



**BANK NEGARA MALAYSIA**  
CENTRAL BANK OF MALAYSIA

***Istisna`***

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## **PART A OVERVIEW**

### **1. Introduction**

- 1.1 Compliance with Shariah requirements 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 *istisna`* contract. The latter outlines the operational requirements, which consist of core principles of good governance and oversight, robust documentations, effective risk management, transparent disclosure to customers, fair business and market conduct. These operational requirements are aimed at complementing and promoting sound application of the Shariah principles. This policy document will be applicable to all products and services that are structured based on *istisna`* contract. For the avoidance of doubt, the requirements set out in this policy document must be observed by an IFI who acts as a seller or purchaser.

### **2. Policy objectives**

- 2.1 This policy document aims to–
- (a) set out the Shariah rulings associated with the *istisna`* contract;
  - (b) set out key operational requirements with regard to the implementation of the *istisna`* contract; 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 sets out Shariah requirements that are mandatory to ensure validity of the *istisna`* contract as well as permissible optional practices.
- 3.2 Part C provides operational requirements on governance and oversight, documentations, risk management, business and market conduct. It describes 5 key principles for sound management and operationalisation of *istisna`* as follows—
- (a) **Principle 1:** The IFI must establish a comprehensive governance and oversight framework to ensure that an *istisna`* transaction is conducted based on sound banking practices and complies with Shariah requirements.
  - (b) **Principle 2:** The IFI must ensure that the implementation of *istisna`* is supported by comprehensive policies, procedures, processes, adequate infrastructure and robust documentation.
  - (c) **Principle 3:** The IFI must identify and establish legal documentation to ensure the transaction is valid and executed in accordance with Shariah.
  - (d) **Principle 4:** The IFI must implement a sound and integrated risk management system to effectively manage risks throughout the life cycle of the *istisna`*.
  - (e) **Principle 5:** The IFI must undertake *istisna`* transaction in a fair and transparent manner in line with the Shariah to protect stakeholder's interest.

### 4. Applicability

- 4.1 This policy document is applicable to all IFIs defined in paragraph 7.2.

## 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 of the Development Financial Institutions Act 2002 (DFIA) and constitutes as a direction to section 129(3) of the 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 The policy document comes into effect on 1 July 2016, except for paragraph 36 which shall come into effect immediately upon issuance of this policy document.

## 7. Interpretation

- 7.1 Terms and expressions used in this policy document must 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.

- 7.2 For the purpose of this policy document–

**“S”** denotes a standard, an obligation, a requirement, specification, direction, condition and any interpretative, 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.

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

- (a) a licensed Islamic bank and a licensed takaful operator;
- (b) a licensed bank and licensed investment bank approved under section 15(1)(a) of the FSA to carry on Islamic banking business; and
- (c) a prescribed institution 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 other relevant legal instruments, policy documents or guidelines that have been issued by the Bank, in particular:

- (i) Shariah Advisory Council (SAC) rulings published by the Bank<sup>1</sup>;
- (ii) Guidelines on Product Transparency and Disclosure (BNM/RH/GL 000-3); and
- (iii) Guidelines on *Ibra'* (Rebate) for Sale-Based Financing (BNM/RH/GL 012-5).

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<sup>1</sup> Including Shariah resolutions in Islamic Finance, standards, circulars or any directive pertaining to Shariah matters issued by the Bank.

## PART B SHARIAH REQUIREMENTS AND OPTIONAL PRACTICES

### 9. Definition

- S 9.1 *Istisna`* refers to a contract which a seller sells to a purchaser an asset which is yet to be constructed, built or manufactured according to agreed specifications and delivered on an agreed specified future date at an agreed pre-determined price.

### 10. Nature

- S 10.1 The specific inherent nature of the *istisna`* contract is the construction, building or manufacturing of an asset according to the agreed specifications and its delivery by the seller to the purchaser.
- S 10.2 The *istisna`* contract must be binding on the contracting parties upon entering into the contract provided that it fulfils its essential elements of *istisna`* contract which must include–
- (a) specifications of the *istisna`* asset; and
  - (b) determination of the price, time and place of delivery and mode of payment.
- S 10.3 Once the *istisna`* asset is duly constructed, built or manufactured in accordance with the agreed specifications and conditions, and is duly accepted by the purchaser, the seller must be entitled to the full payment of the agreed price for the *istisna`* asset.

### 11. Components of *istisna`*

- S 11.1 *Istisna`* contract must consist of the following components:
- (a) contracting parties, comprising seller and purchaser;
  - (b) offer (*ijab*) and acceptance (*qabul*);
  - (c) *istisna`* asset;
  - (d) price and payment mode; and
  - (e) *istisna`* project and delivery of *istisna`* asset.



**12. Contracting parties**

- S 12.1 In an *istisna`* contract, there must be a seller (*sani`*) and a purchaser (*mustasni`*) (collectively referred to as contracting parties).
- S 12.2 The contracting parties in an *istisna`* contract must be a natural person or a legal entity who must have the legal capacity<sup>2</sup> to enter into the *istisna`* contract.
- G 12.3 A party to an *istisna`* contract may enter into the contract through an agent (*wakil*).

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

- S 13.1 The *istisna`* contract must be entered into through an offer and acceptance between the contracting parties.
- G 13.2 The offer and acceptance may be expressed orally, in writing or by any other methods which could be evidenced by appropriate documentation or record.
- S 13.3 Terms and conditions of the *istisna`* contract that have been mutually agreed upon by the contracting parties and consistent with the Shariah must be binding on the contracting parties.

**14. Istisna` asset**

- S 14.1 The *istisna`* asset is the subject matter of the contract, to be constructed, built or manufactured by the seller on the instruction of or at the request of the purchaser according to mutually agreed specifications.
- S 14.2 The specifications of the *istisna`* asset to be constructed, built or

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<sup>2</sup> 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 subject to the Contracts Act 1950 and the Age of Majority Act 1971.

manufactured must be agreed upon by the contracting parties (agreed specifications) at the time of entering into the *istisna`* contract.

- S 14.3 Both the *istisna`* asset and the purpose for constructing, building or manufacturing the *istisna`* asset must be in compliance with Shariah.
- G 14.4 The *istisna`* asset may either be a unique or homogeneous asset that can be constructed, built or manufactured such as a house, vehicle, garment, aircraft or furniture.
- S 14.5 An existing or completed asset that can be specifically identified at the time of entering into the *istisna`* contract must not qualify as a valid *istisna`* asset.

#### **Defect option (*khiyar al-`ayb*)**

- S 14.6 Any defect in the *istisna`* asset which occurred before the delivery of the asset but is discovered by the purchaser after the acceptance of the asset must entitle the purchaser to exercise the defect option (*khiyar al-`ayb*).
- S 14.7 The defect option must entitle the purchaser to either–
- (a) terminate the *istisna`* contract; or
  - (b) accept the defective *istisna`* asset, with or without any variations to the terms of the *istisna`* contract.
- S 14.8 Any defect in the *istisna`* asset which is discovered upon delivery of the asset but accepted by the purchaser must disqualify the purchaser from exercising the defect option (*khiyar al-`ayb*).

#### **15. Ownership of *istisna`* asset**

- S 15.1 Pending delivery of the *istisna`* asset, ownership remains with the seller.
- S 15.2 Ownership of the *istisna`* asset must transfer from the seller to the purchaser upon the purchaser taking possession of the *istisna`* asset that meets the agreed specification.

