



BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Wa`d

Concept Paper

Applicable to:

1. Licensed Islamic banks
2. Licensed takaful operators and professional retakaful operators
3. Licensed banks and licensed investment banks carrying on Islamic banking business
4. Prescribed institutions carrying on Islamic financial business

As part of the objective to strengthen Shariah-compliance practice among Islamic financial institutions (IFIs), Bank Negara Malaysia (the Bank) is developing a Shariah-based regulatory policy with the objective to provide a comprehensive guidance to the Islamic financial industry with respect to end-to-end compliance with Shariah.

This concept paper (CP) consists of two components, Shariah and operational requirements with respect to the operationalisation of the *wa`d*. The Shariah requirements highlight the salient features and optional practices of a valid Shariah contract/concept to facilitate sound understanding of a particular contract/concept by the IFI. The operational requirements outline the regulatory expectations with respect to the governance and oversight, structuring, risk management, business and market conduct as well as financial disclosure.

The Bank invites written feedback and comments on **Part C** i.e. the operational requirements of *wa`d*, including suggestions for particular issues/areas to be clarified or elaborated further and any alternative proposals that the Bank should consider. The Shariah requirements in Part B serves as reference to facilitate the IFIs in providing feedback and comments on operational aspects of the *wa`d* in line with the Shariah requirements. To facilitate the Bank's assessment, please support each comment with a clear rationale, accompanying evidence or illustration, as appropriate.

Responses shall be submitted to the Bank by **10 May 2016** to:

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Jabatan Perbankan Islam dan Takaful
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50480 Kuala Lumpur
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Electronic submission is encouraged. Submissions received may be made public unless confidentiality is specifically requested for the whole or part of the submission.

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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. It is essential for an Islamic financial institution (IFI) to establish sound 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 promote consistency of Shariah contract application in Islamic financial products and services. This policy is envisaged to strengthen legal certainty and Shariah compliance practices by IFIs.
- 1.3 This policy document aims to -
 - (a) provide reference on Shariah rulings applicable to the *wa`d*;
 - (b) set out key operational requirements for the implementation of the *wa`d*; and
 - (c) promote end-to-end compliance with Shariah requirements, which further promote sound banking practices and safeguard consumer interests.
- 1.4 This policy document sets out the following:
 - (a) salient features and essential conditions of *wa`d* in Part B; and
 - (b) regulatory and supervisory expectations for the operational requirements on governance and oversight, structuring, risk management, business and market conduct as well as financial disclosure in Part C.

2. Applicability

- 2.1 This policy document is applicable to all IFIs as defined in paragraph 5.2.
- 2.2 This policy document is applicable on all products and services using the binding *wa`d* and binding bilateral *wa`d (muwa`adah)*.

3. Legal provisions

- 3.1 The requirements in this policy document are specified pursuant to:
 - (a) sections 29(1) and (2), 57(1) and 135(1) of the Islamic Financial Services Act 2013 (IFSA); and
 - (b) section 33E, 41(1) and 42C of the Development Financial Institutions Act 2002 (DFIA).
- 3.2 The guidance in this policy document is issued pursuant to section 277 of the IFSA and section 126 of the DFIA.

4. Effective date

- 4.1 This policy document comes into effect upon issuance of the final document.

5. Interpretation

- 5.1 The terms and expressions used in this policy document must have the same meanings as assigned under the Financial Services Act 2013 (FSA), IFSA and DFIA, as the case may be, unless otherwise defined in this policy document.

- 5.2 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 actions;

“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; and

“Islamic financial institution” or “IFI” means:

- (a) a licensed Islamic bank;
- (b) a licensed takaful operator and a professional retakaful operator;
- (c) a licensed bank and a 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 33B of the DFIA to carry on business or activity in accordance with Shariah.

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

6. Related legal instruments and policy documents

- 6.1 This policy document must be read together with other relevant legal instruments and policy documents that have been issued by the Bank.

PART B SHARIAH REQUIREMENTS AND OPTIONAL PRACTICES**7. Definition**

- S 7.1 A *wa`d* is a unilateral promise or undertaking which refers to an expression of commitment given by one party to another to perform certain action(s) in the future.

8. Nature

- S 8.1 *Wa`d* is a unilateral promise or undertaking which is binding or non-binding¹.
- S 8.2 A binding *wa`d* is a unilateral promise or undertaking attached to a condition, time, price, conduct or event which shall be enforceable on the promisor.
- S 8.3 In relation to paragraph 8.2, the *wa`d* shall be binding from the date the promisor makes the *wa`d*.

9. Parties involved

- S 9.1 The parties involved in a *wa`d* are the *wa`id* (promisor) and the *maw`ud lahu* (promisee).
- S 9.2 The promisor shall have the legal capacity² to execute the subject matter of the *wa`d*.
- G 9.3 The parties involved in the *wa`d* may be a natural person or a legal entity.

Manner expressed

- S 9.4 The *wa`d* shall be effected by an expression of commitment of the promisor to perform certain action(s) in the future.
- G 9.5 In relation to paragraph 9.4, the promisor's expression of commitment may be made orally, in writing or by any other method.

¹ The *wa`d* is not a contract

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 subject to the Contracts Act 1950 and the Age of Majority Act 1971.

10. Subject matter

- S 10.1 The subject matter of a *wa`d* shall be a commitment to perform specific action(s) that will be performed at a specified time in the future.
- S 10.2 The subject matter of the *wa`d* shall be in compliance with Shariah and shall not be used as a means to commit Shariah non-compliant activities.
- G 10.3 At the inception of the *wa`d*, the promisor and promisee may agree that the promisor may be granted an extension of time to execute the *wa`d*, subject to any agreed conditions.
- S 10.4 In respect of paragraph 10.3, if both parties involved agree for the extension of time to execute the *wa`d*, the promisor shall be bound to fulfil the *wa`d* at the new specified time.
- S 10.5 The *wa`d* shall not be provided in exchange for a counter value such as a fee to the promisor.

11. Implication of a binding *wa`d*

- S 11.1 The promisor shall not unilaterally revoke his *wa`d*.
- S 11.2 The promisor shall fulfil his *wa`d* in accordance with the condition specified in the *wa`d* agreement which does not contravene Shariah.
- S 11.3 The promisee has a right to claim compensation for any actual loss suffered due to the failure of the promisor to fulfil his *wa`d*.
- S 11.4 In relation to paragraph 11.3, the promisee's actual loss shall be determined either by:
(a) an authoritative body; or
(b) a methodology accepted as customary market practice (*`urf tijari*).

