



Guidance Notes on Sell and Buy Back Agreement Transactions

**BANK NEGARA MALAYSIA
KUALA LUMPUR**

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FOREWORD

Sale and Buy Back Agreement (SBBA) is an Islamic financial instrument introduced for the purpose of enhancing liquidity in the Islamic Interbank Money Market (IIMM) and providing additional avenue for the IIMM participants to source their funding requirements. The rapid development of Islamic banking system has necessitated the need to create additional instruments for IIMM to address the impeding need and expanded requirement by the Islamic banking participants. One of the avenues to address the lack of instrument is through the introduction of SBBA.

2. The SBBA is akin to the repurchase (repo) agreement and has been modified to comply with Shariah principles. The National Shariah Council for Islamic Banking and Takaful of Bank Negara has approved the SBBA mechanism.

3. The issuance of the Guidance Notes is expected to assist the IIMM participants in the conduct of SBBA transactions with best practices. Should there be any need to obtain further clarification or explanation on the Guidance Notes on SBBA, enquiries may be directed to:

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Appendix I Islamic Securities Eligible for SBBA Transactions

1. Purpose

- 1.1. The Guidance Notes is issued with the objective to assist the market participants in the conduct of SBBA transactions with best practices.
- 1.2. The documentation of the Guidance Notes is aimed towards:
 - Providing a source of reference on the main aspects that govern the SBBA transaction.
 - Promoting uniform and consistent practices in adopting the SBBA process.
 - Outlining primary requirements in handling the SBBA transaction.
 - Ensuring compliance with Shariah principles.
- 1.3. The Guidance Notes on SBBA shall be effective from **15 August 2002**.

2. Coverage

- 2.1. The Guidance Notes are applicable to SBBA transactions undertaken by Islamic banking institutions (IBI) comprise of:
 - Islamic banks licensed under the Islamic Banking Act 1983 (IBA), and
 - Financial institutions that participate in the Islamic Banking Scheme (thereafter referred to as SPI banks) licensed under the Banking and Financial Institutions Act 1989 (BAFIA).
- 2.2. The Guidance Notes shall also govern SBBA transactions undertaken by the Islamic banks and the SPI banks with non-licensed institutions.
- 2.3. Instruments eligible for the SBBA transaction comprise of scripless securities effected under Real Time Electronic Transfer of Funds and Securities system (RENTAS) and non-scripless securities that complied with Shariah principles. The list of Islamic securities eligible for SBBA/ reverse SBBA transactions is specified in Appendix I.

2.4. The Guidance Notes should be read together with:

- a) The Rules on the Scripless Securities under the RENTAS (2001) system;
- b) The operational procedures of the Repo Enhancement Module, which is an online system maintained by BNM for the conduct of SBBA transactions against scripless securities under the RENTAS system;
- c) The Malaysian Code of Conduct for Principals and Brokers in the Wholesale Money and Foreign Exchange Markets (1994); and
- d) Other applicable rules, guidelines, codes and directives relevant to the Guidance Notes.

3. Definition

- 3.1. **SBBA** is an Islamic repurchase agreement (Repo-i) transaction whereby a party (SBBA Seller) sell Islamic securities at an agreed price to the other party (SBBA Buyer) and subsequently the SBBA buyer and SBBA seller enter into another agreement thereon whereby the former promises to sell and the latter to buy back the securities on a specified future date and at an agreed price.
- 3.2. **Reverse SBBA** is an Islamic reverse repurchase agreement transaction whereby the SBBA buyer purchased Islamic securities at an agreed price from the SBBA seller and subsequently the SBBA buyer and SBBA seller enter into another agreement thereon whereby the former promise to sell and the latter to buy back the securities on a specified future date and at an agreed price respectively.

- 3.3. SBBA transactions shall consist of the following:
 - 3.3.1. Commitment by a party to sell Islamic securities and the other to purchase the Islamic securities, and both parties subsequently promise to perform the reversal at a future date.
 - 3.3.2. Results in transfer of ownership of the transacted Islamic securities under SBBA.
- 3.4. For Exchange Control purposes, SBBA transactions are treated as credit facilities. As such, for securities registered in Malaysia, IBI are:
 - 3.4.1. Not allowed to enter into both SBBA and Reverse SBBA transactions with non-residents as the IBI would be deemed to be borrowing and lending in Ringgit from/to non-residents;
 - 3.4.2. Allowed to enter into SBBA transactions with NRCC.