- S 15.3 Possession of the *istisna`* asset must 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 an access to the asset (*tamkin*) and would have assumed its ownership risk.
- S 15.4 Possession of the *istisna`* asset must be either in the form of physical possession (*qabd haqiqi*) or constructive possession (*qabd hukmi*).
- S 15.5 The purchaser must not sell the *istisna`* asset to another party prior to taking its actual or constructive possession.
- G 15.6 The contracting parties may agree that the purchaser may take possession of the *istisna`* asset under construction on an as-is basis. Consequently, the purchaser may sell the asset to another party.
- G 15.7 A purchaser in an *istisna`* contract may enter into another *istisna`* contract to sell to another party an asset having similar specifications to the asset in the previous *istisna`* contract. This is a parallel *istisna`* arrangement.

## **16. Price and mode of payment**

### **Determination of price and manner price is paid**

- S 16.1 Price of the *istisna`* asset must be determined by mutual agreement of the contracting parties (agreed price) at the time of entering into the *istisna`* contract.
- G 16.2 The price may be–
- (a) expressed in monetary value, in kind or other forms of valuable consideration;
  - (b) paid at any time and in any form such as spot, progressive or deferred either by instalments or bullet payments subject to the agreement of the contracting parties.

**Revision to the agreed price**

- G 16.3 The agreed price of the *istisna`* asset may be revised after entering into the *istisna`* contract and before delivery of the *istisna`* asset to the purchaser due to the following circumstances–
- (a) a reduction in the cost of constructing, building or manufacturing of the *istisna`* asset. In this case, the seller may reduce the *istisna`* selling price accordingly.
  - (b) an increase in the cost of constructing, building or manufacturing of the *istisna`* asset. In this case–
    - (i) the purchaser may agree to revise the agreed price of the *istisna`* asset to effect the transfer of the cost to the purchaser; or
    - (ii) the purchaser does not agree to revise the agreed price.
  - (c) the purchaser requests for a change in the agreed specifications of the *istisna`* asset. In this case, if the seller agrees to the purchaser's request, the contracting parties may agree to revise the agreed price.
- S 16.4 In relation to paragraph 16.3(b)(ii), the seller must bear the increased cost of constructing, building or manufacturing of the *istisna`* asset
- G 16.5 In the event that the seller fails to comply with the agreed specifications, the agreed price may be revised even after delivery of the *istisna`* asset subject to mutual agreement by the contracting parties.
- S 16.6 The agreed price must not be revised upwards due to extension of the agreed payment period.

**Other incidental costs and expenses**

- S 16.7 Incidental costs or expenses incurred during the construction, building or manufacturing period of the *istisna`* asset such as those arising from the regulatory or legal requirements must be borne by the seller.
- G 16.8 Notwithstanding paragraph 16.7, the purchaser may agree to bear such costs

or expenses. Such agreement by the purchaser may be incorporated in the *istisna`* contract.

## **17. *Istisna`* project and delivery of *istisna`* asset**

### ***Istisna`* project**

- G 17.1 Unless otherwise provided in the *istisna`* contract that work to construct, build or manufacture the *istisna`* asset (hereinafter referred to as *istisna`* project) must be performed by the seller himself, the seller may carry out the project either himself or by appointing another party or by both of them jointly.
- G 17.2 The seller may fulfil his obligation to deliver the *istisna`* asset by sourcing the asset from the market.
- S 17.3 In relation to paragraph 17.2, in the event where the seller sources the *istisna`* asset from the market, the *istisna`* asset must meet the agreed specifications
- S 17.4 The time of delivery of the *istisna`* asset must be determined and agreed upon by the contracting parties at the inception of *istisna`* contract.

### **Delivery of *istisna`* asset**

- S 17.5 The seller must be discharged of his obligation under the *istisna`* contract upon delivery of the *istisna`* asset which meets the agreed specifications to the purchaser and the purchaser takes possession of the *istisna`* asset.
- S 17.6 If the *istisna`* asset is delivered according to the agreed specifications and time, the purchaser must accept the delivery of the asset and pay the agreed price to the seller.

### **Change of agreed delivery period**

- S 17.7 Delay in the agreed delivery period must entitle the purchaser to claim actual loss or damage from the seller as a result of the latter's failure to deliver on time.

- G 17.8 The purchaser may accept the delivery of the *istisna`* asset which meets the agreed specifications prior to the agreed delivery date.
- S 17.9 In the event that the purchaser delays acceptance of the completed *istisna`* asset without any valid reason, the seller must act as custodian of the asset but must not be held liable for the asset except in the event of misconduct (*ta`addi*) or negligence (*taqsir*). Any cost related to the safekeeping of the asset must be borne by the purchaser.
- G 17.10 Under the circumstances described in paragraph 17.9, the contracting parties are permitted to alternatively mutually agree to any of the following–
- (a) that the seller agrees to safe keep the *istisna`* asset for the purchaser in consideration of a certain fee to be paid by the purchaser. Due to the imposition of fee, the liability of safekeeping the asset remains with the seller in his capacity as the custodian of the asset; or
  - (b) that the purchaser appoints the seller as an agent to act on behalf of the purchaser to engage the services of a third party to safe keep the *istisna`* asset. In this case, the seller may charge the purchaser for this service. The liability of safekeeping the *istisna`* asset remains with the purchaser except in the event of misconduct (*ta`addi*), negligence (*taqsir*) or breach of specified terms (*mukhalafah al-shurut*) by the seller.
- G 17.11 The *istisna`* contract may incorporate a clause which provides that the seller must act as an agent for the purchaser in disposing of the *istisna`* asset at fair market value or at a mutually agreed price, in the event that the purchaser fails to accept the delivery of the asset within a reasonable time, or if the purchaser specifically directs the seller to do so.
- G 17.12 The contracting parties may agree to utilise the proceeds from the sale specified in paragraph 17.11 to settle any outstanding amount on the agreed price of the *istisna`* asset and to pay any actual costs and expenses incurred therefrom.

- S 17.13 Where an *istisna`* asset is disposed in accordance with paragraphs 17.11 and 17.12, any surplus of the sale proceeds must be refunded to the purchaser while any shortfall must be reimbursed by the purchaser.

**Delivery of completed *istisna`* asset not in accordance with agreed specifications**

- G 17.14 In the event that the *istisna`* asset is not in accordance with the agreed specifications, the purchaser may exercise the following options–
- (a) reject delivery of the *istisna`* asset thereby dissolving the contract;
  - (b) accept delivery of the *istisna`* asset at the agreed price; or
  - (c) accept the delivery of the *istisna`* asset subject to new terms to be mutually agreed upon by the contracting parties such as a revision to the agreed price or extension of time given to the seller to meet the agreed specifications of the asset.

**Failure to complete and deliver the *istisna`* asset**

- G 17.15 In the event that the seller fails to complete and deliver the *istisna`* asset on the agreed delivery date, the purchaser may either–
- (a) take possession of the *istisna`* asset on an as-is basis; or
  - (b) dissolve (*fasakh*) the *istisna`* contract.
- S 17.16 In relation to paragraph 17.15(a), the purchaser must pay the *istisna`* selling price up to the stage of completion of the *istisna`* asset. The purchaser must have the right to claim for compensation from the seller for any loss incurred due to the latter's failure to complete and deliver the asset.
- S 17.17 In relation to paragraph 17.15(b), the seller must refund all amount paid by the purchaser up to the date of dissolution and compensate the purchaser for any loss incurred due to the seller's failure to complete and deliver the asset.
- S 17.18 The seller must not stipulate in the *istisna`* contract waiver of liability for failure to complete the construction of the *istisna`* asset according with the agreed

specifications and within the agreed time.