12. Arrangement of a *wa`d* with Other Contracts or Concepts***Arrangement of a wa`d with hamish jiddiyah (security deposit)***

- G 12.1 A promisor may provide the promisee a security deposit to secure the performance of the *wa`d*. The security deposit may be used to compensate the promisee against actual losses incurred in the event the promisor fails to fulfil his *wa`d*.
- S 12.2 Any excess of the security deposit after compensating the promisee against actual loss shall be returned to the promisor.
- S 12.3 Any shortage of the security deposit arising from the actual loss incurred shall be paid by the promisor upon any claim by the promisee.

Wa`d in relation with transfer of ownership

- G 12.4 The promisor may enter into a *wa`d* to transfer the ownership of an asset or usufruct which is yet to be owned by him through an exchange contract such as sale and purchase contract or charitable contract such as *hibah*.

Wa`d and forward currency exchange

- G 12.5 Subject to paragraph 12.6, a forward currency exchange transaction may be arranged based on a *wa`d*.
- S 12.6 The arrangement of the *wa`d* in the transaction involving currency exchange is permissible provided that it is structured for the purpose of hedging.

Wa`d and musyarakah, mudarabah and ijarah

- G 12.7 The contracting parties in a *musyarakah*, *mudarabah* or *ijarah* arrangement may enter into a *wa`d*, to purchase the underlying asset of the respective arrangement upon maturity, dissolution or in the event of a default.

Wa`d and rahn

- G 12.8 In a *rahn* contract, a pledgor may give a *wa`d* to use an existing *marhun* (collateral) for any future debt obligation.
- G 12.9 A promisor may give a *wa`d* to use any future asset as collateral for any debt obligation.

Wa`d and hibah

- G 12.10 Subject to paragraph 12.11, a promisor may provide a *wa`d* to give a *hibah* to another party.
- S 12.11 A borrower in a *qard* contract shall not provide a *wa`d* to give a *hibah* to the lender.

Wa`d and kafalah

- G 12.12 A promisor may give a *wa`d* to enter into a *kafalah* contract on a future date.
- G 12.13 A third party may provide a guarantee on the performance of the *wa`d* by the promisor.

FULFILMENT AND REVOCATION OF A WA`D**13. Fulfilment and revocation of a wa`d**

- S 13.1 A *wa`d* shall be fulfilled when the promisor or his guarantor has performed the *wa`d* obligation(s) in accordance with the agreed conditions.
- S 13.2 The *wa`d* to perform a specific contract shall not be fulfilled unless such contract is executed as promised.
- S 13.3 The *wa`d* shall be revoked under any of the following circumstances:
(a) the promisee agrees to the promisor's revocation of the binding *wa`d*; or
(b) the promisee does not invoke the *wa`d*.
- S 13.4 Upon fulfilment or revocation of the *wa`d*, the promisor shall be free from any obligations related to the *wa`d*.

MUWA`ADAH (BILATERAL WA`D)**14. Muwa`adah**

- S 14.1 A *muwa`adah* is a bilateral promise or undertaking which refers to an expression of commitment given by two parties to each other to perform certain action(s) in the future based on the same subject matter and condition(s).
- S 14.2 The *muwa`adah*³ is a bilateral promise which is binding and enforceable on the promisor.
- S 14.3 All requirements of a *wa`d* specified under this policy document shall be applicable to the *muwa`adah*.
- G 14.4 Subject to paragraph 14.5, the *muwa`adah* may be arranged to structure transaction involving currency exchange (*sarf*).
- S 14.5 The arrangement of the *muwa`adah* in the transaction involving currency exchange shall only be structured for the purpose of hedging.

³ The *muwa`adah* is not a contract.

PART C OPERATIONAL REQUIREMENTS

- S 14.6 Unless stated otherwise, the operational requirements in this policy document shall apply to an IFI regardless of whether the IFI is a promisor or a promisee under the *wa`d* arrangement.

15. Governance and oversight

Board of Directors

- S 15.1 The board of directors of an IFI (the Board) shall establish a sound governance structure to facilitate an effective oversight on the management and application of the *wa`d*. The adequacy of the governance structure shall commensurate with the complexity and risk profile of the *wa`d*.
- S 15.2 The Board has overall responsibility for Shariah governance and Shariah compliance of the IFI. As such, the Board must -
- (a) ensure that the application of *wa`d* is in line with the IFI's business and risk management strategies;
 - (b) approve and oversee the implementation of policies and procedures governing the application of *wa`d* which must include the following aspects:
 - (i) risk management;
 - (ii) information disclosure;
 - (iii) *wa`d* documentations;
 - (c) ensure that appropriate internal controls and infrastructure are in place to ensure the *wa`d* is applied in accordance with Shariah requirements;
 - (d) ensure that sufficient resources are in place, and that the IFI has adequate and qualified personnel with sufficient knowledge and competency on the concept, application and risks associated with the *wa`d*; and
 - (e) ensure 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 15.3 The Shariah Committee has the responsibility to advise the IFI in ensuring its business, affairs and activities comply with Shariah, which includes activities involving *wa`d*. As such, the Shariah Committee must -
- (a) endorse the application of Shariah requirements in the relevant policies and procedures governing the *wa`d*;
 - (b) review that the terms and conditions stipulated in legal documentation and other documents⁴, and endorse that the terms and conditions are in compliance with Shariah;
 - (c) advise and provide clarification on relevant Shariah rulings, decisions or

⁴ Such as promotional materials, product manual or other publications.

- guidelines on Shariah matters issued by the Bank, and if relevant, any other authorities; and
- (d) assess the work carried out by Shariah review and Shariah audit and endorse any rectification measures that are needed to ensure that the *wa`d* complies with Shariah requirements.

Senior management

- S 15.4 The senior management has the responsibility to ensure that the business and operations of the IFI complies with Shariah requirements. As such, the senior management must –
- (a) develop and implement internal control and risk management policies and procedures in line with the business strategy and risk appetite approved by the Board;
 - (b) establish policies, procedures and processes with regard to proper management of the *wa`d*;
 - (c) implement relevant internal systems, infrastructure and adequate mechanisms to identify, control and monitor risk inherent in the *wa`d*;
 - (d) 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 activities under the *wa`d*;
 - (e) develop and undertake regular reviews and compliance monitoring of its *wa`d* transactions with the approved policies; and
 - (f) ensure timely disclosure of relevant information to the Board and the Shariah Committee.

Question 1

In general, IFIs currently practice governance and oversight function in accordance with business segments or products. Given that the application of the *wa`d* cuts-across different business segments and products and is mainly used in support of Shariah contracts, what are the challenges, if any, and strategies that your IFI may consider to fulfill the requirements on Governance and Oversight as specified in paragraph 15?

