



BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Kafalah
Concept Paper

Issued on: 22 September 2015

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As part of the objectives to strengthen the Shariah-compliance practices 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 Shariah-based regulatory policy consists of two components, Shariah and operational requirements. The Shariah requirements highlight the salient features and essential conditions of specific Shariah contracts to facilitate sound understanding of a particular contract by the IFIs. The operational requirements set out the expectations with respect to the oversight function, structuring, risk management, reporting and disclosure as well as consumer and market conduct.

This concept paper (CP) provides both the Shariah and operational requirements for *kafalah* contract. The Bank invites written feedback and comments only on the operational requirements of *kafalah* contract under **Parts C and D**. The Shariah requirements in Part B serves as reference to facilitate the IFIs in providing feedback and comments on operational aspects of *kafalah* in line with the Shariah requirements. The feedback must be supported with clear rationale, accompanying evidence or illustration, as appropriate to facilitate effective review of the standard.

Additional instruction for the IFIs

In addition to providing general feedback, the IFIs are required to respond to the specific questions set out throughout this CP.

Please respond to the Bank by **23 October 2015** addressed to:

Pengarah
Jabatan Perbankan Islam dan Takaful
Bank Negara Malaysia
Jalan Dato' Onn
50480 Kuala Lumpur

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PART A OVERVIEW

1. Introduction

- 1.1. Compliance with Shariah requirement is a prerequisite in ensuring the legitimacy and integrity 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 promote transparency and consistency of Shariah contract application. This would ultimately enhance the contracts' certainty and strengthen Shariah compliance by IFIs.
- 1.3. The Shariah contract-based regulatory policy consists of two components, namely the Shariah and the operational requirements. The Shariah requirements highlight the salient features and essential conditions of a specific contract. The latter outlines the core principles underpinning good governance and oversight, proper product structuring, effective risk management, sound financial disclosure and fair business and market conduct. The operational requirements aim to complement and promote sound application of the Shariah principles.
- 1.4. One of the Shariah contracts used by the IFIs is *kafalah*. *Kafalah* refers to a contract that establishes a guaranteed party's specified liability as a joint liability of the guaranteed party and the guarantor.
- 1.5. In the context of Islamic financial transactions, *kafalah* is used by the IFIs to provide guarantee services, such as bank guarantee, standby letter of credit and shipping guarantee. It is also being used as one of the contracts to supplement various primary Islamic financial products, predominantly for risk mitigation purposes, such as *musharakah*, *mudarabah*, *murabaha*, *salam*, *istisna'*, *ijarah* and *tawarruq*.

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2. Policy objectives

2.1. This policy document aims to:

- (a) provide reference on the Shariah rulings associated with *kafalah* contract;
- (b) set out key operational requirements with regards to the implementation of *kafalah* contract; and
- (c) promote end-to-end compliance with Shariah requirements through adoption of sound banking practices and implementation of business and market conduct measures that safeguards consumers' interests.

3. Scope of policy document

3.1. This policy document covers all products and services structured using the *kafalah* contract.

3.2. For the purpose of the policy document, the subject matter of *kafalah* is confined to financial guarantees (*kafalah bi al-mal*). Therefore, guarantee on ensuring presence of certain person (*kafalah al-nafs*) and appearance of certain person (*kafalah al-wajh*) are excluded from the application of this policy document.

3.3. Part B provides mandatory Shariah requirements to ensure the validity of *kafalah* and its optional practices.

3.4. Parts C and D provide operational requirements on governance and oversight, structuring, risk management, financial reporting and business and market conduct. Part C provides general operational requirements for *kafalah* contract, whereas Part D provides specific operational requirements where IFI is in the capacity of a guarantor or of a beneficiary.

