

Title

Tawarruq

Issuance Date

17 November 2015

Effective Date

1 July 2016

Summary

This policy document specifies the Shariah and operational requirements in relation to the application of *tawarruq* contract in Islamic financial transaction. Shariah requirements highlight the salient features and essential conditions of a *tawarruq* contract. The operational requirements set out the core principles of good governance and oversight, proper product structuring, effective risk management, sound financial disclosure and fair business and market conduct.

Submission Requirements

The IFI shall submit the implementation plan to Jabatan Perbankan Islam dan Takaful no later than 31 January 2016.

Applicability

DFIA

FSA

IFSA

Attachment

[Response to feedback
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BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Tawarruq

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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 policy document contains two distinctive parts, namely the Shariah requirements and the operational requirements. The former highlights the salient features and essential conditions of the *tawarruq* as specific Shariah arrangement. The latter outlines the operational requirements which consist of 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 are aimed at complementing and promoting sound application of the Shariah principles.
- 1.4 A *tawarruq* consists of two sale and purchase contracts. The first involves the sale of an asset by a seller to a purchaser on a deferred basis. Subsequently, the purchaser of the first sale will sell the same asset to a third party on a cash and spot basis.

2. Policy objectives

2.1 This policy document aims to:

- (a) set out 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 Islamic banking practices and safeguarding customers' interest.

3. Scope of policy document

3.1 Part B sets out mandatory Shariah requirements to ensure the validity of the *tawarruq* as well as permissible optional practices.

3.2 Part C provides operational requirements on governance and oversight, structuring, risk management, financial disclosure, business and market conduct. It describes 5 key principles for sound management and operationalisation of *tawarruq* as follows:

- (a) **Principle 1:** The IFI shall establish a comprehensive governance and oversight framework to ensure that a *tawarruq* is conducted based on sound practices and complies with Shariah.
- (b) **Principle 2:** The IFI shall ensure that the structuring and implementation of a *tawarruq* is supported by comprehensive policies and procedures and processes, adequate infrastructure and robust documentation.
- (c) **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*.
- (d) **Principle 4:** The IFI shall undertake *tawarruq* in a fair and transparent manner in line with the Shariah to protect stakeholder's interest.

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

4. Applicability

4.1 Subject to 4.2, this policy document is applicable to all IFIs as defined in paragraph 7.3.

4.2 A licensed takaful operator is only required to comply with Part B of this policy document.

5. Legal provisions

5.1 The requirements in this policy document are:

- (a) specified pursuant to sections 29, 57(1), 135(1) and 155 of the Islamic Financial Services Act 2013 (IFSA); and
- (b) specified pursuant to sections 41(1) and 116 and constitutes a direction pursuant to section 129(3) of the Development Financial Institutions Act 2002 (DFIA).

5.2 The guidance in this policy document is issued pursuant to section 277 of the IFSA and section 126 of the DFIA.

6. Effective date

6.1 This policy document comes into effect on 1 July 2016.

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, an obligation, a requirement, specification, direction, condition and any interpretive, supplemental and transitional provisions that must be complied with.

Non-compliance may result in enforcement action; and

“G” denotes guidance which may consist of statements or information intended to promote common understanding and advice or recommendations that are encouraged to be adopted;

7.3 **“Islamic financial institution” or “IFI”** means –

- (a) a licensed Islamic bank;
- (b) a licensed takaful operator;
- (c) a licensed bank and licensed investment bank 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.

7.4 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 other relevant legal instruments, policy documents or guidelines that have been issued by the Bank, in particular:

- (i) any Shariah Advisory Council (SAC) rulings published by the Bank¹;
- (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) 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) Financial Reporting for Islamic Banking Institutions (BNM/RH/STD 033-4);
- (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);
- (xiv) Responsible Financing (BNM/RH/GL 000-5);
- (xv) Personal Financing (BNM/RH/GL 008-19); and
- (xvi) Introduction of New Products (BNM/RH/STD 028-5).

¹ Including Shariah resolutions in Islamic Finance, standards, circulars or any directive pertaining to Shariah matter issued by the Bank.

PART B SHARIAH REQUIREMENTS AND OPTIONAL PRACTICES**9. Definition**

S 9.1 A *tawarruq* consists of two sale and purchase contracts. The first involves the sale of an asset by a seller to a purchaser on a deferred basis. Subsequently, the purchaser of the first sale will sell the same asset to a third party on a cash and spot basis.

10. Nature

S 10.1 Each sale and purchase contract in the *tawarruq* is binding in nature and 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 The sale and purchase contract in the *tawarruq* may take in the form of a *murabahah* or *musawamah*.

11. Contracting parties

S 11.1 The contracting parties to each sale and purchase contract in the *tawarruq* shall be a seller and a purchaser.

S 11.2 In relation to paragraph 11.1, the seller in the first sale and purchase contract shall not be the purchaser in the second sale and purchase contract in the same *tawarruq*.

G 11.3 The contracting parties in each sale and purchase contract in the *tawarruq* may enter into the sale and purchase contract through a

wakil (agent).

- S 11.4 The contracting parties in the *tawarruq* shall be a natural person or a legal entity that have the legal capacity² to enter into each sale and purchase contract in the *tawarruq*.

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

- S 12.1 Each sale and purchase contract in a *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 The offer and acceptance referred to in paragraph 12.1 must be executed in the following sequence:

- (a) the seller sells an asset to the purchaser by entering into a sale and purchase contract; and
- (b) subsequently, the purchaser from the first sale and purchase contract enters into another sale and purchase contract to sell the same asset to a third party.