16. Structuring

Shariah compliance

- S 16.1 The IFI must ensure that -
- (a) the overall operations of the *wa`d* are in compliance with Shariah requirements as provided in Part B of this policy document;
 - (b) the overall operations of *wa`d* are in compliance with any specific requirements on the *wa`d* as provided in the policy documents on Shariah contracts issued by the Bank;
 - (c) product structure, legal documents, internal policies and procedures involving the *wa`d* are endorsed by the Shariah Committee;
 - (d) any issues pertaining to Shariah matters must be discussed and deliberated at the Shariah Committee; and
 - (e) the opinion of the Shariah Advisory Council of the Bank (SAC) is sought if there are any unresolved Shariah issues involving the *wa`d*.

Binding *wa`d*

- S 16.2 In the event where the IFI is the promisor, the IFI must ensure that -
- (a) the expression of the *wa`d* is in writing or through other legally admissible evidence of such actions which does not contravene Shariah principles; and
 - (b) where the *wa`d* is expressed verbally or *via* a voice recording, the *wa`d* is evidenced by documentations as soon as practicable.
- S 16.3 The IFI⁵ must ensure that the conditions⁶, of which occurrence would cause action(s) to be taken by the promisor to fulfill the *wa`d* are-
- (a) clearly stipulated in the *wa`d* documentation; and
 - (b) identifiable by both the promisor and promisee.

Fulfillment, revocation⁷ and non-fulfillment of *wa`d*

- S 16.4 The IFI³ shall clearly outline the terms of fulfillment, revocation and non-fulfillment of the *wa`d* in the *wa`d* documentation, which shall reflect the following:
- (a) the *wa`d* is fulfilled when the promisor executes the action(s), regardless of whether the promisee invokes the *wa`d*;
 - (b) the *wa`d* is not fulfilled by the promisor when the promisor does not execute the action(s) despite the *wa`d* being invoked by the promisee; and

⁵ If the IFI is the promisee that prepares the *wa`d* documentation or the IFI is the promisor.

⁶ For the purposes of the *wa`d*, conditions includes (i) time period such as date or time; (ii) price such as purchase or sale price of assets, profit rates, currency exchange rates; (iii) conduct such as purchase of asset; and (iv) events such as changes in relevant regulations. As an example, if market disruption is identified as a condition, the IFI may wish to give more clarity in terms of the relevant indicators and the quantification of such indicators that would signify market disruption. This definition applies throughout this document where there are conditions of which occurrence would cause promisor to fulfill the *wa`d*.

⁷ Also refers to withdrawal.

- (c) *wa`d* is revoked when –
 - (i) the promisee agrees to the promisor's revocation of the *wa`d*; or
 - (ii) the promisor does not execute the action(s) and the promisee does not invoke the *wa`d*.

- S 16.5 For the purpose of paragraph 16.4, the IFI shall clearly specify the time period following the occurrence of the conditions, in which –
 - (a) the promisor shall conduct the action(s); and
 - (b) the promisee has the right to invoke the *wa`d*.
- G 16.6 The IFI may refer to Appendix 4 for the illustration on fulfillment, revocation and non-fulfillment of *wa`d*.

Counter value on *wa`d*

- S 16.7 The IFI shall not impose or pay any compensation specifically for the provision of *wa`d* in terms of fees or charges.
- G 16.8 Notwithstanding paragraph 16.7, the IFI may impose or pay counter values such as fees or charges⁸ on other Shariah contracts or arrangements used together with the *wa`d* or incurred for expenses incidental⁹ to the use of the *wa`d*.

Actual loss

- S 16.9 Pursuant to paragraph 11.3, the IFI shall determine the actual loss in accordance with:
 - (a) prescribed mechanism or methodology; or
 - (b) customary market practice (*`urf tijari*).
- S 16.10 For the purpose of paragraph 16.9(a), the IFI shall ensure that the actual loss consists of the following:
 - (a) at minimum –
 - (i) the outstanding principal amount, which includes the amount of shortfall between the cost of asset acquisition and the disposal value of the asset; and
 - (ii) actual direct costs incurred; and
 - (b) any additional components with regard to the *wa`d* as specified in the policy documents issued by the Bank including on Shariah contracts¹⁰.

⁸ In line with the policy requirements under Guidelines on the Imposition of Fees and Charges on Financial Products and Services that was issued by the Bank. E.g. Brokerage fees on commodity *murabahah* transactions.

⁹ For e.g. costs for legal documentations.

¹⁰ For e.g. actual loss as specified in paragraph 25.26 of policy document on *tawarruq*

- S 16.11 For the purpose of paragraph 16.9(b), the IFI shall ensure that –
- (a) policies and procedures are established in applying the appropriate methodology to calculate actual loss; and
 - (b) the methodology is endorsed by the Shariah Committee.

Question 2

- (a) What are the parameters or internal policy that your institution has in place currently to determine actual loss?
- (b) What are the key challenges to fulfil the requirements in paragraph 16.11? Please provide recommendations on how to overcome these challenges, if any.

- G 16.12 In addition to assessing Shariah compliance on the methodology employed, the Shariah Committee of the IFI may also wish to consider that the actual loss claimable is appropriate and reasonable in line with the principal of fairness and justice on the parties involved.

Documentation¹¹

- S 16.13 The IFI shall develop a comprehensive and legally enforceable documentation for the *wa`d* which are in compliance with Shariah requirements as well as the applicable laws.
- S 16.14 The IFI shall ensure that the terms and conditions of the *wa`d* arrangement includes the following:
- (a) time or date that the *wa`d* is binding;
 - (b) specifications on the subject matter, including action(s) to be taken by the promisor, assets or any other items or arrangements involved;
 - (c) conditions attached to the *wa`d*;
 - (d) rights, duties, liabilities and obligations of the parties involved:
 - (i) the promisor and the promisee;
 - (ii) the guarantor(s) of the promisor, if any;
 - (e) time period¹² for the promisor to execute the action(s) following the occurrence of conditions;
 - (f) terms of invocation of the *wa`d* by the promisee, which includes:
 - (i) time period¹³ for invoking the *wa`d* following the occurrence of conditions;
 - (ii) implications if the *wa`d* is not invoked within the stipulated time period;
 - (g) provision on the breach of terms and conditions of the *wa`d*, including:
 - (i) implications on the promisor;

¹¹ Paragraphs 16.14 to 16.18 are applicable to the IFI as a promisee that prepares the *wa`d* documentation or the IFI as a promisor.

¹² Such as specific date or number of days after the occurrence of the conditions.

¹³ Such as specific date or number of days after the occurrence of the conditions.