4. Applicability

4.1 Subject to paragraph 4.2, this policy document is applicable to all IFIs as defined in paragraph 7.2.

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

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5. Legal provision

5.1. The requirements in this policy document are:

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

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

6. Effective date

6.1. This policy document will be effective upon issuance of the final document.

7. Interpretation

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

7.2 For the purpose of this policy document:

“**S**” denotes a standard, an obligation, a requirement, specification, direction, condition and any interpretative, supplemental and transitional provisions that must be complied with. Non-compliance may result in enforcement actions; 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 any:

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

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8. Related legal documents 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:

- (a) Applicable Malaysian Financial Reporting Standards (MFRS);
- (b) Shariah Advisory Council (SAC) rulings published by the Bank¹;
- (c) Shariah Governance Framework for Islamic Financial Institutions;
- (d) Guidelines on Corporate Governance for Licensed Islamic Banks;
- (e) Guidelines on Corporate Governance for Development Financial Institutions;
- (f) Best Practices for Credit Risk Management;
- (g) Guidelines on Product Transparency and Disclosure;
- (h) Guidelines on Imposition of Fees and Charges on Financial Products and Services;
- (i) Guidelines on Late Payment Charges for Islamic Financial Institutions;
- (j) Guidelines on Financial Reporting for Islamic Banking Institutions;
- (k) Guidelines on Financial Reporting for Development Financial Institutions;
- (l) Capital Adequacy Framework for Islamic Banks (Capital component);
- (m) Capital Adequacy Framework for Islamic Banks (Risk-weighted assets);
- (n) Capital Adequacy Framework for Islamic Banks – Disclosure Requirements (Pillar 3);
- (o) Guidelines for Accepting Guarantee as Security for Islamic Banks; and
- (p) Liquidity Coverage Ratio.

9. Policy documents superseded

9.1 Not applicable.

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

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PART B SHARIAH REQUIREMENTS AND OPTIONAL PRACTICES

10. Definition

S 10.1 *Kafalah* refers to a contract where the guarantor conjoins the guaranteed party in assuming the latter's specified liability.

11. Nature

S 11.1 The specific inherent nature of *kafalah* is to provide assurance on the fulfilment of an obligation of the guaranteed party's liability.

S 11.2 *Kafalah* is binding on the guarantor.

12. Components of *kafalah*

S 12.1 The components of a *kafalah* shall consist of the following:

- (a) contracting parties, namely the guarantor (*kafil*), the beneficiary (*makful lahu*), and the guaranteed party (*makful 'anhu*);
- (b) offer (*ijab*) and acceptance (*qabul*); and
- (c) subject matter.

13. Contracting parties

S 13.1 The parties in the *kafalah* contract are the guarantor (*kafil*), the beneficiary² (*makful lahu*) and the guaranteed party³ (*makful `anhu*).

S 13.2 The guarantor shall have the legal capacity⁴ to enter into the *kafalah* contract.

S 13.3 The parties in the *kafalah* contract shall be a natural person or a legal entity.

G 13.4 A guaranteed party may be guaranteed by more than one guarantor.

² The beneficiary is a creditor or a party who has the right to claim the liability from the guaranteed party (*makful `anhu*) or the guarantor (*kafil*).

³ The guaranteed party is a debtor or a party guaranteed by the guarantor.

⁴ The legal capacity of a person, from Shariah perspective, is defined as 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, the legal capacity is governed under the Contracts Act 1950 and the Age of Majority Act 1971.

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

- S 14.1 The *kafalah* contract shall be effected by an offer of the guarantor to provide *kafalah*.
- G 14.2 The offer may be expressed orally, in writing or by any other methods which could be evidenced by appropriate documentation or record.

15. Subject matter of *kafalah*

- S 15.1 The subject matter of the *kafalah* is categorised into⁵:
- (a) *kafalah al-dayn* (guarantee of a debt liability); and
 - (b) *kafalah al-`ayn* (guarantee to deliver a physical asset).
- G 15.2 The subject matter of the *kafalah* may be:
- (a) a financial liability or obligation of the guaranteed party that is already established or that will be established in the future;
 - (b) performance of a certain act by the guaranteed party;
 - (c) fulfilment of an obligation by the guaranteed party; or
 - (d) a combination of any or all of the above.
- G 15.3 Subject to the beneficiary's consent, the guarantor may fulfil the guarantee obligation under the *kafalah* by compensating an agreed amount to the beneficiary.
- S 15.4 The subject matter of the *kafalah* shall not be any obligation arising from Shariah non-compliant contracts or activities.