4. Interpretation

In these Guidance Notes, unless the context otherwise provides:

“Authorised depository institutions” refer to financial institutions licensed under BAFIA and a member of RENTAS system or any other person who is authorised or approved by BNM to hold scripless securities, to receive or make payment relating to such securities, on behalf of customers who are not members of RENTAS;

“Islamic Private Debt Securities (IPDS)” refer to securities issued based on Islamic principles by a corporation, which can be either short-term, medium-term or long-term papers as approved by Securities Commission;

“Islamic Securities” refer to securities issued based on Islamic principles as approved by BNM or Securities Commission.

“Islamic Banking Institutions (IBI)” refer to Islamic banks licensed under section 3(1) of IBA and commercial banks, merchant banks, finance companies and discount houses licensed under section 6(4) of BAFIA that participate in the Islamic Banking Scheme;

“Licensed Financial Institutions (FI)” refer to commercial banks, merchant banks, finance companies and discount houses licensed under section 6(4) of BAFIA;

“Non-Financial Institutions (NFI)” refer to residents not licensed under the BAFIA;

“Non-Resident” means an entity as defined in the Exchange Control of Malaysia (ECM) notice 1;

“Non-Resident Controlled Company (NRCC)” refers to a company in Malaysia as defined in the ECM notice 8;

“Parties” refer to the SBBA seller and SBBA buyer or any authorised depository institution transacting on their behalf.

“RENTAS” means Real Time Electronic Transfer of Funds and Securities system, which is the real time electronic funds and securities transfer settlement system maintained by BNM;

“RENTAS Rules” means Rules on the Scripless Securities Under the Real Time Electronic Transfer of Funds and Securities system (RENTAS).

“RENTAS Members” means the persons approved by BNM to have access to or utilise RENTAS;

“Resident” means an entity as defined in ECM notice 1;

“SBBA seller” refers to the party who initiates to sell Islamic securities for cash consideration.

“SBBA buyer” refers to the party or investor who purchases the Islamic securities and pays cash.

“Scripless securities” refer to securities deposited under RENTAS system.

5. Mechanics on SBBA

The basic elements of a SBBA transaction are summarised as follows:

5.1. Basis of trading

SBBA transaction shall be traded based on price.

5.2. Transfer of ownership

Ownership of the Islamic securities sold under SBBA shall be transferred from the seller to the buyer.

5.3. Dealing in SBBA transaction

Transacting parties may conduct SBBA transaction via the money brokers or through direct dealing. Both parties shall negotiate the terms of SBBA and agreed among others on the type of Islamic securities, SBBA price, tenure and settlement date. The various aspect of risk assessment shall be given due consideration prior concluding SBBA transaction.

5.4. SBBA agreements

The parties shall enter into **two separate agreements** as follows:

5.4.1. First agreement - the SBBA seller sells outright Islamic securities to the SBBA buyer at an agreed price and settlement date.

5.4.2. Second agreement - the SBBA buyer promises to sell back the Islamic securities to the SBBA seller, whom shall also promise to buy back the instrument at an agreed price and at a future settlement date.

The undertaking made by both the SBBA buyer and SBBA seller to sell and buy back the instrument respectively at the maturity date of the SBBA shall be based on promise. To maintain market integrity and ensure the smooth operation of the IIMM, the parties shall be mindful to perform their obligations as promised.

5.5. Initiation of SBBA transaction

On value date, the SBBA seller may initiate the SBBA transaction where specified securities are sold and transferred to the SBBA buyer for an agreed cash consideration. Ownership of the securities shall be transferred to the SBBA buyer upon conclusion of the first agreement on the SBBA.

5.6. Matured SBBA transaction

On maturity date, the SBBA buyer shall perform the reversal of the initial SBBA transaction by selling back specified Islamic securities transaction to the SBBA seller for an agreed cash consideration as promised.

6. Parties

- 6.1. At least one of the parties to a SBBA must be an IBI.
- 6.2. To conduct SBBA transaction using **scripless securities**:
 - 6.2.1. **RENTAS members** are required to transact via the Repo Enhancement Module (REM) in RENTAS; and
 - 6.2.2. **Non-RENTAS members** are required to maintain scripless securities account with an authorised depository institution in order to conduct the repo transactions via REM in RENTAS.
- 6.3. To conduct SBBA transaction using **non-scripless securities**, parties shall conduct the transaction outside REM.

7. Permitted Securities

- 7.1. Either one security or multiple of Islamic securities may be used in conducting a single SBBA/ reverse SBBA transaction. However, the securities for the transaction shall have the following features:

	With Credit Rating	Without Credit Rating*
Scriptless Securities	<ul style="list-style-type: none"> • Shall be of investment grade at the initiation of the SBBA transaction. • Shall be transferable and tradable and non-convertible Islamic securities. 	Shall be transferable and tradable and non-convertible Islamic securities.
Non-Scriptless Securities		

* Include those where rating is not required or rating is exempted.

- 7.2. As a guide, the value of the Islamic securities sold under SBBA transaction shall commensurate with the agreed price by both transacting parties.