- (ii) rights of the promisee to claim for compensation based on actual loss;
 - (h) parameters¹⁴ in determining actual loss; and
 - (i) terms on revocation of *wa`d*.
- S 16.15 The IFI shall ensure that terminologies used in the documentation reflect the definition and concept of the *wa`d*, in line with the requirements in this policy document. Appropriate translation or explanation of any Arabic terminologies used in the documents must be included to facilitate the understanding of the promisor and promisee.
- G 16.16 Unless required otherwise¹⁵, the IFI may document the provision on the *wa`d* used with other Shariah contracts in a master agreement or specific agreements.
- S 16.17 The IFI shall ensure that the document referred to in paragraph 16.16 clearly stipulates the rights and obligation of the parties involved and is legally enforceable.
- S 16.18 Where the IFI uses the *wa`d* in conjunction with other Shariah contracts, the IFI shall ensure that the sequence of executing Shariah contracts as specified in the terms and conditions of the financial products or services is observed¹⁶.
- S 16.19 In the event where the IFI is the promisor, the IFI has the duty to inform or notify the promisee on the *wa`d* arrangement. The IFI shall have measures in place to prove that the promisee has received the *wa`d* documentation¹⁷.

Question 3

What are the potential enhancements that need to be undertaken by your institution following the requirements in paragraph 16.19?

¹⁴ For e.g. a specified formula, items involved or components of actual loss.

¹⁵ If such requirements are prescribed in the policy documents issued by the Bank such as policy documents on Shariah contracts.

¹⁶ For e.g. while the master agreement for an *ijarah muntahia bi al-tamlík* (IMB) is intended to result in the underlying assets to be transferred to the customer, such transfer would only take place if the requirements under *wa`d* is fulfilled.

¹⁷ Such as acknowledgement/initials by the promisee on the *wa`d* documentation or electronic correspondence.

Application of the *wa`d* in currency derivatives

- S 16.20 The IFI shall ensure that the application of the *wa`d* in derivatives involving currency exchange is used to hedge the risk exposures of at least one of the transacting parties.

Question 4

Please provide your opinion and justification on whether the application of *wa`d* in structured products can fulfill the requirements in paragraph 16.20?

- S 16.21 For the purpose of paragraph 16.21, the IFI shall obtain or maintain the relevant information¹⁸ evidencing that the *wa`d* is used only in derivatives for hedging purposes.

17. Risk management

- S 17.1 The IFI shall establish sound risk management policies on the application of the *wa`d* throughout the different stages of its application in accordance with the IFI's role either as a promisor or promisee.
- S 17.2 The IFI's risk management policies shall include the following:
- (a) processes and procedures to ensure effective application of the *wa`d*;
 - (b) processes, procedures and infrastructure required for the identification, monitoring and control of risk exposures associated with the *wa`d*; and
 - (c) periodic review and update the risk management policies, where applicable and procedures on the *wa`d* to ensure consistency with the IFI's risk appetite.
- S 17.3 Where the IFI is a promisee, the IFI shall -
- (a) assess the risks arising from non-fulfilment of the *wa`d* by the promisor; and
 - (b) identify measures to facilitate the recovery process in the event where the promisor breaches the *wa`d* condition. The measures include –
 - (i) identification of the amount of claims on actual loss;
 - (ii) proper maintenance of records and documentary evidence to support the claims¹⁹; and
 - (iii) identification of the procedures to make the claims and mechanisms to handle disputes on claims, if any.
- S 17.4 Where the IFI is the promisee, the IFI shall have in place measures to ensure that the *wa`d* is fulfilled by the promisor including–
- (a) monitoring the occurrence or fulfilment of conditions attached to the

¹⁸ For e.g. documentation on customer's or IFI's actual exposures, customer's declaration on use of derivatives for hedging purposes.

¹⁹ For e.g. receipts, documentations on costs incurred.

- wa`d*;
- (b) invocation of the *wa`d* within the specified time period; and
- (c) communication on invocation of the *wa`d* to the promisor is done in writing or through other legally admissible evidence of such actions.

- G 17.5 As the *wa`d* is binding as soon as the promisor expresses the *wa`d* orally, *i.e.* prior to any documentation or record of the *wa`d* is made, the IFI as the promisee may adopt additional measures to protect the IFI's interests which includes:
- (a) ensuring that the key terms are mutually agreed prior to finalisation of the *wa`d* documentation;
 - (b) ensuring that the IFI prepares the *wa`d* documentation on behalf of the promisor;
 - (c) assess that the promisor or the promisor's guarantor have the ability and capacity to honour the *wa`d* before inception of the *wa`d*; and
 - (d) assess that the documentation on the promisor's guarantor, if any, is in line with the applicable requirements, including Shariah and legal requirements.

Question 5

What are the challenges faced by your institution in ensuring the risks associated with non-fulfillment of a promise is adequately mitigated?

- S 17.6 Where the IFI acts as a promisor, the IFI shall ensure the following:
- (a) monitor the occurrence or fulfilment of conditions attached to the *wa`d*;
 - (b) action(s) to fulfil the *wa`d* are executed within the stipulated time period; and
 - (c) mitigate possible issues that may restrict the IFI from executing the action(s) or for guarantor to guarantee the promisor in accordance with the *wa`d*.
- S 17.7 As the *wa`d* is not binding on the promisee, there is no obligation for the promisee to conduct a transaction in acceptance of the promisor's execution of the action(s) in fulfilling the *wa`d*. The IFI as a promisor shall assess the risks involved in such circumstances and identify the appropriate risk mitigation measures²⁰.

Question 6

What are your suggestions to effectively mitigate the risks associated with IFI's role as a promisor?

²⁰ For *e.g.* if a promisor executes *wa`d* to sell an asset upon trigger event, the promisee is not obliged to purchase the asset from the promisor. To mitigate risk, the use of *muwa'adah* to create two unilateral binding *wa`d* may be used to ensure that the promisee is obliged to purchase the asset when the promisor sells the asset.

18. Business and market conduct

General principle

- S 18.1 The IFI must take into consideration the customer's interests in developing policies, processes and procedures to ensure that the *wa`d* is conducted in a fair, transparent, responsible and professional manner.

Fair dealings

- S 18.2 The IFI must ensure that its policies and procedures on business and market conduct for the *wa`d* reflect fair dealings, including–
- (a) information provided must be accurate and clear; and
 - (b) reasonable care must be taken prior to providing suitable advice and recommendations, if any.
- G 18.3 In order to reflect fair dealings, the IFI may consider the terms in the *wa`d* are in line with market practices and the circumstances specific²¹ to the customers.

Information disclosure

- S 18.4 The IFI shall provide adequate and relevant information to the customers, including prior to the expression of the *wa`d*. At a minimum, the following information shall be disclosed:
- (a) features²² and purpose of the *wa`d*;
 - (b) overview of the *wa`d*, in particular its arrangement with other Shariah contracts or concepts; and
 - (c) terms and conditions of the *wa`d*, including the roles, responsibilities and rights of the parties involved.
- S 18.5 The IFI shall disclose the key potential risks to the customer either as a promisee or promisor of the *wa`d*, which includes the following:
- (a) the *wa`d* is binding on the promisor without requiring the acceptance by the promisee;
 - (b) promisor has no recourse to the promisee, including in the event that the promisee does not conduct a transaction in acceptance of the promisor's execution of the action(s) to fulfill the *wa`d* as mentioned in paragraph 17.7
 - (c) implications arising from non-invocation of the *wa`d* by the promisee; and
 - (d) implications arising from non-fulfilment of the *wa`d* by the promisor.