13. Asset

- S 13.1 An asset which is eligible to be used as the subject matter of a *tawarruq* shall either be a tangible or an intangible asset provided that the asset is:

² *Legal capacity of a person, from Shariah perspective, is defined as the capacity to assume rights and responsibilities; and capacity to give legal effect to his action. Among the important conditions are that the person must possess sound mind and the capacity to distinguish between what is harmful or beneficial to one's interests. Legal capacity of a legal entity is defined as eligibility of an entity to acquire rights and assume responsibilities. In Malaysia, this legal capacity is also subject to the Contracts Act 1950 and the Age of Majority Act 1971.*

- (a) recognised by Shariah as valuable, identifiable and deliverable;
and
 - (b) already in existence and owned by the seller in each respective sale and purchase contracts involved.
- G 13.2 The asset which is the subject matter of a *tawarruq* may either take in the form of a whole asset or part of the whole asset. In the case of the latter, the asset may either 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 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* (contract session), the seller shall provide the purchaser with specific description of the asset.
- S 13.7 Transfer of ownership from the seller to the purchaser shall take effect upon entering into a valid sale and purchase contract; notwithstanding there is no registration of legal ownership to the purchaser.
- S 13.8 The purchaser shall take possession of the asset before the asset can be sold to a third party.
- S 13.9 Possession of the asset shall either be in the form of *qabd haqiqi*

(physical possession) or *qabd hukmi* (constructive possession).

- S 13.10 Possession of the asset shall take effect upon *takhliyah* (the seller releasing the asset to the purchaser) through any mechanism permitted by Shariah including *`urf tijari* (customary business practice) in order for *tamkin* (the purchaser would have access to the asset) to take place and for the purchaser to assume its ownership risk.
- S 13.11 The seller shall be liable for any loss or damage of the asset before the purchaser takes possession of the asset.
- S 13.12 Any defect in the asset which occurred before entering into any sale and purchase contract in the *tawarruq* discovered by the purchaser after the execution of the contract shall entitle the purchaser to the *khiyar al-`ayb* (defect option).
- S 13.13 Where the situation in paragraph 13.12 occurs, the purchaser has the right to:
- (a) terminate the sale and purchase contract;
 - (b) continue with mutually agreed variation of the terms of the sale and purchase contract as a result of the defect discovered; or
 - (c) continue with the sale and purchase contract as it is.
- S 13.14 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 defect option with respect to such defect.
- G 13.15 The contracting parties may mutually agree to specify the period of the defect option at the time of entering into the sale and purchase contract.
- G 13.16 Notwithstanding paragraph 13.12, the contracting parties may mutually

agree for the seller to waive liability for any defect on the asset before entering into the sale and purchase contract.

- S 13.17 In the event that the contracting parties agree to the arrangement in paragraph 13.16 above, the waiver of liability by the seller shall be mutually agreed between the contracting parties.
- S 13.18 The same asset shall not be the subject matter of multiple *tawarruq* at any one time.
- G 13.19 The *tawarruq* may be entered into on a group of assets between the same contracting parties at the same time.

14. Price

- S 14.1 The price used for each sale and purchase contract 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 sale and purchase contract in the *tawarruq* is on a *murabahah* basis, the requirements on price in the *murabahah* sale shall be complied with, including of disclosure of cost and profit.
- G 14.3 The price of each sale and purchase contract in the *tawarruq* may be paid at any time after entering into the contract and on such terms as may be agreed by the contracting parties, including spot or deferred basis, or in instalments or a bullet lump sum payment.
- G 14.4 The contracting parties may mutually agree to reschedule the payment period for the remaining debt arising from the sale and purchase contract.

- S 14.5 In the event the contracting parties mutually agree to reschedule the payment period referred to in paragraph 14.4, such agreed rescheduling shall not lead to any increase of the remaining debt.
- G 14.6 The contracting parties may mutually agree to enter into a new contract that may result in a new debt obligation, whereby the proceeds of the new contract is to be used to settle the outstanding debt obligation arising from the sale and purchase contract under the earlier *tawarruq*.
- S 14.7 Pursuant to paragraph 14.6, such arrangement shall be made only in relation to a solvent debtor.

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 contracts in the *tawarruq* shall be executed by entering into a separate and independent sale and purchase contract.
- S 15.3 Execution of each sale and purchase contract in the *tawarruq* must be respectively evidenced by appropriate documentation or record.
- S 15.4 The purchaser in each sale and purchase contract in the *tawarruq* shall have the right to take delivery of the asset.
- S 15.5 The sale and purchase contract in the *tawarruq* shall not contain 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 Payment of any amount of the deferred selling price including profit shall not be made to the seller before entering into the sale and purchase contract.

16. Arrangement of *wakalah* in *tawarruq*

- G 16.1 The *tawarruq* may be arranged together with a *wakalah* contract.
- G 16.2 Any contracting party in the *tawarruq* may appoint an agent to act on his behalf.
- S 16.3 The *wakalah* contract shall be arranged in a contract separate from the sale and purchase contract of the *tawarruq*.
- S 16.4 Execution of the *wakalah* contract in the *tawarruq* must be respectively evidenced by legal appropriate documentation or record.
- S 16.5 The *wakalah* contract for the purpose of the *tawarruq* shall not restrict the principal or his purchasing agent from taking delivery of the asset.
- S 16.6 Ownership of the asset shall be transferred from the seller to the purchaser even though the sale and purchase contract in the *tawarruq* is entered into through an agent on behalf of the seller or the purchaser.
- S 16.7 Roles and responsibilities of the agent shall be clearly specified 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 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* contract.

