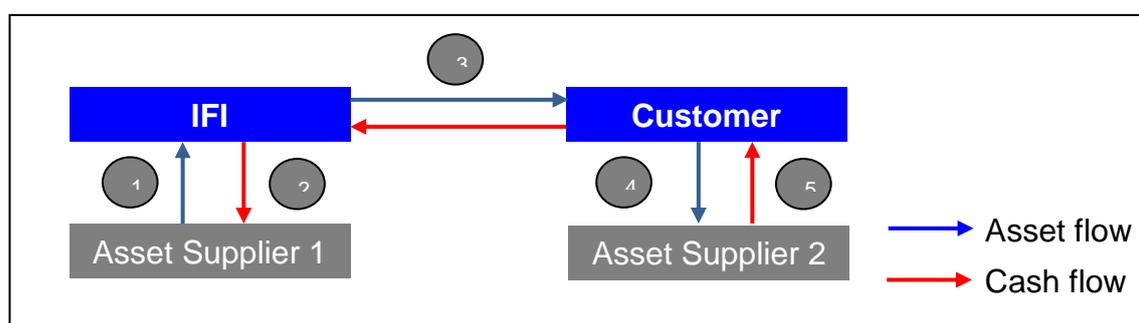
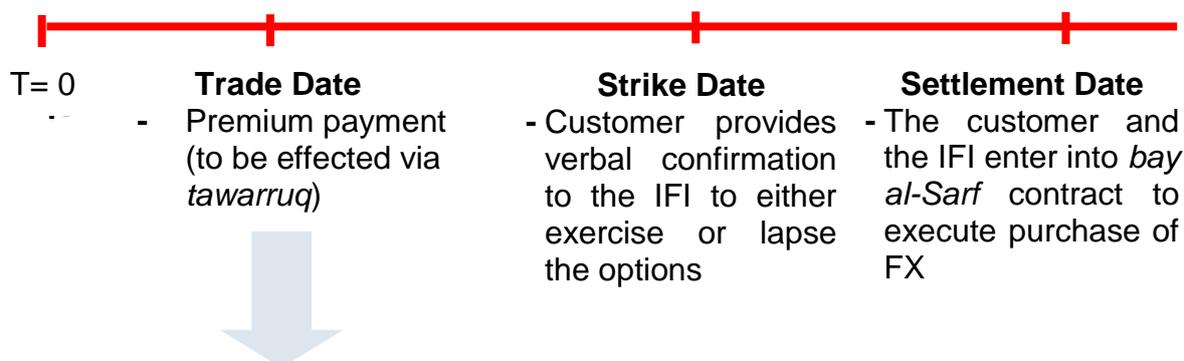


1. On payment date, the customer appoints the IFI as its agent to purchase the asset from Asset Supplier 1 with selling price of RM2 million.
2. Subsequently, the customer appoints the IFI as its agent to sell the asset to IFI itself at an agreed selling price of RM2 million + KLIBOR x 3 months.
3. The IFI makes lump sum payment and subsequently sells the asset to Asset Supplier 2 on spot at selling price of RM2 million.



4. Separately, the IFI purchases the asset with selling price of RM2 million from Asset Supplier 3.
5. Subsequently, the IFI sells the asset to the customer at an agreed selling price of RM2 million + 3.5% per annum.
6. The customer makes lump sum payment and subsequently appoints the IFI as its agent to sell the asset to Asset Supplier 4 on spot at selling price of RM2 million.

Example 4: Options



A customer decides to hedge its receivables of USD1 million by buying a USD/MYR put option. The IFI as counterparty to the option, quotes a strike price of USD1 = RM3.10 and premium of USD5,000 with 3 months maturity. The IFI executes *tawarruq* arrangement to effect the option agreement and premium payment.

1. The IFI purchases the asset with selling price of USD1 million from Asset Supplier 1.
2. The IFI pays cash to Asset Supplier 1.
3. Subsequently, the IFI sells the asset to the customer at an agreed selling price of USD1 million + USD5,000 (being the premium for the option).
4. The customer then appoints the IFI as its agent to sell the asset to Asset Supplier 2 on spot as selling price USD1 million.
5. The customer obtains cash and pays the IFI the selling price and premium.

Appendix 5 Accounting Treatment

The following is a record of *tawarruq* with dual-agency for the purpose of deposit acceptance. The terms of the deposit are as follows:

Initial placement: RM10,000

Agreed selling price: RM10,000 + profit RM450 (4.5% per annum)

Repayment term: 1 year

1. Customer appoints Bank ABC to purchase commodity asset from asset exchange on spot basis

Dr Cash	RM10,000
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Cr Customer deposit – <i>wadiah</i>	RM10,000
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(Initial placement by customer)

Dr Customer deposit – <i>wadiah</i>	RM10,000
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Cr Customer deposit – commodity	RM10,000
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(Change of deposit nature from cash to commodity form)

Dr Commodity asset	RM10,000
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Cr Cash	RM10,000
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(Purchase of commodity asset from asset exchange)

2. Customer appoints Bank ABC to sell commodity asset to Bank ABC on deferred basis

Dr Customer deposit – commodity	RM10,000
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Dr Deferred profit	RM450
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Cr Customer deposit – <i>tawarruq</i>	RM10,450
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(Change of deposit nature from commodity to *tawarruq* debt obligation)

3. Bank ABC sells commodity asset to asset exchange on spot basis

Dr Cash	RM10,000
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Cr Commodity asset	RM10,000
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(Sale of commodity asset to asset exchange)

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Summary of accounting record:

Dr Cash	RM10,000
Dr Deferred profit	RM450
Cr Customer deposit – tawarruq	RM10,450

Note: Notwithstanding the illustration above, the IFI's accounting may be simplified depending on the operational approach to execute *tawarruq* that is adopted by the IFI.