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⁵ Pursuant to paragraph 3.2, this document is confined to financial guarantee only.

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MANAGEMENT OF *KAFALAH*

16. Rights and responsibilities

- G 16.1 The guarantor may provide *kafalah* without conditions (unrestricted *kafalah*) or with conditions (restricted *kafalah*).
- S 16.2 The guarantor under an unrestricted *kafalah* shall be held liable in accordance with the terms and conditions of the original liability.
- G 16.3 The guarantor may provide a restricted *kafalah* whereby the terms and conditions of the guarantee are specified. The specified terms and conditions may include time, effective date, trigger events, amount or any additional terms and conditions of the guarantee which are acceptable by Shariah.
- S 16.4 Pursuant to paragraph 16.3, the terms and conditions of *kafalah* shall be consistent with the terms and conditions of the original liability.
- S 16.5 The guarantor under a restricted *kafalah* shall be held liable to the *kafalah* obligation according to the specified terms and conditions referred to in paragraphs 16.3 and 16.4.
- G 16.6 The beneficiary may claim his rights from the guaranteed party and/or the guarantor, either:
 - (a) for the full amount of the liability from either of them; or
 - (b) a part of the liability from the guaranteed party and the other part from the guarantor or guarantors (based on the agreed sequence, if any).
- G 16.7 The guarantor may stipulate a condition that the beneficiary shall first claim from the guaranteed party and will only claim from the guarantor if the guaranteed party is unable to settle his liability.
- S 16.8 If the guaranteed liability becomes claimable before its maturity due to the demise or dissolution of the guaranteed party or any agreed trigger events, the *kafalah* contract remains enforceable unless otherwise specified.
- G 16.9 The guarantor may request the guaranteed party to place an asset as

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collateral at the inception of the *kafalah* contract.

S 16.10 If the beneficiary grants the guaranteed party an extension period to settle the liability, such extension shall also apply to the guarantor.

S 16.11 However, if the extension or grace period to settle the liability which is due is granted by the beneficiary to the guarantor instead of the guaranteed party, such extension shall not automatically apply to the guaranteed party.

G 16.12 In the event that guarantee involves more than one guarantor, the contracting parties may agree to the specific terms of the guarantee such as priority of claims against each guarantor, the guarantee limit, and the extent of their respective liabilities, whether jointly, severally or both.

17. Imposition of fees or charges on *kafalah*

G 17.1 The guarantor may impose a fee for providing the *kafalah* service.

G 17.2 Pursuant to paragraph 17.1, the fee as agreed in the *kafalah* contract may be in the form of:

- (a) an agreed fixed amount; or
- (b) a percentage of the guaranteed amount.

18. Recourse and recovery

S 18.1 The guarantor shall have the right of recourse against the guaranteed party notwithstanding the *kafalah* is given on a voluntary basis.

S 18.2 The guarantor is only entitled to recourse up to the amount he has paid to the beneficiary as a result of providing the *kafalah*.

G 18.3 Notwithstanding paragraph 18.2, the guarantor may recover from the guaranteed party the actual cost incurred for disbursement of the *kafalah* amount to the beneficiary.

G 18.4 In the event that the guarantor has a debt obligation against the guaranteed party, the amount of recourse may be set-off against the debt obligation.

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S 18.5 The right of recourse arises subsequent to the payment to the beneficiary or at such times as agreed between the guarantor and the guaranteed party.

G 18.6 If the guaranteed party fails to settle the amount claimed by the guarantor pursuant to exercising its right of recourse, the guaranteed party is subjected to late payment charges as determined by the relevant authorities.