**18. Other terms, conditions, representations and warranties in *istisna`* contract**

- S 18.1 The seller must not stipulate in the *istisna`* contract, waiver of liability for any material defect which affects the agreed specifications of the *istisna`* asset after acceptance of the asset by the purchaser.
- G 18.2 The contracting parties may agree on a certain degree of variation or tolerance in terms of the expected level of accuracy in meeting the agreed specifications of the *istisna`* asset as long as it is in line with the acceptable market practice (*`urf tijari*).
- G 18.3 The contracting parties may include warranty of the *istisna`* asset and clauses requiring maintenance work to be carried out by the seller after acceptance of the *istisna`* asset by the purchaser to safeguard the interest of the purchaser against defects.
- G 18.4 The contracting parties may engage the services of a third party to provide additional services such as advisory or consultancy services relating to the *istisna`* contract or asset. The cost of the third party engagement may be borne by both or either one of the contracting parties subject to mutual agreement between them.
- G 18.5 The contracting parties may vary the *istisna`* contract due to force majeure.
- S 18.6 In the event the variation is made to the *istisna`* contract, it must be agreed upon by the contracting parties.



## ARRANGEMENT OF *ISTISNA`* CONTRACT WITH OTHER CONTRACTS OR CONCEPTS

### 19. Arrangement of *istisna`* contract with assurances

- G 19.1 For the purpose of assurances, the *istisna`* contract may be arranged with other Shariah-based contracts or concepts such as guarantee (*kafalah*), takaful coverage, pledge/ charge (*rahn*), security deposit (*hamish jiddiyyah*) or earnest money (*urbun*).

### 20. Assurance of *istisna`* contract through guarantee (*kafalah*)

- G 20.1 A third-party guarantee (*kafalah*) may be arranged alongside with an *istisna`* contract to guarantee–
- (a) payment of the agreed price of the *istisna`* asset within the agreed time; and/or
  - (b) delivery of the *istisna`* asset by the seller which meets the agreed specifications and within the agreed time.

### 21. Assurance of *istisna`* contract through takaful coverage

- G 21.1 Upon entering into an *istisna`* contract, the seller may require the purchaser to subscribe to a takaful coverage to guarantee payment of the agreed price of the *istisna`* asset in the event of loss of legal capacity by the purchaser.
- G 21.2 The purchaser may require the seller to subscribe to takaful coverage to guarantee delivery of the *istisna`* asset by the seller.

### 22. Assurance of *istisna`* contract through pledge/ charge (*rahn*)

- G 22.1 The debt arising from an *istisna`* contract may be secured by pledge of collateral (*marhun*).
- S 22.2 The proceeds from the liquidation of the collateral must be utilised as follows:
- (a) to recover payment of the outstanding debt amount from the purchaser;
- or

(b) to guarantee delivery of the *istisna`* asset by the seller.

- G 22.3 In relation to paragraph 22.2(a), the contracting parties may agree to include the claim on actual costs incurred for the recovery of the outstanding debt payment from the collateral.
- G 22.4 The seller in the *istisna`* contract may pledge the *istisna`* asset to any other third party as collateral.
- S 22.5 In relation to paragraph 22.4, in the event the *istisna`* asset is pledged to the third party, the *istisna`* asset must not yet delivered to and possessed by the purchaser.
- S 22.6 The purchaser in the *istisna`* contract must not pledge an *istisna`* asset as collateral prior to its delivery and acceptance by the purchaser.
- G 22.7 The contracting parties may agree upon entering into the *istisna`* contract that the purchaser may take possession of the *istisna`* asset on as is basis where thereafter, the purchaser may pledge the asset.

### **23. Assurance of *istisna`* contract through security deposit (*hamish jiddiyyah*)**

- G 23.1 The seller may require the purchaser to place a security deposit (*hamish jiddiyyah*) with the seller to secure the purchaser's undertaking to enter into the *istisna`* contract. In the event that the purchaser fails to enter into the *istisna`* contract, the security deposit (*hamish jiddiyyah*) may be used to compensate against the actual loss incurred by the seller.
- S 23.2 In relation to paragraph 23.1, any remaining balance of the security deposit (*hamish jiddiyyah*) after payment of compensation against actual loss has been made must be returned to the purchaser. Any shortfall or insufficiency to cover actual losses must be borne by the purchaser.
- G 23.3 Upon entering into the *istisna`* contract, the security deposit (*hamish jiddiyyah*) may be treated as part payment of the agreed price of the *istisna`*

asset.

- S 23.4 The security deposit (*hamish jiddiyyah*) must be returned to the purchaser prior to or upon settlement of the agreed price if it is not treated as part payment of the agreed price of the *istisna`* asset.

#### **24. Assurance of *istisna`* contract through earnest money (*`urbun*)**

- G 24.1 Upon entering into the *istisna`* contract, the purchaser may place earnest money (*`urbun*) with the seller, which enables the purchaser to have an option of either to proceed with entering into or alternatively terminate the *istisna`* contract within an agreed specified time.
- S 24.2 If the purchaser exercises the option to proceed with the *istisna`* contract within the specified time, the earnest money (*`urbun*) must be treated as part payment of the agreed price of the *istisna`* asset.
- S 24.3 If the purchaser fails to exercise the option to proceed with the contract within the specified time or decides to terminate the *istisna`* contract, the seller must be entitled to the return of earnest money (*`urbun*).

#### **25. Incorporation of rebate (*ibra`*) in *istisna`***

- G 25.1 In the event of early settlement by the purchaser, the seller may waive part of the outstanding agreed price in the form of rebate (*ibra`*) to the purchaser.
- G 25.2 In the event that the *istisna`* contract involves payment of the agreed price on a deferred or instalments basis, the seller may provide periodic *ibra`* to the purchaser based on certain benchmarks or thresholds agreed by the contracting parties.
- S 25.3 A rebate clause must be incorporated in the *istisna`* contract provided that it is a requirement imposed by the authority.

**26. Arrangement of *istisna`* with forward lease agreement (*ijarah mawsufah fi al-zimmah*)**

- G 26.1 The contracting parties may enter into a forward lease agreement (*ijarah mawsufah fi al-zimmah*), where the purchaser may lease the *istisna`* asset under construction to the seller or to any other party.
- S 26.2 The forward lease agreement (*ijarah mawsufah fi al-zimmah*) must be entered into separately from the *istisna`* contract.
- S 26.3 The execution of the *istisna`* contract must be evidenced by respective legal document or any other methods which could be evidenced by appropriate documentation or record.

**27. Arrangement of *istisna`* with compensation (*ta`widh*), penalty (*gharamah*) and/or late delivery charge (*shart jaza'i*)**

- G 27.1 The contracting parties may agree to include a clause in the *istisna`* contract which stipulates imposition of late payment charges as determined by the relevant authorities.
- S 27.2 The late payment charges must consist of–
- (a) compensation (*ta`widh*) for actual loss borne by the seller, which may be recognised as income to the seller; and/or
  - (b) penalty (*gharamah*) which must not be recognised as income. Instead, it must be channelled to charitable bodies and/or Baitulmal.
- G 27.3 The seller may claim for compensation of the actual cost incurred in the event that the purchaser decides not to proceed with the contract after he has undertaken to enter into it through a binding promise (*wa`d mulzim*).
- G 27.4 The contracting parties may agree to include a clause on late delivery charge (*shart jaza'i*) on the seller in the event of late delivery of the *istisna`* asset and the amount of the late delivery charge may be recognised as income to the purchaser.