²¹ For e.g. ensuring that a reasonable time frame is given to the customer as promisor to execute the action(s) under the *wa`d*, depending on the circumstances such as complexity of the transactions involved to conduct the action(s).

²² Clarity on the concept of the *wa`d*, in particular that *wa`d* is not a contract but is enforceable and binding on the promisor.

Question 7

The proposed disclosure requirements as stipulated in paragraph 18.4 aims to caution the counterparties of the risks exposure associated with the *wa`d*. What are the challenges faced to fulfill the requirement in paragraph 18.4, if any?

19. Financial disclosure

- S 19.1 The IFI must ensure that all internal records on the *wa`d* are updated regularly and are available for inspection by the Bank or external auditors as and when required.
- G 19.2 The IFI may provide clarity in notes to the accounts on the impact²³ of applying the *wa`d* together with Shariah contracts on a particular product or service.

²³ For e.g. while co-ownership of asset in the *musyarakah mutanaqisah* between the IFI and obligor may signify equity risk, the application of the *wa`d* to transfer asset ownership to the obligor creates credit risk profile for the product.

APPENDICES

Appendix 1 Legitimacy of wa`d

The legitimacy of a wa`d 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 the wa`d and the obligation to fulfil it:

.1 وَأَوْفُوا بِالْعَهْدِ إِنَّ الْعَهْدَ كَانَ مَسْئُولًا

*“And be true to every promise - for, verily, (on Judgment Day) you will be called to account for every promise which you have made”.*²⁴

.2 وَالَّذِينَ هُمْ لِأَمْتِنَتِهِمْ وَعَهْدِهِمْ رَاعُونَ

*“Those who are true to their trusts and pledges”.*²⁵

.3 يَا أَيُّهَا الَّذِينَ ءَامَنُوا لِمَ تَقُولُونَ مَا لَا تَفْعَلُونَ كَبُرَ مَقْتًا عِنْدَ اللَّهِ

أَنْ تَقُولُوا مَا لَا تَفْعَلُونَ

*“O you who believe! why do you say that which you do not? It is most hateful in the sight of Allah that you say that which you do not”.*²⁶

.4 وَأَذْكُرُ فِي الْكِتَابِ إِسْمَاعِيلَ إِنَّهُ كَانَ صَادِقَ الْوَعْدِ وَكَانَ رَسُولًا نَبِيًّا

*“Also mention in the Book (the story of) Ismail: He was (strictly) true to what he promised, and he was an apostle (and) a prophet.”*²⁷

²⁴ Surah al-Isra', verse 34.

²⁵ Surah al-Mu'minun, verse 8.

²⁶ Surah al-Saf, verse 2-3.

²⁷ Surah Maryam, verse 54.

The Sunnah of Prophet Muhammad (peace be upon him)

The following hadith implies the general permissibility of a *wa`d* and the obligation to fulfil it.

عن ابي هريرة ، عن النبي صلى الله عليه وسلم أنه قال : آية المنافق ثلاث إذا حدث كذب وإذا وعد أخلف وإذا ائتمن خان.

Abu Hurairah reported that Prophet Muhammad (peace be upon him) said: There are three signs of a hypocrite; when he speaks, he tells lies; when he makes a promise, he breaks it; and when he is entrusted, he betrays his trust.²⁸

²⁸ Muslim, *Al-Jami` Al-Sahih*, Hadith no. 220.

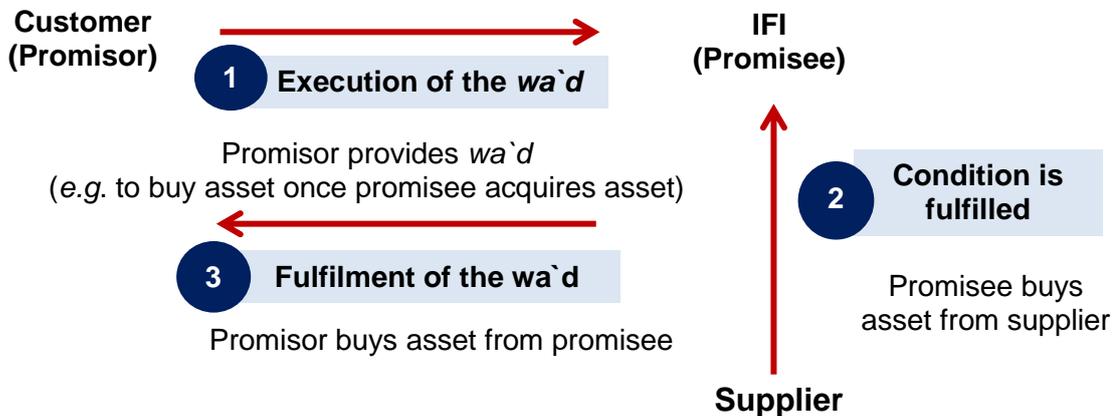
Appendix 2 Glossary

Terms	Explanation
<i>Hamish jiddiyah</i>	A security deposit placed to secure an undertaking to purchase an asset before execution of the sale and purchase agreement contract.
<i>Hibah</i>	A transfer of ownership of an asset from a donor (<i>wahib</i>) to a recipient (<i>mawhub lahu</i>) without any consideration.
<i>Ijarah</i>	Lease
<i>Mudarabah</i>	A contract between a capital provider (<i>rabbul mal</i>) and an entrepreneur (<i>mudarib</i>) under which the <i>rabbul mal</i> provides capital to be managed by the <i>mudarib</i> and any profit generated from the capital is shared between the <i>rabbul mal</i> and the <i>mudarib</i> according to a mutually agreed profit sharing ratio (PSR) whilst financial losses are borne by the <i>rabbul mal</i> provided that such losses are not due to the <i>mudarib</i> 's misconduct (<i>ta`addi</i>), negligence (<i>taqsir</i>) or breach of specified terms (<i>mukhalafah al-shurut</i>).
<i>Musarakah</i>	A partnership between two or more parties, whereby all parties will share the profit and bear the loss from the partnership.
<i>Muwa`adah</i>	Two parties give two <i>wa`d</i> with same conditions on the same subject matter.
<i>Rahn</i>	Pledge or charge.
<i>`Urf tijari</i>	Common business practice which is acceptable by the community and does not contradict the Shariah rulings (perhaps we can standardise with other Shariah Standards? In <i>Istisna'</i> , it is referred as 'customary business practice which is acceptable by the community and does not contradict the Shariah principles).