S 18.7 Pursuant to paragraph 18.6, the late payment charges shall consist of:

- (a) compensation (*ta`widh*) for actual loss incurred by the guarantor, which may be recognised as income to the guarantor; and/ or
- (b) penalty (*gharamah*) which shall not be recognised as income, it shall be channeled to charitable bodies.

S 18.8 In the event that the guarantor fails to fulfill his commitment under the *kafalah*, he shall be subjected to the same actions taken against the guaranteed party.

19. Arrangement of *kafalah* with other contracts or concepts

G 18.9 *Kafalah* may be arranged with other Shariah contracts or concepts including exchange-based contract, agency contract, partnership contract, benevolent (*tabarru`at*) contract and *wa`d* provided that requirements for the arrangement of *kafalah* with such contracts/concepts are observed⁶.

DISSOLUTION (*FASAKH*) AND COMPLETION (*INTIHA'*) OF *KAFALAH* CONTRACT

20. Dissolution of *kafalah*

S 20.1 Subject to paragraph 20.2, a *kafalah* contract is dissolved when the beneficiary discharges the guarantor from the specified liability, whether or not at the guarantor's request. Discharge of the guarantor's liability shall not affect the responsibility of the guaranteed party to fulfill his obligations to the beneficiary.

⁶ Please refer to the relevant policy document.

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S 20.2 If a fee is paid by the guaranteed party for the *kafalah*, the *kafalah* contract shall not be dissolved without the consent of the guaranteed party.

21. Completion of *kafalah*

S 21.1 The *kafalah* contract completes upon the occurrence of any of the following circumstances:

- (a) full settlement of the guaranteed liability by the guaranteed party, his agent (*wakil*), or the guarantor;
- (b) set-off (*muqassah*) of full debt obligations between the beneficiary and the guaranteed party;
- (c) the beneficiary waives his right to claim the whole of the guaranteed liability from the guaranteed party; or
- (d) expiry of the guarantee period and/or period to claim the guaranteed liability by the beneficiary.

S 21.2 Upon completion of the *kafalah*, the guarantor shall be free from the specified liability under the *kafalah* contract.

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PART C GENERAL OPERATIONAL REQUIREMENTS FOR *KAFALAH* CONTRACT

22. Background

G 22.1 In the Islamic finance industry, an Islamic financial institution (IFI) may enter into *kafalah* contract in the capacity of a guarantor or beneficiary and, below are some of the common applications of the *kafalah* contracts:

- (a) In the capacity of a guarantor, the IFI provides a guarantee to customers through various *kafalah*-based financial products such as bank guarantee, standby letter of credit and shipping guarantee; and
- (b) In the capacity of a beneficiary, the IFI accepts the guarantee provided by a third party for the financing facilities extended.

S 22.2 Requirements stipulated in paragraph 23 to 27 are applicable to an IFI in its capacity as guarantor and beneficiary.

23. Governance and oversight

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

S 23.1 The Board of Directors (Board) of an IFI shall ensure:

- (a) comprehensive internal policies governing *kafalah* transactions are established, approved and adhered to at all times by the IFI;
- (b) application of *kafalah* contract is in line with the IFI's business and risk management strategies;
- (c) the internal policies are reviewed regularly in order to remain current, relevant and adequate to ensure the operational conduct and risk profile of *kafalah* transactions are managed appropriately. Any material changes to the internal policies must be approved by the Board;
- (d) all Shariah-related matters are endorsed by the Shariah Committee (SC); and

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- (e) independent reviews are conducted regularly to assess compliance to the standards issued by the Bank and internal policies established by the IFI.

S 23.2 The SC shall:

- (a) validate and endorse that the terms and conditions provided in documentations including fees and charges, contracts, product manual, marketing advertisement, sales illustrations and brochures, are in compliance with Shariah;
- (b) endorse the application of Shariah in relevant internal policies and procedures governing the application of *kafalah* contract; and
- (c) perform oversight role on the conduct of *kafalah* transactions through the Shariah review and Shariah audit functions to ensure due adherence to the Shariah requirements.