**ARRANGEMENT OF PARALLEL *ISTISNA`*****28. Parallel *istisna`***

- G 28.1 The contracting parties to an *istisna`* contract may enter into parallel *istisna`*, which is another *istisna`* contract with specifications similar to those of the *istisna`* asset of the first *istisna`* contract.
- S 28.2 Pursuant to paragraph 28.1, the following must be observed–
- (a) the parallel *istisna`* must consist of two separate and independent *istisna`* contracts with similar specifications of the *istisna`* asset;
  - (b) the seller in each *istisna`* contract must deliver the respective *istisna`* assets to the purchaser and the purchaser in each *istisna`* contract must pay the respective agreed price of the *istisna`* asset to the respective seller; and
  - (c) the obligations under and performance of each *istisna`* contract must be independent of the other *istisna`* contract.
- S 28.3 In the event that a purchaser has already contracted to purchase an *istisna`* asset from the actual party performing the construction, building or manufacturing, the seller in the second *istisna`* contract must establish his ownership of the asset either by–
- (a) the purchaser terminating the contract in order to allow the seller to enter into a new *istisna`* contract with the actual party performing the job; or
  - (b) the seller may also use other means of acquiring ownership of the *istisna`* asset which is in compliance with Shariah.
- G 28.4 The seller may appoint the purchaser as an agent to supervise the construction, building or manufacturing of the *istisna`* asset by a third party developer/manufacturer to ensure that the *istisna`* asset meets the agreed specifications and is delivered within the agreed time.

- G 28.5 In the event that the purchaser recommends a third party developer/manufacturer, the seller may request the purchaser to guarantee the performance of the third party developer/manufacturer (*kafalah*).
- S 28.6 In relation to paragraph 28.5, the *kafalah* contract entered into by the purchaser as guarantor must be independent from his role as the purchaser to the effect that validity of the *kafalah* is not made contingent to the *istisna`* contract or vice versa.

## COMPLETION (*INTIHA`*) AND DISSOLUTION (*FASAKH*) OF *ISTISNA`*

### 29. Completion of *istisna`* contract

- S 29.1 An *istisna`* contract is completed upon–
- (a) acceptance of the *istisna`* asset by the purchaser, regardless whether it meets the agreed specifications; and
  - (b) full settlement of the agreed price by the purchaser.
- S 29.2 Unless otherwise specified, the contracting parties must be free from their respective contractual obligations upon completion of the *istisna`* contract.

### 30. Dissolution of *istisna`* contract

- S 30.1 An *istisna`* contract is a binding contract. Therefore, it must not be unilaterally revoked by any of the contracting parties.
- S 30.2 Notwithstanding paragraph 30.1, an *istisna`* contract must be dissolved unilaterally under the following circumstances:
- (a) the purchaser in an *istisna`* contract with earnest money (*`urbun*) exercises the option to terminate the *istisna`* contract within the specified time period;
  - (b) the purchaser exercises the option to terminate the *istisna`* contract prior to its acceptance because the *istisna`* asset does not meet the agreed specifications (*khiyar fawat al-wasf*);
  - (c) the purchaser exercises the defect option (*khiyar al-`ayb*) to terminate

the *istisna`* contract;

- (d) any of the contracting parties exercises the mutually agreed options to terminate the *istisna`* contract within the agreed time period; or
- (e) the purchaser exercises the option to terminate the contract due to the seller's failure to deliver the *istisna`* asset.

G 30.3 In the event of demise (in the case of individuals) or dissolution (in the case of legal entities) or loss of legal capacity of the seller, the purchaser may exercise the following options:

- (a) take possession of the *istisna`* asset on an as-is basis; or
- (b) notwithstanding paragraph 30.1, dissolve the *istisna`* contract unilaterally.

S 30.4 In relation to paragraph 30.3(a), the purchaser must pay the seller or his lawful representative the *istisna`* selling price up to the stage of completion of the *istisna`* asset. Hence, the contract ends.

S 30.5 In relation to paragraph 30.3(b), the purchaser is entitled to claim the price that has been paid by the purchaser to the seller.

S 30.6 In the event of demise or dissolution or loss of legal capacity of the purchaser, the *istisna`* contract continues and the seller is obliged to deliver the *istisna`* asset. Hence, the seller is entitled to claim the *istisna`* selling price.

G 30.7 The contracting parties may mutually agree to revoke the *istisna`* contract.

S 30.8 Upon dissolution of the *istisna`* contract due to the circumstances stipulated in paragraphs 30.2 and 30.3(b) –

- (a) ownership of the *istisna`* asset remains with the seller;
- (b) the purchaser's obligation to pay the agreed price of the *istisna`* asset is waived; and
- (c) with the exception of paragraph 30.2(a), any amount paid must be returned to the purchaser.

S 30.9 In relation to paragraph 30.1, other than those provided in paragraphs 30.2 and 30.3(b), the party who unilaterally revokes the *istisna`* contract must compensate the other contracting party due to the breach of the *istisna`* contract.



## PART C OPERATIONAL REQUIREMENTS

### 31. Background

- G 31.1 An IFI may enter into an *istisna`* contract with a customer who intends to acquire an asset that needs to be constructed or manufactured based on an agreed specification.
- S 31.2 The IFI that enters into *istisna`* contract as a seller or a purchaser which result in the following obligation must comply with Shariah requirements (Part B) and operational requirements (Part C):
- (a) the IFI as a seller has the obligation to deliver the completed *istisna`* asset to customer regardless if the IFI directly undertake the *istisna`* project or hiring a contractor or manufacturer (hereinafter must be referred to as a contractor) to complete the *istisna`* project; or
  - (b) the IFI as a purchaser is expected to ensure the *istisna`* asset is completed as per the agreed specification and delivered on the agreed date since the IFI would have the obligation to deliver the completed *istisna`* asset to the customer arising from the transaction to transfer the ownership of *istisna`* asset to the customer either via a forward sale or lease arrangement.

Illustrations of the product structures that use *istisna`* as the underlying Shariah contract is provided in Appendix 3.

### 32. Governance and oversight

- S 32.1 While the broad governance and oversight principles can be applied, specific requirements are needed to manage the distinct risks and the unique nature of the *istisna`* contract. The IFI must have sufficient understanding of its risk profile and availability of the resources with the appropriate knowledge and skill set.
- S 32.2 The board of directors (the Board) must establish a sound governance structure to facilitate an effective oversight function on the management and

implementation of the *istisna`* contract. The adequacy of the governance structure must commensurate with the nature, scale, complexity and risk profile of the *istisna`* contract.

S 32.3 The roles and responsibilities of the Board with respect to *istisna`* transaction must include the following:

- (a) set the IFI's business strategy and risk appetite with regard to the application of the *istisna`* contract;
- (b) approve the IFI's internal policies and oversee the internal procedures for effective risk management to ensure compliance with the relevant law and regulations;
- (c) establish appropriate systems to implement the application of *istisna`* contract consistent with Shariah requirements;
- (d) ensure that the IFI has adequate and qualified personnel with sufficient knowledge and competency on the concept, application and risks associated with the *istisna`* contract;
- (e) ensure independent reviews are conducted regularly to assess compliance with the policy documents issued by the Bank and relevant internal policies established by the IFI.

S 32.4 The Shariah Committee (SC) must perform the following to ensure that *istisna`* transaction is conducted in line with Shariah requirements–

- (a) endorse the application of Shariah requirements in the relevant policies and procedures governing the *istisna`* contract;
- (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;
- (c) assess the work carried out by Shariah review and Shariah audit, to identify issues and propose appropriate corrective measures; and
- (d) advise and provide clarification on relevant Shariah rulings, decisions or policy documents on Shariah matters issued by the Bank, if relevant, any other authorities.

