



**BANK NEGARA MALAYSIA**  
CENTRAL BANK OF MALAYSIA

## ***Rahn***

Applicable to:

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

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## PART A OVERVIEW

### 1 Introduction

- 1.1 Compliance with Shariah requirements 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 its conduct of Islamic financial transactions is consistent with Shariah.
- 1.2 The Shariah contract-based regulatory policy is intended to promote consistency of Shariah contracts application in Islamic financial products and services. This policy is envisaged to strengthen legal certainty and Shariah compliance practices by an IFI.
- 1.3 This policy document aims to–
- (a) provide reference on the Shariah rulings applicable to a *rahn* (collateral) contract;
  - (b) set out key operational requirements for the implementation of the *rahn* contract; and
  - (c) promote end-to-end compliance with Shariah requirements which further promote sound Islamic banking and takaful practices and safeguard consumer interests.
- 1.4 This policy document sets out the following:
- (a) salient features and essential conditions of the *rahn* contract 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 that applies the *rahn* contract for its products and services<sup>1</sup>.

### 3 Legal provisions

- 3.1 The requirements in Part B of this policy document are specified pursuant to–
- (a) section 29(1) of the Islamic Financial Services Act 2013 (IFSA); and
  - (b) section 33E(1) of the Development Financial Institutions Act 2002 (DFIA).
- 3.2 The requirements in Part C of this policy document are specified pursuant to–
- (a) sections 29(2), 57, 135(1) and 155 of the IFSA; and
  - (b) section 33E(2), 41, 42C(1) and 116 of the DFIA.

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<sup>1</sup> For the avoidance of doubt, products and services do not include financing facilities offered to an IFI's employees.

- 3.3 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 on 1 August 2019 except for paragraph 33 which takes effect immediately upon issuance of this policy document.
- 4.2 The Bank is committed to ensure that its policies remain relevant and continue to meet the intended objectives and outcome. Accordingly, the Bank will review this policy document within 5 years from the date of issuance or the Bank's last review and, where necessary, amend or replace this policy document.

#### 5 Interpretation

- 5.1 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.

- 5.2 For purposes 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;

“**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;

“**direct cost**” refers to costs that are directly related to the *rahn* transaction, either based on actual or estimated amount, without any profit or mark-up element;

“**Islamic financial institution**” or “**IFI**” refers to—

- (a) licensed Islamic banks;
- (b) licensed takaful operators and professional retakaful operators;
- (c) licensed banks and licensed investment banks approved under section 15(1)(a) of the FSA to carry on Islamic banking business; and
- (d) prescribed institutions approved under section 33B(1) of the DFIA to carry on Islamic financial business;

“**obligor**” means a person who has a liability or obligation owed to a pledgee; and

“**third party pledgor**” refers to a third party who pledges either his asset or another party's asset as collateral to fulfil the liability or obligation of an obligor owed to a pledgee.

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, policy documents or guidelines that have been issued by the Bank, in particular–
- (a) Corporate Governance; and
  - (b) Guidelines on Imposition of Fees and Charges on Financial Products and Services.

## PART B SHARIAH REQUIREMENTS AND OPTIONAL PRACTICES

### 7 Compliance with Part B

- S** 7.1 An IFI which uses the *rahn* contract for its products and services must ensure that such products and services are in compliance with Part B of this policy document.

### 8 Definition

- S** 8.1 *Rahn* refers to a contract where a party, as pledgor (*rahin*) pledges an asset as collateral (*marhun*) to another party, a pledgee (*murtahin*) to fulfil an obligor's liability or obligation (*marhun bih*) owing to the pledgee in the event of default of such obligor.

### 9 Nature

- S** 9.1 The inherent nature of *rahn* is the assurance that the liability or obligation owed by the obligor to the pledgee will be fulfilled in the event of a default as agreed in the terms and conditions of *rahn*.
- S** 9.2 *Rahn* is binding on the pledgor upon entering into the contract. The pledgor does not have the right to revoke the *rahn* contract without the consent of the pledgee.
- S** 9.3 Terms and conditions that have been mutually agreed upon and are consistent with Shariah principles shall be binding on the pledgor and pledgee.

### 10 Components of a *rahn* contract

- S** 10.1 A *rahn* contract shall consist of the following components:
- (a) the pledgor and pledgee (collectively referred to as contracting parties);
  - (b) the offer (*ijab*) and acceptance (*qabul*) to enter into the *rahn* contract; and
  - (c) the subject matter of the *rahn* contract.

### 11 Contracting parties

- S** 11.1 The contracting parties in a *rahn* contract shall, at a minimum, comprise a pledgor and a pledgee.
- G** 11.2 The pledgor in the *rahn* contract may be an obligor or a third party pledgor.
- S** 11.3 A contracting party shall be a natural person or legal entity that must have the legal capacity<sup>2</sup> to enter into the *rahn* contract.