S 23.3 The senior management shall:

- (a) develop and implement internal policies and procedures governing *kafalah* transactions. At minimum, the internal policies shall include:
 - (i) the structuring policies;
 - (ii) risk management policies; and
 - (iii) business and market conduct policies.
- (b) ensure adequate system and infrastructure to support *kafalah* implementation, Shariah audit and Shariah compliance;
- (c) clearly communicate the approved internal policies to internal stakeholders to facilitate effective implementation; and
- (d) undertake regular review and compliance monitoring on the established policies and seek the Board's approval on enhancement to the policies.

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24. Structuring

Principle 2: The IFI shall ensure structuring of *kafalah* is consistent with Shariah requirements and supported by comprehensive policies and procedures, as well as robust documentation

Structuring policies

S 24.1 At minimum, the structuring policies shall include:

- (a) methodologies in ascertaining fees and charges;
- (b) criteria and conditions to determine the acceptable collateral/ security for *kafalah* transactions; and
- (c) procedures with regard to claims, recourse and recovery, which include the recourse period, claims limit, forms of notification and payment method(s).

Documentation

S 24.2 The IFI shall ensure legally enforceable documents⁷ to reflect *kafalah* transactions are established.

S 24.3 Provisions that are prohibited by Shariah shall be excluded from the documentations. This includes when *kafalah* contract is applied with a *wakalah* contract, the contracts shall be entered into independently and separately where the effect of one contract shall not be interrelated to the other.

S 24.4 Adoption of Arabic terminologies shall be sufficiently clarified or explained.

S 24.5 The IFI, at minimum, shall include the terms and conditions that are in line with Shariah requirements in the *kafalah* contract, covering the following aspects:

- (a) the main terms, including:
 - (i) roles and responsibilities of the contracting parties;

⁷ Include contracts, agreements and other generally acceptable documents in financial transactions.

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- (ii) fees and charges, if any;
 - (iii) purpose of guarantee;
 - (iv) tenure of guarantee, where applicable;
 - (v) guaranteed amount;
 - (vi) expiry date and claim period, if applicable;
 - (vii) claims procedure;
 - (viii) recourse and recovery terms including the recourse period, forms of notification and payment method ;
 - (ix) fee refund procedure, if applicable, in the event of early termination of the *kafalah* contract; and
 - (x) collateral including the types of collaterals, tenure and criteria to release the collateral or security.
- (b) termination and completion events of the *kafalah* contract; and
- (c) requirements for all contracting parties to ensure continuous compliance with Shariah.

S 24.6 For the purposes of paragraph 10.1 and 16.7, the IFI must ensure that the legal documentation for *kafalah* contains the following terms:

- (a) the beneficiary shall first claim financial liability from the guaranteed party; and
- (b) in the event that the guaranteed party is unable to settle his liability, only then the beneficiary can claim from the guarantor.

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25. Risk management

Principle 3: The IFI must institute and implement a sound risk management framework to effectively manage risks associated with *kafalah* contract

Risk Management Policies

- S 25.1 The IFI shall establish risk management policies associated with *kafalah*.
- S 25.2 At minimum, the IFI's risk management policies shall encompass the following:
- (a) processes and procedures for the identification, measurement, monitoring, reporting and control of all risk exposures associated with *kafalah*;
 - (b) internal limits on risk exposures in line with the IFI's risk appetite and capacity of the IFI;
 - (c) appropriate risk mitigation measures, including Shariah screening, valuation of the collateral and credit assessment of the customer; and
 - (d) reporting requirements to the Board, the SC and the senior management.
- S 25.3 The IFI shall establish processes to periodically review and update the risk management policies, procedures and internal limits to ensure consistency with the risk appetite of the IFI.

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26. Business and market conduct

Principle 4: Due regards shall be given to the interests of all contracting parties in its policies and procedures to ensure that the *kafalah* contract is conducted in a fair, transparent, responsible and professional manner in line with Shariah requirements

Business and market conduct policies

s 26.1 The internal policies and procedures of the IFI on business and market conduct for the *kafalah* contract shall reflect fair dealing practices to the contracting parties. The IFI shall ensure that the information provided is accurate, clear and not misleading.