S 32.5 The roles and responsibilities of the senior management with regards to *istisna`* transaction must include the following:

- (a) develop and implement business strategies, internal control and risk management requirements in line with the IFI's business objective;
- (b) establish internal policies, processes and procedures governing *istisna`* transaction;
- (c) implement relevant internal systems, infrastructure and adequate mechanisms to identify, measure, control and monitor risk inherent in the *istisna`* contract;
- (d) ensure the IFI monitors and has proper and adequate reporting of the operation and performance of the *istisna`* contract;
- (e) identify, assign and train key personnel with the appropriate skill and ensure that the roles and responsibilities are properly delegated to the relevant functions to undertake the different activities under the *istisna`* contract;
- (f) undertake regular reviews and monitor compliance with the approved policies; and
- (g) ensure timely disclosure of relevant information to the Board and the SC.

S 32.6 At minimum, the IFI must ensure that–

- (a) the *istisna`* asset is in compliance with Shariah and consistent with the IFI's risk appetite and risk management capacities;
- (b) adequate capacities (such as funding sources, skills and expertise) are available to fulfil the proposed specification of the *istisna`* asset;
- (c) delivery process of the completed *istisna`* asset is effective and efficient; and
- (d) defects of the *istisna`* asset is effectively managed.

**Assessment of the *istisna`* asset**

- S 32.7 In respect of paragraphs 32.6(a) and (b), the IFI is required to assess the specification of the *istisna`* asset that is proposed by the customer prior to entering into the *istisna`* contract. The assessment must–
- (a) verify the *istisna`* asset in order to ensure that its purpose is in compliance with Shariah requirements; and
  - (b) identify the relevant capacities that IFI must have in order to fulfil the proposed specification of the *istisna`* asset and validate whether the IFI have the identified capacities.
- S 32.8 The IFI is required to develop the internal eligibility criteria of the *istisna`* asset to facilitate its assessment on the specification of *istisna`* asset that is proposed by the customer.
- G 32.9 The IFI may consider parameter such as availability of secondary market for the proposed *istisna`* asset in developing the internal eligibility criteria of the *istisna`* asset. For highly customised *istisna`* asset that has limited secondary market, the IFI is expected to use stable type of funding source and to have adequate level of expertise to monitor the progression of the *istisna`* project.

**Delivery of *istisna`* asset**

- S 32.10 In respect of paragraph 32.6(c), the IFI is required to develop the internal policy and procedure on delivery of the *istisna`* asset. At minimum, the internal policy and procedure must provide for the following:
- (a) verification that the *istisna`* asset fulfills the agreed specification prior to the delivery;
  - (b) procedure for delivery of the *istisna`* asset; and
  - (c) treatment for rejecting delivery of the *istisna`* asset and the non-delivery event.

G 32.11 For the purpose of paragraph 32.10(b), the IFI may notify and obtain customer's consent prior to delivery of the completed *istisna`* asset, especially in the event where the delivery is earlier than the agreed delivery date.

### **Defect of *istisna`* asset**

S 32.12 In respect of paragraph 32.6(d), the IFI must establish the internal policy and procedure on defect management of the *istisna`* asset. At minimum, the policy and procedure must include mechanism to manage customer's rights due to defect<sup>3</sup>.

S 32.13 Prior to entering into the *istisna`* contract, the IFI as a purchaser, must ensure that the contractor establishes a mechanism to manage defects of the *istisna`* asset.

G 32.14 The IFI may provide a provision of warranty as a mechanism for defect management in the *istisna`* contract.

G 32.15 The IFI may appoint another party to manage defects of the *istisna`* asset.

## **33. Documentations**

S 33.1 The IFI must ensure that the documentation on the *istisna`* transaction is enforceable and complies with Shariah.

S 33.2 At minimum, the IFI must ensure the following transactions are documented in writing and executed by the contracting parties:

- (a) sale and/or purchase transaction (*istisna`* contract) and financial arrangement<sup>4</sup>;
- (b) accepting or rejecting the delivery of the *istisna`* asset; and
- (c) where applicable, appointment of an agent, acceptance of guarantee, security deposit (*hamish jiddiyyah*), earnest money (*urbun*) or collateral

<sup>3</sup> For the avoidance of doubt, the defect occurred before the delivery of the *istisna`* asset but discovered after the acceptance of the delivery of *istisna`* asset.

<sup>4</sup> Financial arrangement refers to method and other terms of the settlement of the selling price

(*rahn*).

- S 33.3 The IFI must ensure the rights, duties, liabilities and obligations of contracting parties are clearly stipulated in the respective documentations.
- S 33.4 The IFI must ensure that the application for the construction, building or manufacturing of the *istisna`* asset is supported by a written document. At minimum, such written document must outline the following:
- (a) specification including feature and quantity of the *istisna`* asset;
  - (b) purpose of the asset;
  - (c) delivery date<sup>5</sup>; and
  - (d) where applicable, proposed contractor of the *istisna`* asset.
- S 33.5 Prior to entering into the *istisna`* contract, the IFI (seller) must ensure that its ownership of the *istisna`* asset is evidenced in the enforceable document.
- S 33.6 In the event where the customer has purchased the *istisna`* asset from a contractor, the IFI (seller) must ensure that the mechanism to transfer ownership of the *istisna`* asset from the customer to the IFI complies with Shariah requirements.
- G 33.7 In relation to paragraph 33.6, list of possible legal instruments as example of the mechanism to transfer the customer's ownership of the *istisna`* asset to the IFI is provided in Appendix 4.
- S 33.8 At minimum, the IFI must ensure the documentation on sale and/ or purchase transaction (*istisna`* contract) includes the following:
- (a) specification of the asset or subject matter of sale;
  - (b) total selling price;
  - (c) settlement terms of selling price;
  - (d) delivery date;
  - (e) delivery arrangement;
  - (f) where applicable, provision of rebate due to early settlement of selling

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<sup>5</sup> This includes the time or period as agreed by the contracting parties

price;

- (g) where applicable, the proposed contractor of the *istisna`* asset;
- (h) events of default;
- (i) clause on compensation or treatment due to events of default;
- (j) options available due to non-delivery and defects of the *istisna`* asset;  
and
- (k) treatment of force majeure events.

S 33.9 The IFI must ensure the terms and conditions in all legal documentations do not–

- (a) waive the seller's obligation to deliver the completed *istisna`* asset on the agreed delivery date; and
- (b) waive the seller's liability for any material defect of *istisna`* asset after acceptance of delivery by customer.

S 33.10 The IFI must ensure any variation to the agreed terms and condition of the *istisna`* contract such as specification or selling price after entering into the *istisna`* contract is mutually agreed by the contracting parties and documented.

G 33.11 In the event where a person is appointed to undertake the *istisna`* project or to monitor progression of the *istisna`* project, the IFI may include the following terms and conditions in the relevant documentations:

- (a) progress schedule including the proposed timeline for the cash disbursement from the IFI;
- (b) roles and responsibilities of the person who monitor progression of the *istisna`* project;
- (c) description of trigger events that enable the IFI's intervention in the *istisna`* project; and
- (d) rights of the IFI to intervene in the *istisna`* project upon occurrence of any trigger events.

S 33.12 The IFI must ensure the following are included in relevant documentation on delivery of the *istisna`* asset:

- (a) date of delivery of the *istisna`* asset;
- (b) person accepting or rejecting the delivery of the *istisna`* asset; and
- (c) where applicable, confirmation that the *istisna`* asset fulfils the agreed specification by the person whom accepting the delivery of the *istisna`* asset.

S 33.13 In the event where the application of *istisna`* contract is combined with agency (*wakalah*) and/ or guarantee (*kafalah*) contract, the IFI must ensure that–

- (a) *istisna`* contract is executed separately from agency (*wakalah*) and/ or guarantee (*kafalah*) contract; and
- (b) terms and conditions of the agency and/ or guarantee arrangement must not be made conditional upon any terms and conditions of the *istisna`* contract.