Appendix 3 Illustration of wa`d application

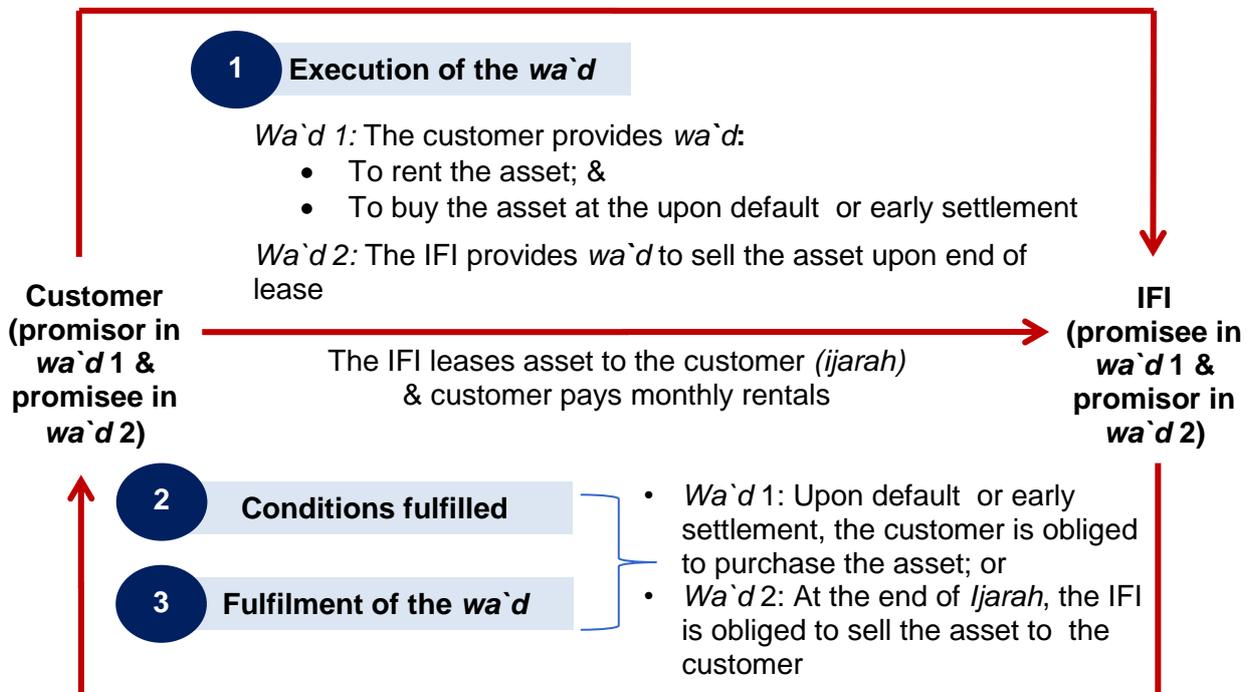
Example 1: Wa`d in Murabahah for Purchase Orderer (MPO)

A customer requires an asset financing (e.g. machinery) via a murabahah. The wa`d is used to ensure the transfer of the asset to the customer.



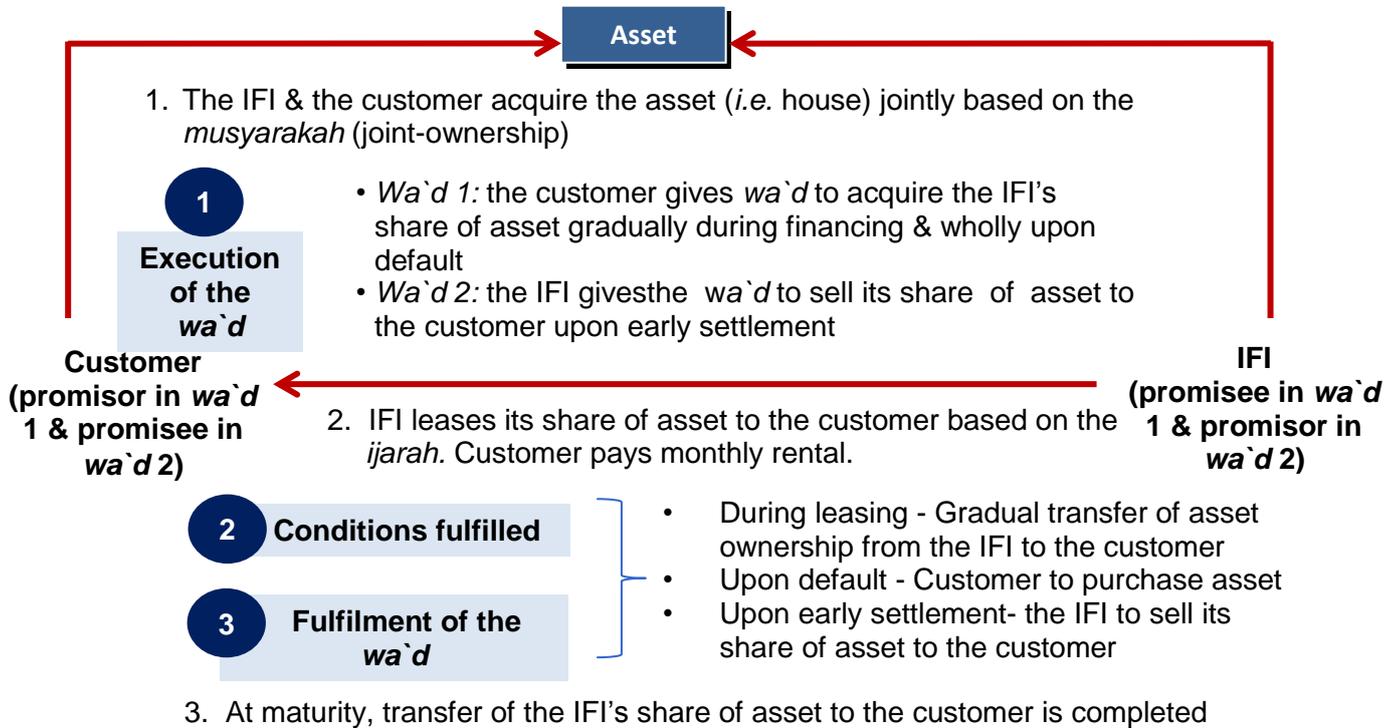
Example 2: Wa`d in Ijarah Muntahiyah Bi Tamlik (IMB)

A customer requires an asset financing (e.g. car) under the IMB. The wa`d is used to ensure the transfer of the asset to the customer. In this illustration, the transfer will be effected using a sale contract.