Disclosure of information

s 26.2 The IFI shall provide explanation to facilitate understanding of the contracting parties on the concept of a *kafalah* contract.

27. Financial disclosure

Principle 5: The IFI shall provide disclosure and transparency to facilitate stakeholders in the understanding and assessment of *kafalah*

s 27.1 The IFI shall maintain accounting records and other records in a timely manner that will sufficiently enable the preparation and reporting of true and fair financial statements.

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PART D SPECIFIC OPERATIONAL REQUIREMENTS

28. Specific operational requirements where the IFI enters into *kafalah* contract in the capacity of a guarantor

Structuring

- s 28.1 Pursuant to paragraph 18.6, in the event where the IFI impose late payment charges, the treatment shall be in accordance with the *Guidelines on Late Payment Charges for Islamic Financial Institutions*.
- s 28.2 For trade related documentations, the IFI shall ensure that the documentations are in conforming to the international rules⁸ and are in compliance with Shariah.

Risk management

- G 28.3 In executing a *kafalah* contract, the IFI may require the guaranteed party to provide collateral or security to safeguard itself from default events.
- s 28.4 Pursuant to paragraph 28.3, the collateral or security shall be liquidated in the event that the guaranteed party failed to settle his obligations.
- s 28.5 For purposes of paragraph 28.3, the IFI shall ensure continuous valuation of the collateral if the collateral is not in the form of cash.
- s 28.6 Pursuant to subparagraph 24.1(b), the IFI shall take into account the contingent liabilities to ascertain funding liquidity risk in setting out the exposure limit.
- s 28.7 Pursuant to paragraph 16.12, for a *kafalah* contract involving multiple guarantors, the IFI shall ensure that the terms of the *kafalah* contract, such as priority of claims and guarantee limit by guarantors, are clearly stipulated in the legal documentation.

⁸ Including Uniform Customs and Practice (UCP) rules.

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Business and market conduct

s 28.8 To ensure that the potential customer are able to make an informed decision, the IFI shall disclose and provide adequate information to the potential customer in the marketing or promotional materials, product disclosure sheet and any other relevant materials with regard to the *kafalah* contract during the pre-contractual stage and at time of entering into the contract. The information shall include:

- (a) key features of the *kafalah* contract;
- (b) salient terms and conditions of *kafalah*, such as:
 - (i) tenure and purpose;
 - (ii) rights and obligations of the contracting parties;
 - (iii) significant risks associated with the *kafalah* contract;
 - (iv) fees and charges that will or may be payable by the contracting parties and the time at which those amount will or may be payable; and
 - (v) the requirements for collateral, if any.

s 28.9 During the term of the contract, the IFI shall communicate to the customer⁹ on any change, including but not limited to the terms and conditions, features of financial products, and rights and obligations of the customer.

s 28.10 The IFI shall honour the claim by the beneficiary subject to the terms and conditions set upon in the *kafalah* contract, provided that *kafalah* has not dissolved or terminated.

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⁹ *Subject to Guidelines on Product Transparency and Disclosure*

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29. Specific operational requirements where the IFI enters into *kafalah* contract in the capacity of a beneficiary

Risk Management

s 29.1 The IFI shall ensure the effectiveness of *kafalah* as a risk mitigation tool.

s 29.2 Pursuant to paragraph 29.1, in ensuring the effectiveness of the *kafalah* contract, at minimum, the IFI shall:

- (a) assess capability of the guarantor in fulfilling the obligation; and
- (b) ensure that the *kafalah* contract is enforceable.

Business and market conduct

s 29.3 The IFI shall ensure that the guarantor understand the terms and conditions of the *kafalah* contract including the sequence of claims from the IFI to the guaranteed party and the guarantor as provided in paragraph 24.6.

Question 1:

Does the policy document sufficiently address the arrangement for social guarantor¹⁰? If no, please state your recommendations.