#### **34. Risk Management**

G 34.1 The application of *istisna`* contract may expose the IFI to various types of risk, such as credit, market, liquidity and operational risk. 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 contract framework.

S 34.2 The IFI must 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 *istisna`* contract which must include the following:

- (a) the identification and monitoring of risks including, if applicable, risk arising from the performance of a contractor and the delivery process;
- (b) the establishment of prudential limits including concentration limits on the *istisna`* asset and/ or a contractor to be involved in *istisna`* transaction;
- (c) the risk mitigation techniques including establishing–
  - (i) appropriate eligibility criteria and review process in identifying a list



of contractor to be involved in *istisna`* transaction; and

(ii) list of key trigger events that require the IFI's intervention in the *istisna`* project and procedure to manage the identified trigger events.

(d) the monitoring and reporting mechanism.

S 34.3 The IFI must ensure that the relevant resources to undertake the risk management processes, which include identification, measurement, mitigation, monitoring and review of the risks associated with *istisna`* are available.

### **Risk associated with performance of contractor**

S 34.4 Prior to appointing a third party contractor to undertake the *istisna`* project, the IFI as a seller, must assess the contractor's capacity to construct or manufacture the *istisna`* asset as per the agreed specification in the *istisna`* contract.

S 34.5 The IFI as a purchaser must assess capacity of the contractor that is identified or proposed by customer.

S 34.6 The IFI must establish the internal eligibility criteria on the contractor. At minimum, the criteria are able to ensure the contractor has the capacity to undertake the *istisna`* project and fulfil the agreed specification of the *istisna`* asset.

S 34.7 At minimum, the IFI must consider the following aspects in developing the internal eligibility criteria of the contractor:

- (a) financial position of the contractor; and
- (b) the contractor's performance in its previous projects.

G 34.8 The IFI may identify and maintain a list of alternative contractor to facilitate the construction of the *istisna`* asset in the event that the appointed contractor fails to complete the *istisna`* project.

G 34.9 The IFI as a seller may request a third party or customer to guarantee performance of the contractor to deliver the *istisna`* asset as per the agreed specification and at the agreed date, time or period.

**Risk associated with the *istisna`* project**

S 34.10 The IFI is required to monitor the progress of the *istisna`* project.

S 34.11 The IFI must establish the internal policy and procedure on monitoring of the *istisna`* project. At minimum, the internal policy and procedure must include the following:

- (a) scope of monitoring including aspects to be monitored;
- (b) method of monitoring, such as periodical on-site inspection or submission of progress report;
- (c) timeline or frequency of the project monitoring; and
- (d) identification of a party to be involved in the project monitoring and the accountabilities.

G 34.12 The IFI as a purchaser may monitor the progress of the *istisna`* project to ensure that the disbursement for payment of the *istisna`* selling price commensurate with the stage of completion of the *istisna`* project.

G 34.13 In relation to paragraph 34.10, the IFI may appoint another party as its agent to monitor the progress of the *istisna`* project.

S 34.14 Pursuant to paragraph 34.2(c)(ii), upon occurrence of any identified trigger events, the IFI must take necessary actions in line with the internal procedure to manage the trigger event.

G 34.15 Illustration on the trigger events and risk mitigation strategies to be undertaken by the IFI upon the occurrence of the trigger events is provided in Appendix 5.

S 34.16 The IFI must assess and review the suitability and effectiveness of the

monitoring method for different nature of *istisna`* asset and project.

### **Risk associated with the delivery of *istisna`* asset**

- G 34.17 The IFI may employ risk transfer mechanism such as takaful coverage to minimise the risk associated with the delivery of the *istisna`* asset. For instance, the takaful coverage may minimise potential losses arising from any damage to the *istisna`* asset during the delivery process to the customer.
- S 34.18 For the purpose of paragraph 34.17, the scope of takaful coverage and payer of the contribution amount must be determined and agreed by contracting parties.

## **35. Business and market conduct**

- S 35.1 The IFI must give due regard to the interests of the customers in its policies and procedures to ensure that the *istisna`* contract is conducted in a fair, transparent, responsible and professional manner.

### **Fair dealings**

- S 35.2 The IFIs' internal policies and procedures on business and market conduct for the *istisna`* must reflect fair dealing practices, including–
- (a) the information provided must be accurate, clear and not misleading;
  - (b) the fees and charges, if any; and
  - (c) reasonable care is taken to ensure suitability of advice and recommendations made by the IFI, if any.

### **Disclosure of information**

- S 35.3 The IFI must explain clearly to the customer on the concept of *istisna`* contract to facilitate the customer's understanding on the *istisna`* transaction.
- S 35.4 The IFI must ensure the accuracy of the description, nature and feature of the *istisna`* and other Shariah contracts or concepts applicable to the particular

purpose and product structure.

S 35.5 At the pre-contractual stage, the IFI must 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 *istisna`*. The information must include–

- (a) an overview of the product's structure including a description of the nature and salient features of *istisna`*;
- (b) the roles and responsibilities of the contracting parties:
  - (i) customer's rights and obligation as a purchaser. At minimum, the following must be disclosed–
    - (A) obligation to accept the delivery of the *istisna`* asset that has been completed and fulfilled the agreed specification and pay the *istisna`* selling price; and
    - (B) rights to exercise options arising from non-delivery of the *istisna`* asset and defects
  - (ii) customer's rights and obligation as a seller. At minimum, the following must be disclosed–
    - (A) obligation to deliver the *istisna`* asset that has been completed and fulfilled the agreed specification; and
    - (B) obligation to provide options arising from non-delivery and defects of the *istisna`* asset;
  - (iii) where relevant, customer's obligation and liabilities as the IFI's agent and/or guarantor;
- (c) a description of eligible asset to be financed under *istisna`* contract;
- (d) the key terms and conditions of the relevant documentation for the purpose of *istisna`* contract;
- (e) an explanation on the event of default and negligence;
- (f) the applicable fees and charges, including the fees and charges imposed due to the following:
  - (i) safe keeping the *istisna`* asset due to delay on the acceptance of the *istisna`* asset by the customer; and
  - (ii) appointment of a person to perform a specific function in the

*istisna`* transaction.

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.

- G 35.6 During term of the *istisna`* contract, the IFI may disclose statement on work-in-progress of the *istisna`* asset to the customer.

### **Late delivery charges**

- G 35.7 The IFI may agree with other contracting parties on the provision of late delivery charges (LDC).
- S 35.8 In the event where the contracting parties agree to impose late delivery charges, the IFI is required to ensure a clause on LDC and computation of the LDC are incorporated in the relevant documentations.

### ***Ibra`* (rebate)**

- S 35.9 Notwithstanding paragraph 3.2 of the Guidelines on *Ibra`* (Rebate) for Sale-based Financing (the Guidelines), the IFI must comply with the Guidelines except for the requirements on termination of financing arising from non-delivery or non-possession of the underlying asset<sup>6</sup>.

### **Treatment for non-delivery and defect of *istisna`* asset**

- S 35.10 The IFI, as a seller is required to provide options to customer in the event of non-delivery and defect of the *istisna`* asset. The options must be endorsed by the SC.
- S 35.11 The IFI, as a seller must ensure that the customer understands the options and implication of each option.
- S 35.12 For the purpose of paragraph 35.11, the IFI must provide the following

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<sup>6</sup> As described in paragraphs 8.9 – 8.12 of Guidelines on *Ibra`* (Rebate) for Sale-Based Financing

options to customers in the event of defective *istisna`* asset:

- (a) terminate the *istisna`* contract; or
- (b) accept the defective *istisna`* asset, with or without any variations to the terms of the *istisna`* contract.