- G 16.10 The name of the principal in the *wakalah* contract may be disclosed in the sale and purchase documentation of the *tawarruq* between the third party and the principal.
- G 16.11 In relation to paragraph 16.10, the agent and the principal may agree that only the name of the agent is disclosed in all documents relating to the sale and purchase contract between the third party and the agent.
- S 16.12 In the event that the principal requires the agent to provide several quotations for the price of the asset, the principal shall clearly specify to the agent the preferred price quotation.
- G 16.13 The 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 The amount advanced by the agent under paragraph 16.13 shall be reimbursed by the principal or set-off against the agreed selling price between the principal and the agent.
- S 16.15 Where a sale and purchase contract in the *tawarruq* is executed by the agent on a date later than the date on which the fund is received from the principal, the following requirements shall be observed:
- (a) the fund must be held based on *amanah* (trust) by the agent; and
 - (b) both the agent and principal must ensure that funds received from the principal shall not be treated as *qard* to the agent prior to the purchase of the underlying asset.
- S 16.16 Notwithstanding paragraph 16.15, in a situation where the funds need to be treated as *qard* to the agent due to necessity and *tabi`*

(unavoidable incidental circumstances), such treatment is allowed.

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

- G 17.1 Dual-agency may be implemented in a *tawarruq*.
- G 17.2 A dual-agency in the *tawarruq* 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 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 contracts between the principal and the agent shall comply with the following requirements:
- (a) essential criteria or specification of the authorised task, such as price, tenure and asset specification, shall be mutually agreed by the contracting parties; and
 - (b) the transaction shall be in a proper sequence as provided in paragraph 17.2 and supported by proper evidence.
- S 17.4 In the event where:
- (a) the sale and purchase contracts in the *tawarruq* are executed on a date later than the date on which the funds are received from the principal; and
 - (b) the profit of the sale and purchase contract which is on a deferred basis is calculated from the day the funds are accepted,

the selling price shall be disclosed by the agent to the principal.

18. Arrangement of *wa`d* (promise) in *tawarruq*

- G 18.1 In a *tawarruq*, the purchaser may provide a promise to purchase the asset from the seller upon its acquisition from a third party.
- S 18.2 The *tawarruq* shall not contain any condition that requires the purchaser to promise that the asset will be sold to a third party.
- S 18.3 In line with paragraph 11.2, the *tawarruq* shall not contain any condition that requires the purchaser to promise that the asset will be sold to its original seller.

19. Arrangement of assurances in *tawarruq*

- G 19.1 A *tawarruq* may be arranged with assurances which may be in the form of other Shariah contracts or concepts such as *kafalah* (guarantee), *takaful*, *rahn* (pledge) or *hamish jiddiyah* (security deposit).

(a) Assurance through *kafalah* (guarantee)

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

(b) Assurance through *takaful*

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

(c) Assurance through *rahn* (pledge)

- S 19.4 Any *marhun* (collateral) pledged to secure the payment of debt under the sale and purchase contract in the *tawarruq* shall be an asset which is recognised by Shariah as valuable, in existence, identifiable, and deliverable.
- S 19.5 Notwithstanding paragraph 19.4, if the collateral used is shares of a company which are involved in mixed Shariah compliant and Shariah non-compliant activities, the core business of the company must be Shariah compliant.
- G 19.6 Shariah non-compliant financial assets may be used as collateral where the collateral can be separated and valued in accordance with paragraph 19.7.
- S 19.7 In accordance with paragraph 19.6, the collateral value for Shariah non-compliant financial assets shall be limited as follows:
- (a) the collateral value for interest-bearing debt-based asset such as conventional fixed deposit certificate and conventional bonds shall be limited to the principal amount of the instrument; and
 - (b) the collateral value for Shariah non-compliant unit trust shall be limited to the value of investors' initial and subsequent/additional investment.
- S 19.8 The proceeds from the realisation of the collateral shall be utilised only to recover the outstanding debt under the sale and purchase contract in the *tawarruq*.
- G 19.9 Notwithstanding paragraph 19.8, the contracting parties may agree to also utilise the proceeds to recover the actual costs pertaining to the recovery of the outstanding debt.

(d) Assurance through *hamish jiddiyah* (security deposit)

- G 19.10 The seller may require the purchaser to provide security deposit to secure a promise to purchase the asset.
- G 19.11 The security deposit may be used to compensate for actual loss incurred from the purchaser's failure to purchase the asset from the seller.
- S 19.12 Pursuant to paragraph 19.11, any excess of the security deposit after compensating for actual loss shall be refunded to the purchaser.
- S 19.13 The seller shall not utilise the security deposit prior to the execution of the sale and purchase contract in the *tawarruq*.
- S 19.14 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 19.15 The security deposit may be treated as part of the payment of the agreed selling price for the sale and purchase contract upon entering into the sale and purchase contract.
- S 19.16 The security deposit shall be refunded in full to the purchaser if it is not treated as part payment of the selling price.

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

- G 20.1 The seller may give a rebate on part or the entire outstanding selling 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, a 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 instalments, the seller may provide periodic rebate on the instalment amount based on a formula mutually agreed by the contracting parties.

21. Arrangement of *tawarruq* with *ta`widh* (compensation) and/or *gharamah* (penalty) in *tawarruq*

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 The late payment charges shall consist of:

- (a) compensation for actual loss suffered by the seller, which may be recognised as income to the seller; and/or
- (b) penalty, which shall not be recognised as income and 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 the *tawarruq* is dissolved when:

- (a) the purchaser exercises the 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) any of the contracting parties exercises the option to terminate the sale and purchase contract due to breach of the specified terms; or
- (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.