<sup>2</sup> From Shariah perspective, legal capacity of a natural person is defined as the capacity to assume rights and responsibilities and capacity to give legal effect to his action. Among the important

- G** 11.4 Any party to the *rahn* contract may enter into the contract through an agent (*wakil*).

## **12 Offer (*ijab*) and acceptance (*qabul*)**

- S** 12.1 The *rahn* contract must be entered into through an offer and acceptance between the contracting parties.
- G** 12.2 The offer and acceptance may be expressed orally, in writing or by any other methods recognised by Shariah.

## **13 Subject matter of *rahn***

- S** 13.1 The subject matter of the *rahn* contract shall be–
- (a) collateral that is recognised by Shariah; and
  - (b) Shariah-compliant liability or obligation owing to the pledgee.
- S** 13.2 The subject matter of the *rahn* contract must be determined upfront, made known to and accepted by the contracting parties.

## **14 Salient features of *rahn***

### **Type of collateral**

- G** 14.1 In relation to paragraph 13.1(a), collateral recognised by Shariah in a *rahn* contract may be–
- (a) a physical asset that is used to carry on activities which are Shariah-compliant or otherwise; or
  - (b) a financial asset that is Shariah-compliant, partially Shariah-compliant (referred to as mixed financial asset) or Shariah non-compliant.
- S** 14.2 In relation to paragraph 14.1(b)–
- (a) where a mixed financial asset is used as collateral, the core business of a person issuing such asset must be Shariah-compliant; and
  - (b) where a Shariah non-compliant financial asset is used as collateral, the recognised collateral value must be limited to the principal amount of the financial asset.

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conditions are that the person must possess sound mind and the capacity to distinguish between what is harmful or beneficial to one's interests. The legal capacity of a legal entity is defined as eligibility of an entity to acquire rights and assume responsibilities. In Malaysia, the legal capacity of both natural person and legal entity is governed by the Contracts Act 1950 and the Age of Majority Act 1971.

### Ownership of collateral

- S** 14.3 The collateral must be owned either by–
- (a) the obligor;
  - (b) a third party; or
  - (c) the obligor and a third party.
- G** 14.4 In relation to paragraph 14.3, the pledgor may pledge an asset that will exist and will be owned in the future as collateral under a *rahn* contract.
- S** 14.5 In the case where the pledgor pledges collateral that is wholly or partially owned by a third party under paragraphs 14.3(b) or 14.3(c), the pledgor must obtain the third party's consent to pledge such collateral.
- G** 14.6 An undivided asset that is jointly owned by the pledgor with another third party may be pledged–
- (a) in proportion to the value of the pledgor's ownership; or
  - (b) as a whole in the event the undivided asset cannot be pledged in proportion to the value of the pledgor's ownership, provided that the consent of the third party is obtained.

### Possession of collateral

- S** 14.7 Unless a pledgee approves a delay in possession, the collateral shall be immediately possessed by the pledgee upon entering into *rahn* contract.
- S** 14.8 Possession of collateral by the pledgee shall be in the form of–
- (a) physical possession (*qabd haqiqi*); or
  - (b) constructive possession (*qabd hukmi*).
- G** 14.9 The contracting parties may mutually agree for the possession of the collateral to be transferred to a third party for safekeeping.
- S** 14.10 Collateral in a *rahn* contract shall be held on trust (*amanah*) by the person who is in possession of such collateral.
- S** 14.11 In the event of a misconduct (*ta`addi*), negligence (*taqsir*) or breach of specified terms (*mukhalafah al-shurut*) by the person in possession of the collateral, he shall be liable and shall compensate for the damage or loss of such collateral.

### Multiple pledgees

- S** 14.12 If an asset is used as collateral with more than one pledgee under more than one *rahn* contract, the following requirements shall apply:
- (a) where the pledgees are ranked equally (*pari passu*)–
    - (i) the consent of all pledgees must be obtained; and
    - (ii) the pledgees' rights in the collateral will be shared in proportion to their respective debts; or
  - (b) where the pledgees are ranked in a way that the right of claim of a

preceding pledgee is prioritised over a subsequent pledgee, the consent of the succeeding pledgee shall be obtained.

### **Return of asset**

- S** 14.13 The pledgee or third party, as the case may be, shall return the collateral upon the obligor's fulfilment or discharge of his obligations unless the contracting parties agree to enter into a new *rahn* contract using the same collateral.
- G** 14.14 Notwithstanding paragraph 14.13, the contracting parties may agree for the collateral to be kept by the pledgee for any subsequent obligation within a period agreed by the contracting parties.