7.3. BNM may, from time to time, revise the list of eligible securities for SBBA transaction.

8. Tenure

SBBA transaction must have a fixed maturity. The maximum tenure for SBBA transaction must not exceed one year.

9. Minimum Value of Transaction

The value of a SBBA transaction (in terms of proceeds/cash amount) shall be at least RM50,000.00 (fifty thousand).

10. Computation of Proceeds

The proceeds shall be calculated based on specific formula adopted by specific Islamic securities. Part IV of the rules on RENTAS and Appendix V of the rules on Bond Information and Dissemination System (BIDS) provide references to the formula applied on certain scripless Islamic securities and calculation of proceeds for Repo transactions respectively.

11. Settlement Procedures

The settlement procedures under RENTAS system shall be applicable for the SBBA transaction.

12. Accounting Treatment

12.1. In line with the Shariah principles, Islamic securities that are sold outright under the SBBA shall cease to form part of the seller's investment portfolio.

12.2. The obligation of the SBBA seller to perform its promise to buy back the specified Islamic securities at maturity of the transaction should be treated as contingent liability.

13. Unexpected Holiday

When a public holiday or bank holiday falls on a day that was originally expected to be a business day or when a holiday is declared at the eleventh hour, the settlement date of the SBBA transaction shall be deemed to fall on the next business day immediately following the holiday without any adjustment to the originally agreed terms by both parties.

14. Pre mature of promise

14.1. Subject to mutual agreement of both, either party may negotiate to renew the original term of promise and to enter into an early settlement on their commitment to sell and buy back Islamic securities under SBBA at an originally agreed price.

14.2. Internal control procedures shall be in place to ensure authenticity of such early settlement transaction.

15. Event of Default or Non-Fulfilment of Promise

15.1. In the event of default or non-fulfilment of promise, the Shariah permits for a party that suffer losses to claim for compensation from the defaulting counter party. In this regard, transacting parties shall incorporate both compensation and recourse provisions in the agreement of the SBBA to mitigate the risk from possible event of default or non-fulfilment of promise.

15.2. On maturity date, the SBBA seller is entitled to claim compensation for losses suffered arising from the non-fulfilment of the promise on the part of the SBBA buyer.

15.3. The SBBA buyer is allowed to claim compensation from the SBBA seller in the event of non-fulfillment of the promise by the latter to buy back the Islamic securities instruments on the maturity date of the agreement.

15.4. As a reference, the mechanism for the determination and calculation of compensation for delayed or failed settlement of securities transactions and procedure for buy-in as provided under Part VII of the rules on the scripless Islamic securities under RENTAS system shall apply on the delayed or failed settlement of SBBA transaction.

16. Eligible Liabilities

Attributed to the nature of outright sale contract, SBBA transaction will not form part of an item under Eligible Liabilities for the purpose of computation Statutory Reserve Requirement.

17. Liquefiable Asset Status under the Liquidity Framework

17.1. Securities sold under SBBA shall not be eligible for liquefiable asset status during the transaction period.

17.2. Securities purchased and held during the transaction period under reverse SBBA shall be eligible for liquefiable asset status.

18. Agreement

18.1. Parties intending to enter into SBBA transaction shall execute proper documentation to safeguard their interest against non-performance of obligations.

18.2. The SBBA transaction shall be Shariah compliant and subject to a legal agreement between both parties.

18.3. The written agreement shall specify all terms and conditions of the transaction and the duties of both the SBBA seller and buyer. Sufficient clauses shall be enacted to address the event of default.

18.4. The parties to the SBBA transaction shall consult their legal counsel regarding the content of the agreement.

18.5. The agreement shall be subject to Malaysian Law

18.6. BNM will be entering into master agreement with the counter parties to conduct SBBA transactions.

19. Other Related Matters

19.1. Parties to the SBBA transaction should have established appropriate risk management framework and conduct proper risk assessment so as to minimise relevant risk exposure.

19.2. The transacting parties shall refer to the respective existing guidelines of the approved IIMM instruments on related matters pertaining to the trading of the instruments not addressed in this Guidance Notes.

Appendix I

Islamic Securities Eligible for SBBA Transactions

A. Scripless Securities

1. Government Investment issues
2. Bank Negara Negotiable Notes
3. Khazanah Bonds
4. Sanadat Mudharabah Cagamas
5. Islamic Private Debt Securities
6. Any other Islamic Securities as specified by BNM from time to time

B. Non-Scripless Securities

1. Islamic Accepted Bills
2. Green Bankers Acceptance
3. Negotiable Islamic Debt Certificate
4. Islamic Negotiable Instrument of Deposits
5. Non-scripless Islamic Private Debt Securities