S 22.3 The dissolution of the sale and purchase contract shall be effective provided that the asset can be returned to the seller. Otherwise, the seller is entitled to the value of the asset.

23. Completion of *tawarruq*

S 23.1 The sale and purchase contract in the *tawarruq* is completed 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 a 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**24. Governance and oversight**

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 distinct risks and the unique nature of the *tawarruq*. The IFI shall have sufficient understanding of its risk profile and availability of personnel with the appropriate knowledge and skill set.

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 governing the *tawarruq* and risk management to ensure compliance with relevant legal and regulatory requirements;
- (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 associated with a *tawarruq* undertaken by the IFI are conducted in line with Shariah:

- (a) endorse the application of Shariah requirements in the relevant policies and procedures governing the *tawarruq*; and
- (b) deliberate and endorse that the terms and conditions stipulated in the legal documentation and other documents such as information published on promotional materials, product manuals or other publications are in compliance with Shariah;
- (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:

- (a) developing and implementing business strategies, internal control and risk management requirements in line with the IFI's business objectives;
- (b) establishing policies and procedures and processes with regard to proper management of the *tawarruq*;
- (c) implementing relevant internal systems and 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.

25. Structuring

(a) Shariah compliance

S 25.1 The IFI shall ensure:

- (a) the overall structure of the *tawarruq* is in compliance with Shariah as provided in Part B of this policy document;
- (b) the opinion of the SAC of the Bank is sought to resolve issues pertaining to Shariah matters as outlined in the *Shariah Governance Framework for Islamic Financial Institutions and Introduction of New Products* issued by the Bank; and
- (c) all requirements in paragraph 26 are complied with.

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.

(b) Purpose

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

G 25.4 In respect of the structure and purpose of the *tawarruq*, the IFI may refer to examples in Appendix 3.

(c) Contracting parties

- S 25.5 The contracting parties in the *tawarruq* contract shall involve at least three parties which consist of the customer, the IFI and the asset trader or asset exchange (e.g. Bursa Suq Al-Sila’).
- S 25.6 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*.
- S 25.7 In the case where a contracting party appoints an agent to act on its behalf for the purpose of the *tawarruq* arrangement, the IFI shall identify the agent appointed by any of the contracting parties.
- S 25.8 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) Offer and acceptance

- S 25.9 Pursuant to paragraph 12.1, the IFI shall specify the date and where applicable, the frequency of when the offer and acceptance of the first sale and purchase contract shall be executed (e.g. in the case of financing, at specified disbursement dates or in the case of deposit, at specified roll-over dates).

(e) Assets

- S 25.10 The IFI shall specify the asset to be traded (the asset) in the *tawarruq*. In line with the requirements under paragraph 13, the asset must satisfy the following conditions:
- (a) can be objectively valued in the open market;
 - (b) of an acceptable contract grade³ as specified by a recognised commodity exchange (local or global) or an accepted industry standard (local or global);

³ Refers to the quality of a commodity that can be delivered against a particular contract, in accordance with

- (c) in a good condition prior to the completion of both sale and purchase transactions e.g. in the case of perishable assets, it has not expired; and
- (d) have an active market and not recognised as intangible assets under applicable Malaysian Financial Reporting Standards (MFRS) e.g. brand, patents and intellectual property.

Illustration 1: Valid assets for *tawarruq*

- (a) Commercially traded consumer goods which are valued at available market prices.
- (b) Commercially traded airtime coupons⁴ which are valued at available market prices.
- (c) Commercially traded crude palm oil (CPO) which meets the contract grade as specified by the Bursa Suq Al-Sila' or specification by the industry standard determined by the Malaysia Palm Oil Board.
- (d) Commercially traded consumer goods with an expiration period provided that each sale and purchase contract is completed before the consumer goods expire.

S 25.11 Pursuant to paragraph 13.3, where the asset is undivided⁵, 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 the specification/description agreed between the contracting parties.

the rules of the respective exchange on which the commodity is traded.

⁴ Airtime coupon or telecommunication prepaid card of a certain monetary amount represent the units of service that can be used by the purchaser e.g. minutes of talk time or unit of internet data. The talk time or internet data provided by the telecommunication operator is an intangible asset under Shariah.

⁵ 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.

Illustration 2: Undivided assets

Crude palm oil (CPO) is stored in 10,000 tonnes storage tanks. Each sale and purchase contract is carried out per 1,000 tonnes. In the case of 2 different sale and purchase contracts of 1,000 tonnes and 4,000 tonnes each, the asset trader/ asset exchange records the proportion of the CPO in the storage tank to identify the ownership of the respective purchasers. The asset trader/ asset exchange need not physically divide the CPO into separate storage tanks.

(f) Price

- S 25.12 The selling price in the *tawarruq* shall consist of the acquisition cost of the asset and profit⁶⁷.
- S 25.13 The acquisition cost of the asset under the *tawarruq* shall be determined based on the quoted price in a specified exchange/ trading platform or available market price.

Illustration 3: Acquisition cost of the asset

- (a) In the case of commercially traded CPO, the acquisition cost shall be based on the price quoted in specific commodity exchange (e.g. Bursa Suq Al-Sila') or available market price as published by the Malaysian Palm Oil Board.
- (b) In the case of air time coupon issued by a telecommunication service provider, the acquisition cost shall be based on the available market price published by the telecom service provider or recognised trading platform.