### **Liability or obligation (*marhun bih*)**

- S** 14.15 In relation to paragraph 13.1(b), a liability or obligation owing to a pledgee shall be an obligation that must be fulfilled by the obligor.
- G** 14.16 The liability or obligation may include those arising from any or a combination of the following:
- (a) a loan contract (*qard*);
  - (b) exchange contracts (*mu`awadat*);
  - (c) debt from the termination of sale contract;
  - (d) compensation on misconduct, negligence or breach of specified terms; or
  - (e) compensation for breach of *wa'd*.
- S** 14.17 The liability or obligation must be that–
- (a) it is already established; or
  - (b) will be established.

## **MANAGEMENT OF RAHN**

### **15 Utilisation of collateral**

- G** 15.1 The collateral may be utilised by the owner with or without the consent of the pledgee.
- S** 15.2 In relation to paragraph 15.1, the utilisation by the owner must not affect the rights of the pledgee on the collateral.
- S** 15.3 The pledgee shall only utilise the collateral if the following requirements are met:
- (a) consent has been obtained from the owner;
  - (b) the liability or obligation owed by the obligor to the pledgee does not arise from a loan contract (*qard*);
  - (c) terms of utilisation by the pledgee is stipulated in the contract; and
  - (d) the period of utilisation by the pledgee is specified.

**16 Expenses in *rahn***

- S** 16.1 Expenses in *rahn* are categorised into–
- (a) expenses incurred that are directly related to the maintenance<sup>3</sup> of collateral; and
  - (b) all other expenses incurred that are directly related to the *rahn* contract including safekeeping, documentation, liquidation and discharging of collateral.
- S** 16.2 The owner of the collateral shall bear all expenses under paragraph 16.1(a).
- S** 16.3 Except otherwise agreed by the contracting parties, the pledgor shall bear all expenses under paragraph 16.1(b).
- G** 16.4 In the event the owner or pledgor fails to fulfil its obligations in accordance with paragraphs 16.2 or 16.3, the pledgee may provide cash advance to pay the expenses on behalf of the owner or pledgor.
- S** 16.5 Subject to paragraph 16.3, any advances paid by the pledgee to settle the expenses under paragraph 16.4 shall be considered as a debt owing to the pledgee and the pledgee reserves the right to claim it from the owner or the pledgor as the case may be.

**17 Liquidation of collateral**

- S** 17.1 The liquidation of collateral shall be carried out in accordance with the terms of the agreement entered into by the contracting parties.
- G** 17.2 The contracting parties may stipulate at the time of entering the *rahn* contract that the owner authorises the pledgee, his agent or other party to perform the liquidation process.
- S** 17.3 In the absence of any stipulation as per paragraph 17.2, any person who performs the liquidation process must obtain prior approval of the owner.
- G** 17.4 The liquidation of collateral may be performed in whole or in part.
- S** 17.5 In the event a mixed financial asset is liquidated, the liability or obligation owing to the pledgee must be fulfilled in any of the following manner:
- (a) provided that the mixed financial asset can be segregated, only proceeds from the Shariah-compliant component of the mixed financial asset may be utilised; or
  - (b) in the event that the mixed financial asset cannot be segregated, all of the proceeds may be utilised.

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<sup>3</sup> This is maintenance that would have to be done even if the asset was not being used as collateral in a *rahn* contract.

- S** 17.6 The pledgee has the right to claim proceeds from the liquidation of the collateral to settle the liability or obligation of the obligor.
- S** 17.7 In the event proceeds from the liquidation of the collateral are insufficient to fulfil the liability or obligation owing to the pledgee, the balance shall remain as a liability or obligation of the obligor.
- G** 17.8 In relation to paragraph 17.7, the pledgee may either demand the balance from the obligor or waive his right to claim such balance.
- S** 17.9 In the event that proceeds from the liquidation of the collateral exceed the liability or obligation of the obligor, the excess amount shall be returned to the owner of the asset.
- G** 17.10 If there is more than one form of collateral, the pledgee may stipulate any of the collaterals to be liquidated to settle the liability or obligation of the obligor.
- G** 17.11 In the event the collateral is in the form of money, the pledgee may directly claim the amount of the liability or obligation owed by the obligor from the collateral.

## **APPLICATION OF *RAHN* WITH OTHER CONTRACTS**

### **18 Application of *rahn* in *qard***

- G** 18.1 A *rahn* contract may be arranged with *qard* contract.
- S** 18.2 The collateral shall be liquidated to recover payment of the outstanding debt amount arising from the *qard* in accordance with the terms and conditions agreed between the contracting parties.