G 35.13 For the purpose of paragraph 35.11, the illustration on the options available in the event of non-delivery and the implication to the customers is provided in Appendix 6.

### **36. Submission requirement**

- S 36.1 The Board and the SC must respectively approve and endorse the IFI's implementation plan to ensure compliance with the policy document by 1 July 2016.
- S 36.2 The IFI that offers product or service that is structured based on *istisna`* contract, must submit the implementation plan to Jabatan Perbankan Islam dan Takaful no later 31 January 2016.
- G 36.3 In relation to paragraph 36.1, the Bank expects the IFI to–
- (a) review and confirm existing policies, procedures and internal limits;
  - (b) clarify roles and accountabilities; and
  - (c) where applicable, undertake enhancement to the existing system to address the risks associated with *istisna`* contract.
  - (d) establish appropriate monitoring and reporting mechanisms to ensure compliance with the requirements.
- S 36.4 The IFI must 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 *istisna`* contract

1. The legitimacy of *istisna`* is derived from the *Quran* and founded on *Sunnah* of the Prophet Muhammad (peace be upon him), and the consensus of Muslim jurists (*Ijma`*).

#### The Quran

2. The following verses of the *Quran* imply the general permissibility of sales contract including *istisna`* contract:

i. وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرِّبَا

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

ii. يَا أَيُّهَا الَّذِينَ آمَنُوا أَوْفُوا بِالْعُقُودِ

“O you who believe! fulfil (all) obligations...” (*Surah al-Maidah, verse 1*).

#### *Sunnah* of Prophet Muhammad (peace be upon him)

3. The following hadiths imply the permissibility of *istisna`* contract:

i. عن عبيد الله عن نافع عن ابن عمر، قال: إن رسول الله صلى الله عليه وسلم

اصطنع خاتماً من ذهب، فكان يجعل فسه في باطن كفه إذا لبسه، فصنع الناس، ثم

إنه جلس على المنبر فنزعه، وقال: إني كنت ألبس هذا الخاتم وأجعل فسه من

داخل فرمى به، ثم قال: والله لا ألبسه أبداً، فنبد الناس خواتيمهم.

Ibn Umar reported that the Prophet (peace be upon him) had a gold ring made for himself, and when he wore it he used to turn its stone toward the palm of his hand. So the people too had gold made for themselves. The Prophet (peace be upon him) then ascended the pulpit, removed the ring, and he said, "I had it made for me, but now I will never wear it again." He threw it away, and then the people threw away their rings too." (*Sahih Bukhari and Muslim*)

.ii عن سهل رضي الله عنه أن النبي صلى الله عليه وسلم أرسل إلى امرأة من المهاجرين

وكان لها غلام نجار، قال لها: مري عبدك، فليعمل لنا أعواد المنبر، فأمرت عبدها

فذهب فقطع من الطرفاء فصنع له منبراً، فلما قضاه أرسلت إلى النبي صلى الله

عليه وسلم إنه قد قضاه، قال صلى الله عليه وسلم: أرسلني به إلي فجاءوا به،

فاحتمله النبي صلى الله عليه وسلم فوضعه حيث ترون.

Sahl reported that the Prophet (peace be upon him) sent for a woman from the immigrants who had a slave who was a carpenter. The Prophet (peace be upon him) told her, "Order your slave to prepare wood (pieces) for a pulpit." So she ordered her slave, who went and cut wood from a tamarisk tree and prepared a pulpit for the Prophet (peace be upon him). When he finished the pulpit, the woman informed the Prophet (peace be upon him) that it had been finished. The Prophet (peace be upon him) asked her to send that pulpit to him so they brought it. Sahl said, "The Prophet lifted it and placed it at the place in which you see it now." (*Sahih al-Bukhari*)

### **The consensus of contemporary Muslim jurists (*ijma`*)**

4. Contemporary Muslim jurists have reached *ijma`* on the permissibility of *istisna`*.



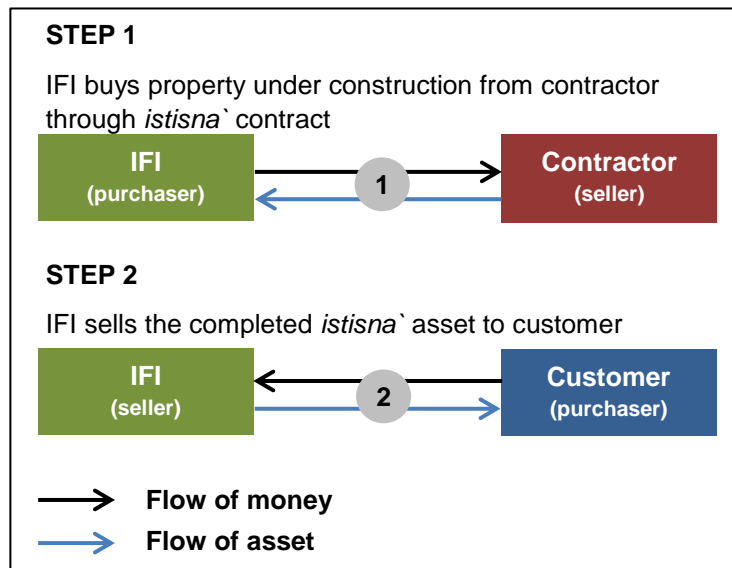
## Appendix 2: Glossary

Terms	Definition
<i>Gharamah</i>	Penalty
<i>Hamish jiddiyyah</i>	A security deposit placed to secure an undertaking to purchase of an asset before execution of a certain specified contract
<i>Ibra`</i>	Rebate
<i>Ijarah</i>	A contract that transfers the ownership of a usufruct and/or service for a specified period in exchange for a specified consideration
<i>Ijarah mawsufah fi al-zimmah</i>	A contract that transfers ownership of a usufruct for a specified duration in the future based on an agreed specification by the contracting parties at the inception of the <i>ijarah</i> contract.
<i>Ijma`</i>	Consensus of the Muslim jurists
<i>Kafalah</i>	A contract where the guarantor conjoins the guaranteed party in assuming the latter's specified liability.
<i>Khiyar al-`ayb</i>	Option arising from discovery of a defect in the asset purchased which entitles the option holder to either dissolve or continue with the contract.
<i>Khiyar fawat al-wasf</i>	Option to void a contract due to a missing characteristic in the subject matter which the contracting party had stipulated to be present in it.
<i>Marhun</i>	Collateral
<i>Mukhalafah al-shurut</i>	Breach of specified terms
<i>Muqassah</i>	Offsetting
Parallel <i>istisna`</i>	Two separate and independent <i>istisna`</i> contracts, which have similar specification of the <i>istisna`</i> asset
<i>Qabd haqiqi</i>	Physical possession. It refers to a state where a