Question 2:

Does the risk management requirement sufficiently address all risks involved in a *kafalah* contract? If not, please state the risk that is not sufficiently address and the recommendation.

Question 3:

Pursuant to paragraph 28.2, are there instances where international rules impede the IFI from producing documentations that are in compliance to Shariah? If yes, please state the issue and how often does it occur.

¹⁰ "Social guarantor" means a person who provides, not for the purpose of making profit, the following guarantees:
(a) a guarantee for a loan, scholarship or grant for educational or research purposes;
(b) a guarantee for a hire-purchase transaction of a vehicle for personal or non-business use; and
(c) a guarantee for a housing loan transaction solely for personal dwelling.

APPENDICES

Appendix I Legitimacy of *kafalah*

1. The legitimacy of the *kafalah* contract is derived from the *Quran* and founded on the *Sunnah* of Prophet Muhammad (peace be upon him) and the consensus of the muslim jurists (*ijma`*).

The Quran

2. The following verse of the Quran implies the permissibility of the *kafalah* contract:

قَالُوا نَفَقْدُ صُوعَ الْمَلِكِ وَلَمَنْ جَاءَ بِهِ حِمْلُ بَعِيرٍ وَأَنَا بِهِ زَعِيمٌ ﴿٧٢﴾

[The officials] said, "We are missing the king's goblet." [And their chief added], "He who brings it shall have a camel-load of provisions; I personally guarantee it."¹¹

The Sunnah of Prophet Muhammad (peace be upon him)

3. The following *hadith* implies the permissibility of *kafalah*.

عن جابر، قال: كان رسول الله صلى الله عليه وسلم لا يصلي على رجل مات وعليه دين، فأتي بميت، فقال: أعليه دين؟ قالوا: نعم، ديناران، قال: صلوا على صاحبكم. فقال أبو قتادة الأنصاري: هما علي يا رسول الله. قال: فصلى عليه رسول الله صلى الله عليه وسلم.

*Jabir narrated: The Messenger of Allah (peace be upon him) would not say funeral prayer over a person who died while a debt was due from him. The body of a Muslim was brought to him, and he asked: "Is there any debt due from him?" [The companions] said: "Yes, two dinars." He said: "Pray over your companion [as he has unpaid debt]." Then Abu Qatadah al-Ansari said: "I shall pay them, Messenger of Allah." The Messenger of Allah (peace be upon him) then prayed over him."*¹²

¹¹ Surah Yusuf, verse 72.

¹² Abu Daud, Sunan Abi Daud, hadith no. 3343.

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Consensus of the Muslim jurists (*Ijma'*)

4. The Muslim jurists have reached *ijma'* on the permissibility of *Kafalah* in general, as cited by Ibn Qudamah¹³.

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¹³ *Ibn Qudamah, Al-Mughni, 4:400.*

Appendix II Glossary

For the purpose of this policy, the following definitions shall have the following meanings.

Terms	Definition
<i>Dayn lazim</i>	A legally binding debt
<i>Ibra'</i>	Rebate
<i>Ijma`</i>	Consensus of Muslim jurists
<i>Kafalah al-`ayn</i>	Guarantee of a physical asset
<i>Kafalah al-dayn</i>	Guarantee of a debt liability
<i>Kafalah bi al-mal</i>	Financial guarantee
<i>Kafil</i>	Guarantor
<i>Makful `anhu</i>	The guaranteed party who is a debtor or a party guaranteed by the guarantor
<i>Makfullahu</i>	The beneficiary who is a creditor or a party who has the right to claim the liability (debt) from the guaranteed party (<i>makful `anhu</i>) or the guarantor (<i>kafil</i>)
<i>Ma ya`ulilaluzum</i>	A debt that will become legally binding in the future
<i>Muqassah</i>	Offsetting
<i>Tabarru`at</i>	Benevolent
<i>`Urf</i>	Common business practice which is acceptable by the community and does not contradict the Shariah rulings
<i>Wa`d</i>	Promise or undertaking

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