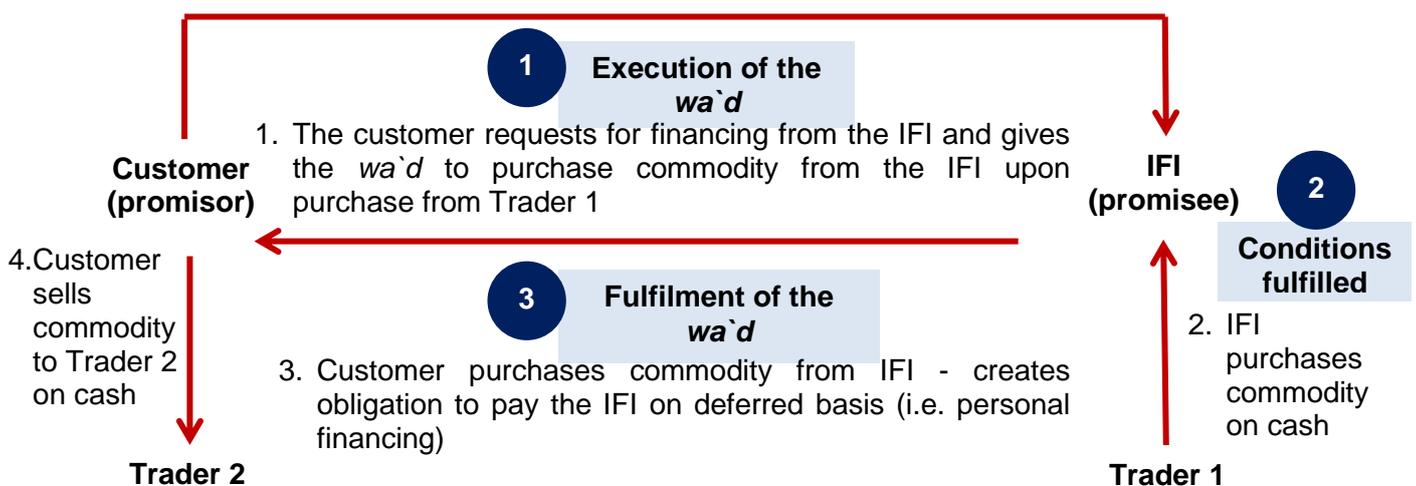
Example 3: Wa`d in Musyarakah Mutanaqisah (MM)

A customer requires an asset financing (e.g. house) under the MM. The wa`d is used to ensure the transfer of the IFI's share of asset to the customer.



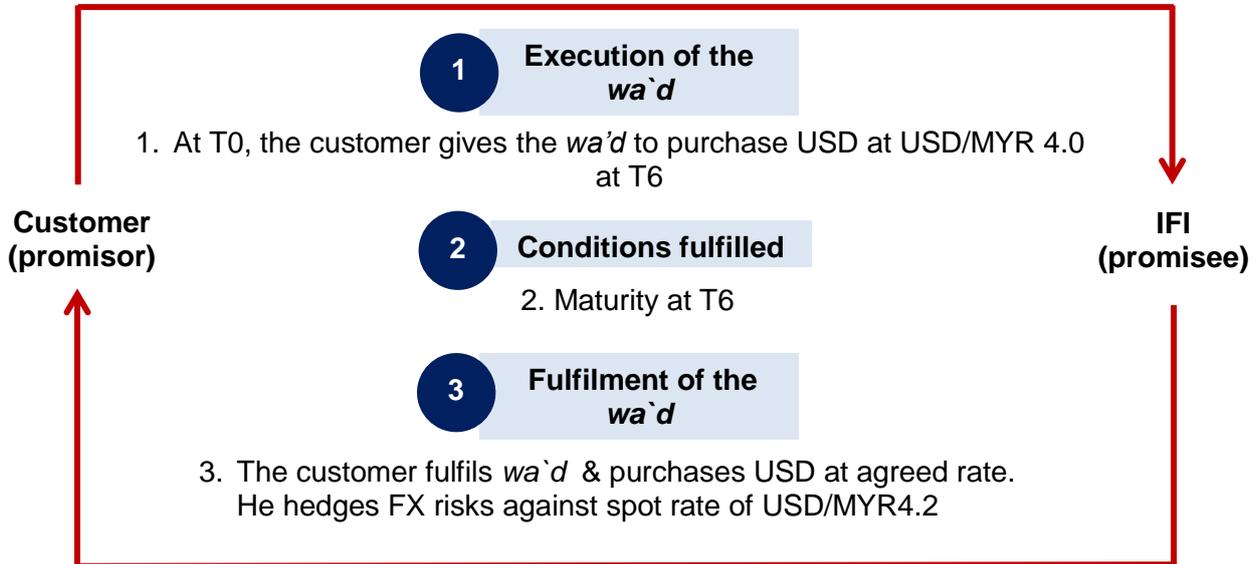
Example 4: Wa`d in Tawarruq

A customer requires a personal financing using the *tawarruq*. The wa`d is used to mitigate commodity acquisition risk for IFI.



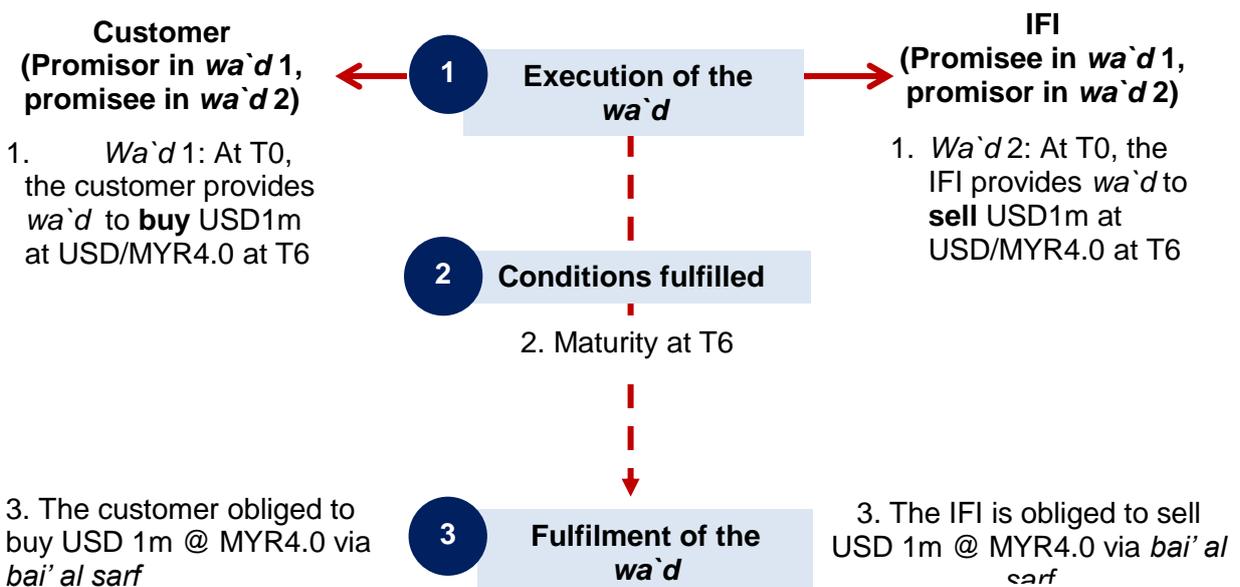
Example 5: Wa`d in foreign currency forward (Bai' al-sarf)

A customer has to pay USD1m for his imports in 6 months-time (at T6). He enters into foreign exchange (FX) forward with the IFI to hedge risk of increase in USD against MYR.