- G 25.14 In addition to paragraph 25.12, if applicable, the IFI may identify other costs relating to the sale and purchase of the asset which would be borne by the customer. These costs may include the brokerage fee,

⁶ For the avoidance of doubt, the *tawarruq* may take the form of a *murabahah* or *musawamah* in line with paragraph 10.3.

⁷ The profit may be nil.

wakalah (agency) fee due to the application of agency arrangement as specified in paragraph 25.20 and relevant taxation requirements.

- S 25.15 The costs that are determined based on paragraph 25.14 shall be consistent with the approved internal policies and procedures that govern the *tawarruq*.
- S 25.16 If the *tawarruq* arrangement is undertaken based on *murabahah*, the IFIs shall clearly determine the acquisition cost of the asset and the profit in line with the requirements provided in the policy document on *Murabahah* issued by the Bank.
- S 25.17 The IFIs as an agent shall specify the absolute value of the agreed selling price in the legal documentation if the *tawarruq* transaction is executed later than the date that the funds are accepted from customers.

(g) Settlement

- S 25.18 Pursuant to paragraph 14.3 and 23.1, the IFI shall stipulate the settlement terms that include the following:
- (a) commencement date⁸, duration of the payment, (e.g. 30 days or 5 years), specific payment due date (e.g. by the 30th day of every month);
 - (b) mode of payment (e.g. instalments, lump sum payment(s) or cash);
 - (c) payment amount (e.g. fixed amount or minimum amount); and
 - (d) where applicable, arrangement of off-setting⁹ or netting-off¹⁰ the amount due with available deposits, including security deposits.
- S 25.19 For the purpose of rescheduling and restructuring of the *tawarruq* specified in paragraphs 14.4 and 14.7, the IFI shall comply with the

⁸ In line with paragraph 15.3, on payment of selling price.

⁹ Refer to paragraph 16.14, on setting-off amount advanced by the agent against the agreed selling price.

¹⁰ Refer to paragraph 19.15, on treating security deposit as part payment of the selling price.

policy requirements provided under the policy document on the *Classification and Impairment Provisions for Loans/Financing* that was issued by the Bank and the IFI's internal policies and procedures on risk management.

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

- S 25.20 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 arrangements will effectively achieve the purpose outlined in paragraph 25.3.
- S 25.21 In line with paragraph 16.15, where the IFI as an agent is not able to execute the *tawarruq* on the same day, the IFI shall comply with the requirements of *amanah* (trust) and segregate the funds received from other funding sources¹¹.
- S 25.22 Notwithstanding paragraph 25.21 and pursuant to paragraph 16.16, the IFI as an agent shall be allowed to treat the funds received as *qard* when the IFI is not able to execute the *tawarruq* on the same day due to the following circumstances:
- (a) normal close of business/operation including public holidays and other state holidays;
 - (b) unexpected disruptions to operation e.g. system breakdown, force majeure event, unexpected holiday; or
 - (c) reasonable period required for the processing of *tawarruq* application from the customer which shall be no later than 3 working days from the date that the funds were received i.e. T+2.

¹¹For the avoidance of doubt, this requirement is applicable where the IFI has received money from the customer e.g. for the purpose of deposit acceptance or premium payment from customer for the purchase of a derivative instrument.

S 25.23 Where the principal requested for the provision of quotations, the IFI as an agent shall clearly outline the:

- (a) minimum number of quotations to be provided;
- (b) sources of the quotation; and
- (c) duration for the customer or principal to provide decision on the quotation, and if applicable, the expiration date of the quotations.

(i) Arrangement with a promise and other assurances

S 25.24 Pursuant to paragraphs 18 and 19, the IFI shall determine the applicability and terms of the promise and/or any assurances in the *tawarruq*. For example, to secure a firm commitment from the customer to perform the purchase of the asset, the IFI as the seller can require a placement of security deposit from the customer.

S 25.25 The IFI must outline trigger events which warrant the invocation of the promise or assurances and recovery of the losses from the contracting parties.

S 25.26 In the case where the *tawarruq* is arranged with a promise, the IFI shall determine the actual loss caused by the customer defaulting on his promise to purchase the asset in the *tawarruq*, based on costs which are directly attributable to non-purchase of the asset such as the cost of legal action, storage cost of the asset and any shortfall between the disposal price compared to the purchase price (if any). However, the actual costs shall not include indirect costs such as allocated overhead costs or salary or opportunity costs such as cost of funds.

S 25.27 In the case where the *tawarruq* is arranged with a pledge, securities that are listed on Bursa Malaysia or other securities exchanges which are recognised as Shariah compliant securities based on the Shariah screening criteria set out by the respective regulatory or supervisory authority shall be accepted as collateral in line with paragraph 19.5.

- S 25.28 In addition to paragraph 25.27, financial assets of non-listed companies which have been assessed by the IFI to be Shariah compliant based on the Shariah screening criteria issued by Securities Commission of Malaysia, and endorsed by the SC shall also be accepted as collateral in line with paragraph 19.5.
- S 25.29 Further to paragraph 19.13 and 19.14, the security deposit shall be distinguished from the selling price prior to the execution of the sale and purchase contract.
- S 25.30 The amount of security deposit shall be determined based on mutually agreed terms by the contracting parties.

Illustration 5: Arrangement of *tawarruq* with security deposit

On 1 May 2015, Bank ABC accepts deposit placement from a customer based on *tawarruq* according to the following terms:

Selling price: RM100,000 (principal) + RM5,000 (profit)

Tenure: 6 months (e.g. due date on 30 Nov 2015)

Security deposit: RM1,000

As part of the assurance to purchase the asset from customer, Bank ABC provides security deposit to the customer on the date of deposit acceptance. Bank ABC is required to clearly segregate the amount of security deposit from the selling price prior to execution of *tawarruq*.