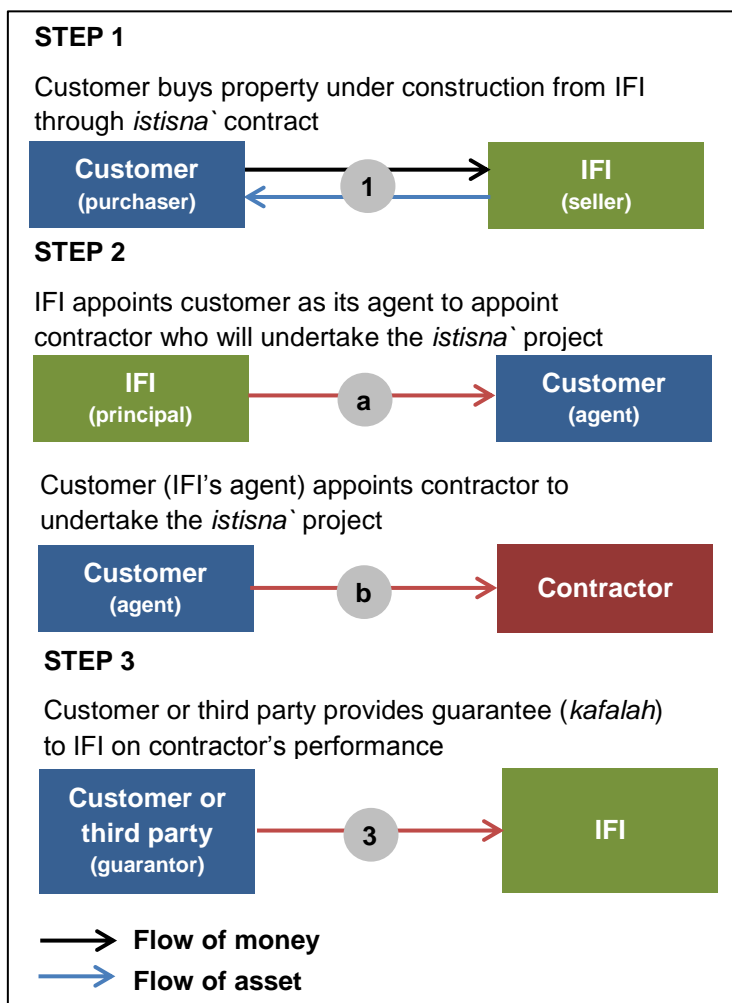
<b>Terms</b>	<b>Definition</b>
	person has actual possession and the right to control an asset
<i>Qabd hukmi</i>	Constructive possession. It does not refer to an actual possession, but it is a presumptive possession based on the right of the owner towards an asset.
<i>Rahn</i>	Pledge/ Charge
<i>Shart jaza'i</i>	Punitive condition
<i>Takaful</i>	An arrangement based on mutual assistance under which takaful participants agree to contribute to a common fund providing for mutual financial benefits payable to the takaful participants or their beneficiaries on the occurrence of pre-agreed events
<i>Takhliyah</i>	Relinquishing the possession of an asset
<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>Ta`widh</i>	Compensation
<i>`Urbun</i>	Earnest money paid to secure purchase of an asset in an exchange contract which is considered part of the price if the purchaser decides to continue the contract and is not refundable.
<i>`Urf tijari</i>	Common business practice which is acceptable by the community and does not contradict the Shariah principles
<i>Wa`d mulzim</i>	A binding promise

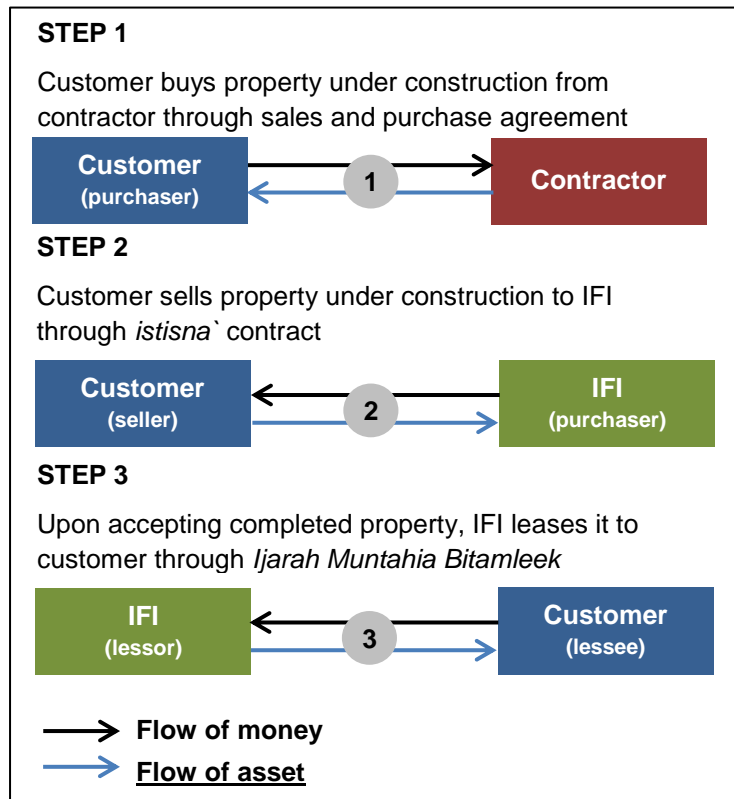
## Appendix 3: Illustration on structures of *istisna`* products

### *Istisna`*



### *Istisna`* with *wakalah* and *kafalah*



***Istisna` with ijarah***

#### **Appendix 4: Illustration on possible legal instruments to effectively transfer ownership of *istisna`* asset from customer to IFI**

<b>No.</b>	<b>Legal instruments that transfer ownership of <i>istisna`</i> asset from customer to IFI</b>
1.	Agency agreement (a) Agreement reflects/confirms that the customer acts as an agent, on behalf of the IFI, when the customer executed the sale and purchase agreement (S&P) with contractor
2.	Novation agreement (a) The customer's rights, interest & liabilities under the S&P will be transferred to the IFI as the 'owner'
3.	Assignment of rights, interest and liabilities (a) The customer assigns his rights, interest & liabilities under the S&P to the IFI

## Appendix 5: Illustration on trigger events that require IFI's intervention and potential actions taken

No.	Trigger Event	Action Taken
1.	<p>Performance-specific trigger events</p> <p>(a) Progress of <i>istisna`</i> project is lagged and behind the agreed schedule</p>	<p>(a) The IFI discontinues the disbursement of the funding to the contractor until the <i>istisna`</i> asset is completed as per the agreed schedule</p> <p>(b) The IFI appoints an alternative contractor in the event where the earlier contractor has failed to make the necessary rectification to meet the agreed schedule</p>
2.	<p>Organisation-specific trigger events</p> <p>(a) Financial position of the contractor is deteriorating</p>	<p>(a) In the event where the weak financial position of the contractor potentially leads to the non-delivery of the <i>istisna`</i> asset, the IFI must appoint an alternative contractor.</p>

## Appendix 6: Illustration of options for customer due to non-delivery of *istisna`* asset and corresponding implication

No.	Options	Implications
<i>Istisna` asset is not completed and not delivered</i>		
1.	Take possession of the <i>istisna`</i> asset on as-is basis	(a) Customer (purchaser) must pay the selling price up to the stage of completion of the <i>istisna`</i> asset. (b) IFI (seller) must compensate customer (purchaser) for loss incurred due to non-completion of the <i>istisna`</i> asset.
2.	Terminate the <i>istisna`</i> contract	(a) IFI (seller) must refund all amount paid by the customer (purchaser). (b) IFI (seller) must compensate customer (purchaser) for loss incurred due to non-completion and non-delivery of the <i>istisna`</i> asset.
<i>Istisna` asset is delivered but not meeting specification</i>		
1.	Reject delivery	(a) Ownership of <i>istisna`</i> asset remains with the IFI (seller). (b) Customer (purchaser)'s obligation to pay <i>istisna`</i> selling price is waived. (c) IFI (seller) must refund all amount paid by the customer (purchaser).
2.	Accept delivery and pay original price	(a) Customer (purchaser) agrees to pay the agreed selling price of <i>istisna`</i> asset. (b) IFI (seller) must deliver the <i>istisna`</i> asset to customer based on as-is basis.
3.	Accept delivery at new terms agreed by contracting parties	(a) Customer (purchaser) agrees to take possession of the <i>istisna`</i> asset on as-is bases and pay the revised selling price. (b) IFI (seller) must deliver the completed <i>istisna`</i> asset to customer on the revised delivery date.