Example 6: Muwa`adah

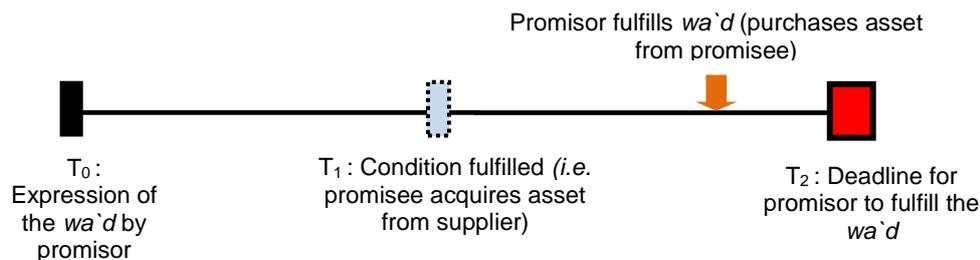
A customer enters into a forward transaction (using Bai al- sarf & wa`d) to purchase USD and hedge against potential appreciation of USD against MYR. In order to ensure that the IFI will also be obligated to sell the USD, a muwa`adah is used as this create an obligation on both parties to fulfil the wa`d.



Appendix 4 Illustration of a wa`d fulfilment, breach and revocation

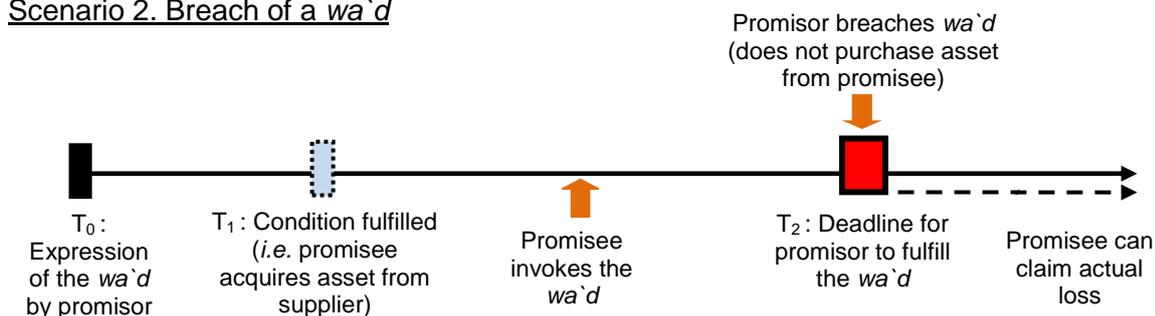
1. At T₀, promisor provides a wa`d to purchase an asset from promisee upon acquisition of the asset from the supplier by the promisee. The time period for promisor to fulfil his wa`d upon the occurrence of condition is T₂.
2. At T₁, the wa`d condition is fulfilled when the promisee acquires the asset from the supplier. As such, the promisor is obligated to purchase the asset from the promisee.

Scenario 1. Fulfilment of the wa`d



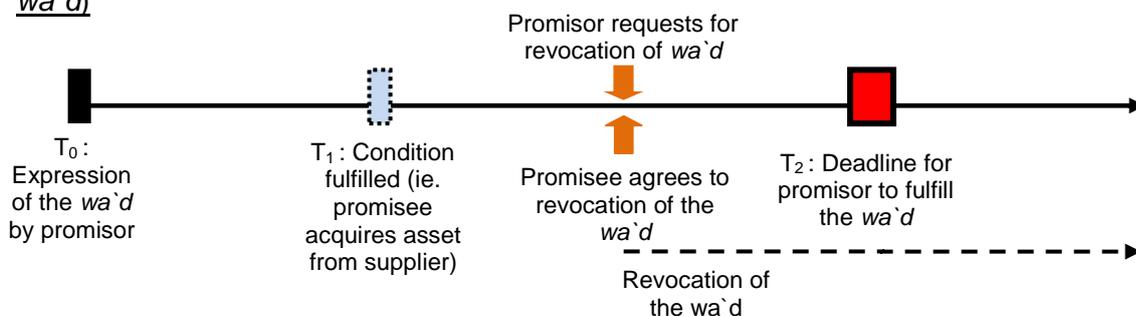
Wa`d is fulfilled when the promisor purchases the asset from promisee by T₂, regardless of whether the promisee invokes the wa`d.

Scenario 2. Breach of a wa`d

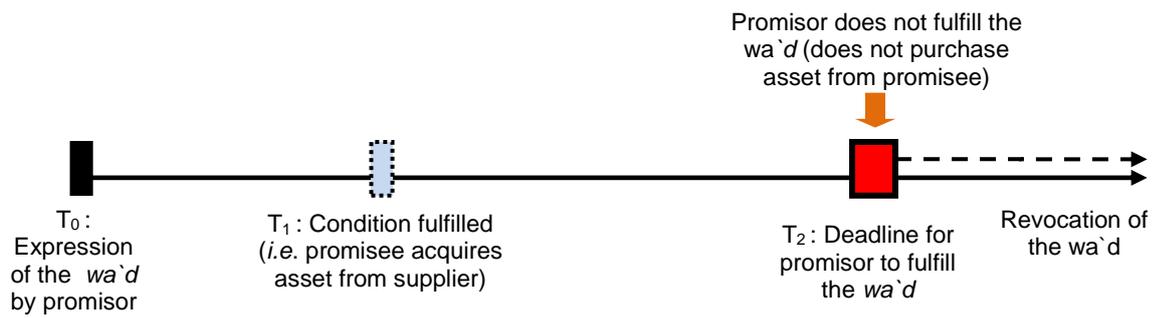


Before T₂, the promisee invokes the wa`d since he wants to ensure that the promisor fulfils the wa`d. As the promisor fails to fulfil his wa`d by T₂, the promisee has the right to claim for actual loss.

Scenario 3. Revocation of a wa`d (when the promisee agrees to promisor's revocation of the wa`d)



Before T₂, the promisor obtains promisee's agreement to revoke the wa`d. Hence, the wa`d is revoked and no longer valid upon the agreement to revoke.

Scenario 4. Revocation of a wa`d (when the promisee does not invoke the wa`d)

By T₂, the promisor does not fulfill the wa`d and the promisee does not invoke the wa`d. Hence, wa`d is revoked and no longer valid after T₂.