(j) Arrangement of rebate

- S 25.31 The IFI shall determine the applicability of rebate e.g. in event of pre-payment or early settlement of selling price or in a variable rate pricing.

Illustration 6: 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 in accordance with the mutually agreed terms under the deposit contract.
- (b) A customer is accorded with house financing, which is payable over a 30-year period. The customer fully settles the outstanding debt in the 12th year. The IFI must provide rebate to the customer in accordance with the terms specified in the financing contract.

- S 25.32 Pursuant to paragraph 20.2, the IFI shall incorporate a rebate clause in the sale and purchase contract under the *tawarruq*.
- S 25.33 In determining the amount of outstanding debt¹² arising from the deferred sale and purchase contract under the *tawarruq*, the IFI shall calculate the outstanding selling price less any rebate.
- S 25.34 In respect of financing, the IFI shall comply with the *Guidelines on Ibra' (Rebate) for Sale-based Financing*.
- S 25.35 In respect of deposit, the IFI and the customer shall agree on the terms and computation of rebate under the *tawarruq*. At minimum, the terms shall specify eligibility criteria for rebate and the formula for the computation of rebate.

¹²For the avoidance of doubt, as described in paragraph 5.2 of the *Guidelines on Late Payment Charges*, the IFI can claim any late payment charges or other direct expenses related to the recovery of the outstanding debt upon default separately from the customer.

(k) Arrangement of *tawarruq* with compensation and/or penalty

S 25.36 In addition to paragraph 21, the IFI must satisfy the requirements set out in the *Guidelines on Late Payment Charges for Islamic Financial Institutions*.

26. Risk management

G 26.1 The *tawarruq* may expose the IFI to various types of risks, such as market, liquidity, credit and operational risks. These risks, which appear at various stages of transactions, may change in nature that may necessitate the establishment of a comprehensive and sound risk management infrastructure, reporting and control framework.

S 26.2 The IFI shall establish comprehensive risk management policies and procedures, processes, 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, if applicable, risk exposure to inventories arising from the acquisition and holding of an asset for the purpose of the *tawarruq* arrangement prior to the execution of the sale and purchase contract;
- (b) the formulation of appropriate pricing methodology of the asset and as applicable, establishing controls to ensure quotations are obtained in an independent and objective manner;
- (c) the establishment of risk exposure limits including trading or concentration limits on approved asset, asset trader and/or asset exchange, as applicable, in line with the IFI's risk appetite;
- (d) the risk mitigation techniques including establishing;
 - (i) appropriate eligibility criteria and review process in identifying a list of approved asset, asset trader and/or asset exchange to be used in the *tawarruq*;

- (ii) clear segregation of roles and duties to be performed under dual-agency e.g. designating separate personnel to perform each role or implementing appropriate system 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. in the event of inadequate supply of asset; and
- (e) the monitoring and reporting mechanism.

Illustration 7: 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 the asset trader and/or asset exchange is subject to comprehensive risk assessment and has satisfied 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 include 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, quality specification; and
 - (c) the availability of Shariah compliance oversight function. If such 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 on-going 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 regularly review and update its policies and procedures, processes and internal limits and shall ensure consistency with the risk appetite of the IFI and any changes by the regulators or the industry.

27. Business and market conduct

- S 27.1 The IFI shall give due regard to the interests of customers in its policies and procedures to ensure that the *tawarruq* is conducted in a fair, transparent, responsible and professional manner.

(a) Fair dealings

- S 27.2 The IFIs' internal policies and procedures on business and market conduct for the *tawarruq* shall reflect the IFI's fair dealing practices with its customers, including:
- (a) the provision of accurate, clear and not misleading information;
 - (b) the fees and charges, if any; and
 - (c) reasonable care to ensure suitability of advice and recommendations, if any.

(b) Disclosure of information

- S 27.3 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 8: Inaccurate description

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

- S 27.4 At the pre-contractual stage, the IFI shall provide adequate and relevant information to the customer in the marketing or promotional materials, product disclosure sheet and any other relevant materials with regard to the *tawarruq*. The information shall include:
- (a) the name of the product and the objective/ purpose of the *tawarruq*;
 - (b) an overview of the product structure including a description of the nature and salient features of a *tawarruq*;
 - (c) the roles and responsibilities of the contracting parties;
 - (d) a description of the approved asset and/or asset exchange used, price and disclosure of cost and profit where *murabahah* is applied;
 - (e) the key terms and conditions of the sale and purchase contract under a *tawarruq* arrangement including arrangement with other Shariah contracts or concepts such as guarantee, takaful, pledge, security deposit including rights and obligations of the contracting parties;
 - (f) fees and charges including rebate, late payment charges, brokerage fees, agency fee and/or tax if applicable; and
 - (g) illustration of computation of profit, 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 specified in the *Guidelines on Product Transparency and Disclosure*.

S 27.5 Notwithstanding the information provided to the customer in paragraph 27.4, the IFI shall facilitate the customer's understanding by explaining to the customer on the following:

- (a) the rights and obligations of the customer under the *tawarruq* e.g. ability of customer to take delivery of asset, obligation of the customer to provide rebate to the IFI in a deposit product; and
- (b) the processes involved in a *tawarruq* which may differ from other Shariah contracts used in a similar type of product.

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 documentations¹³ 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;

¹³*Legally enforceable documentations covers contracts, agreements, master agreements and commercial documents such as invoices, delivery notes, trade confirmation and other generally acceptable documents in trade and financial transactions.*

- (c) the rights, roles and responsibilities of the contracting parties to the *tawarruq*;
- (d) a description of asset and/or asset exchange used;
- (e) the selling or purchase price including breakdown of cost and profit, if *murabahah* is adopted;
- (f) the proposed asset trader or asset exchange used and delivery details;
- (g) the settlement terms of the selling or purchase price,
- (h) the arrangement with other Shariah contracts or concepts such as guarantee, takaful, pledge, security deposit including rights and obligations of the contracting parties; and
- (i) the terms, fees and charges including rebate and where applicable, the late payment charges, brokerage fees, agency fee and/or tax to be borne by the relevant contracting parties.

S 27.9 The documents shall not contain terms and conditions which are prohibited by Shariah as specified in paragraphs 15.5, 15.6, 16.5, 18.2 and 18.3.

S 27.10 Pursuant to paragraphs 12.2, 15.2 and 16.3, the IFI shall ensure that the following conducts are appropriately documented or recorded by the contracting parties as evidence of their proper execution:

- (a) each leg of the sale and purchase contract in sequence¹⁴;
- (b) asset ownership¹⁵; and
- (c) where applicable, appointment of an agent and sub-agent¹⁶.

For the avoidance of doubt, where the IFI is performing a dual-agency role, performance of each role must be evidenced by appropriate documentation or record.

¹⁴In line with paragraph 12.3, on sequence for offer and acceptance.

¹⁵In line with paragraph 13.8, with regard to possession prior to sale and purchase to third party.

¹⁶In line with paragraph 16.4, where the execution must be evidenced by respective legal document.

- S 27.11 The use of Arabic terminology in the documents shall be sufficiently clarified and translated to enhance understanding of the contracting parties. Any translation shall be consistent with the rulings of SAC.

28. Financial disclosure

- S 28.1 The IFI shall maintain adequate accounting and other records that sufficiently enables the preparation and reporting of the financial statements in a true and fair view and 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.
- S 28.3 Where applicable, the IFI shall ensure that the accounting records are able to reflect the different types of Shariah contract i.e. *amanah* and/or *qard*, adopted prior to the execution of *tawarruq*.

29. Submission requirements

- S 29.1 The Board and the SC shall respectively, approve and endorse the IFI's implementation plan to ensure full compliance with the policy document by 1 July 2016.
- S 29.2 The IFI shall submit the implementation plan to Jabatan Perbankan Islam dan Takaful no later than 31 January 2016.
- S 29.3 The IFI shall immediately notify Jabatan Perbankan Islam dan Takaful if the IFI identifies any cause that will affect full compliance by 1 July 2016.

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.

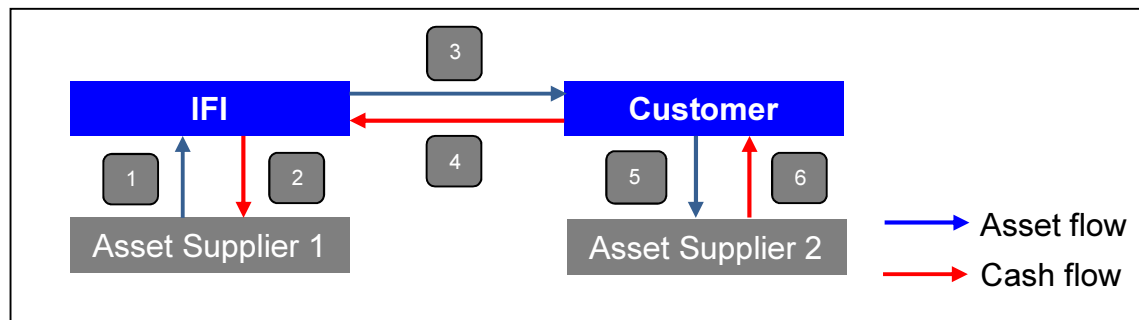
Appendix 2 Glossary

Terms	Definition
<i>Amanah</i>	Trusteeship
<i>Gharamah</i>	Penalty
<i>Hamish jiddiyah</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>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

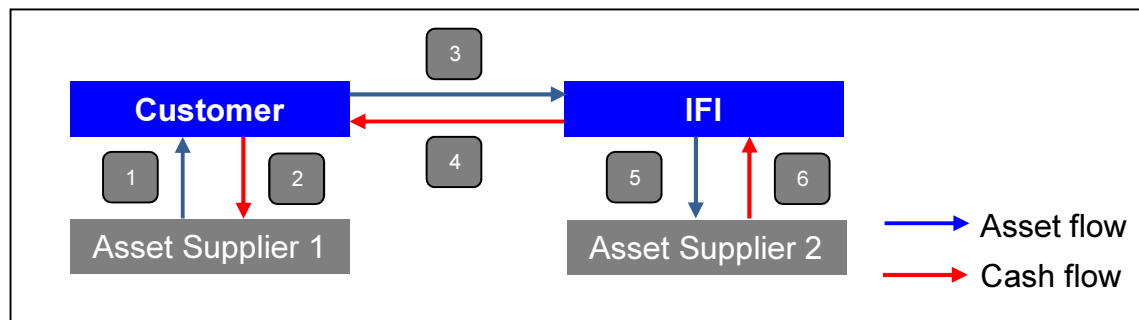
Appendix 3 Product structures

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.

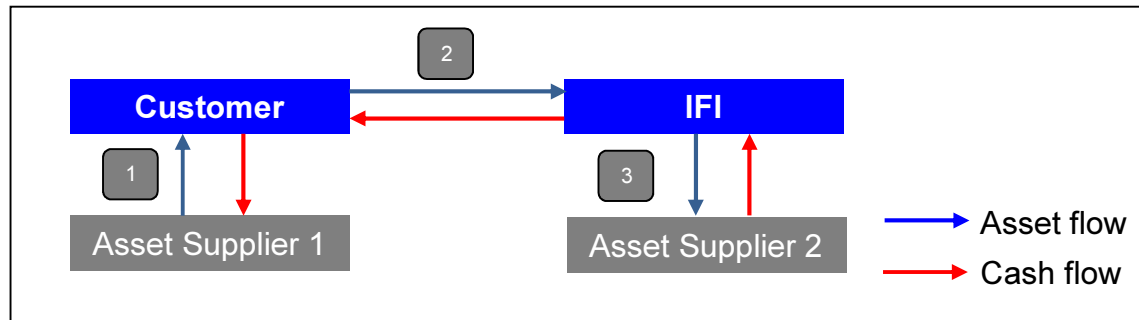
Example 2: Deposit

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.

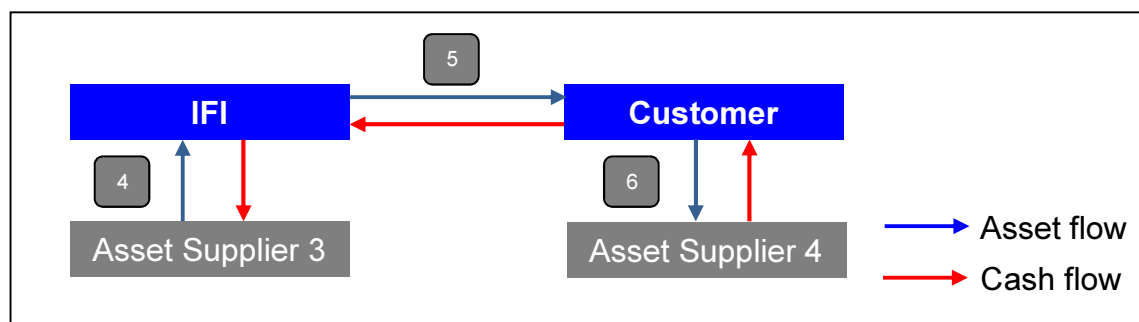
1. The customer appoints the IFI as its agent to purchase the asset from Asset Supplier 1 with selling price of RM100,000.
2. The IFI uses the cash deposit placed by customer to pay for the purchase.
3. Subsequently, the customer appoints the IFI as its agent to sell the asset to the IFI itself at an 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.

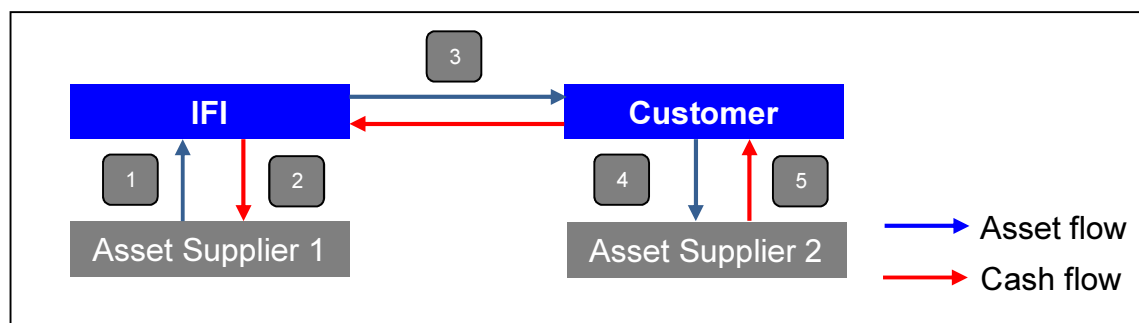
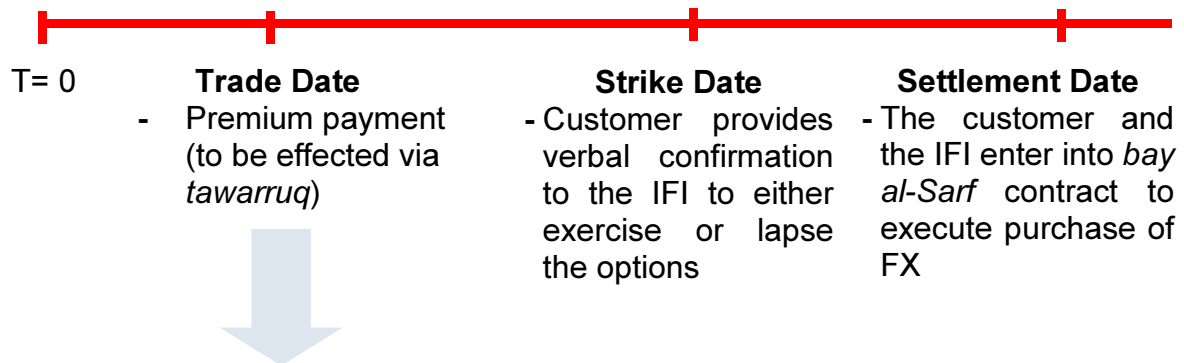


1. On payment date, the customer appoints the IFI as its agent to purchase the asset from Asset Supplier 1 with selling price of RM2 million.
2. Subsequently, the customer appoints the IFI as its agent to sell the asset to IFI itself at an agreed selling price of RM2 million + KLIBOR x 3 months.
3. The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