### **19 Arrangement of *rahn* in *murabahah*, *tawarruq* and *bai` `inah***

- G** 19.1 A *rahn* contract may be arranged with *murabahah*, *tawarruq* or *bai` `inah* contract.
- S** 19.2 The collateral shall be liquidated to recover payment of any outstanding debt amount arising from the *murabahah*, *tawarruq* or *bai` `inah* contract.
- G** 19.3 In connection to paragraph 19.2, the contracting parties may agree to include a claim on any expenses directly related to the recovery of the outstanding debt payment from the collateral.

### **20 Arrangement of *rahn* in *istisna`***

- G** 20.1 A *rahn* contract may be arranged with an *istisna`* contract.
- S** 20.2 The collateral shall be liquidated to—  
(a) recover payment of any outstanding debt amount owed by the

- purchaser; or
- (b) guarantee debt liability borne by the seller arising from the failure to deliver the *istisna`* asset.

- G** 20.3 In connection to paragraph 20.2, the contracting parties may agree to include a claim on any expenses directly related to the recovery of the outstanding debt payment from the collateral.

## **21 Arrangement of *rahn* in *ijarah***

- G** 21.1 A *rahn* contract may be arranged with *ijarah* contract.
- G** 21.2 The contracting parties may agree to liquidate the asset for any or a combination of the following:
- (a) overdue rental;
  - (b) any expenses directly related to the recovery of the overdue rental; or
  - (c) any other amount due arising from the lessee's misconduct or negligence or breach of specified terms.

## **22 Arrangement of *rahn* in *kafalah***

- G** 22.1 In a *kafalah* contract with recourse, the guarantor may request the guaranteed party to place an asset as collateral upon entering into the *kafalah* contract.
- G** 22.2 In relation to paragraph 22.1, if the guaranteed party fails to settle the recourse amount within the agreed period, the guarantor may liquidate the collateral to settle the debt due.

## **23 Arrangement of *rahn* in *mudarabah*, *musyarakah*, or *wakalah bi al-istithmar***

- S** 23.1 A *rahn* contract shall not be arranged in a *mudarabah*, *musyarakah*, or *wakalah bi al-istithmar* contract to guarantee the capital or profit.
- S** 23.2 Notwithstanding paragraph 23.1, if–
- (a) the *rabbul mal* (capital provider) takes collateral from the *mudarib* (entrepreneur) in *mudarabah*;
  - (b) any partner is required to provide collateral in *musyarakah*; or
  - (c) the *muwakkil* takes collateral from the *wakil* (agent),
- the collateral can only be liquidated in the event of losses due to misconduct, negligence or breach of specified terms of contract by the *mudarib*, partner(s) or *wakil*.

## **24 Arrangement of *rahn* in *wa`d***

- G** 24.1 A *rahn* contract may be arranged with a *wa`d* contract.
- G** 24.2 The pledgor may promise the pledgee to pledge the collateral in the future.

## 25 Arrangement of *rahn* with takaful

- G** 25.1 Takaful coverage may be arranged in a *rahn* contract to provide takaful coverage on the asset in relation to–
- (a) maintenance; or
  - (b) safekeeping.
- S** 25.2 In relation to paragraph 25.1, unless otherwise agreed by the contracting parties, the takaful contribution for–
- (a) maintenance of asset must be borne by owner; and
  - (b) safekeeping of asset must be borne by pledgor.

## DISSOLUTION (*FASAKH*) AND COMPLETION (*INTIHA'*) OF THE *RAHN* CONTRACT

### 26 Dissolution of *rahn*

- S** 26.1 The *rahn* contract shall dissolve under any of the following circumstances:
- (a) destruction of collateral caused by force majeure or by actions other than misconduct, negligence or breach of specified terms;
  - (b) termination of the *rahn* contract by the pledgee;
  - (c) termination or mutual cancellation (*iqalah*) of the contract that the collateral is pledged to; or
  - (d) disposal of collateral by the owner with the consent of the pledgee, resulting in the transfer of ownership of the collateral through contracts such as sale, *hibah* and *waqf*.
- S** 26.2 Notwithstanding paragraphs 26.1(a) and 26.1(d), the *rahn* contract shall not dissolve if there is a prior agreement between the contracting parties to repair or substitute the destroyed or disposed collateral, as the case may be.
- S** 26.3 Dissolution of *rahn* contract does not dissolve the liability or obligation of the obligor owing to the pledgee.
- S** 26.4 In the event that there is demise, dissolution or loss of legal capacity of either contracting party as the case may be–
- (a) the *rahn* contract shall not dissolve; and
  - (b) the legal heirs or successors shall assume the rights and obligations of the contracting party that has demised, dissolved or lost the legal capacity.

### 27 Completion of *rahn*

- S** 27.1 The *rahn* contract completes under the following circumstances:
- (a) settlement of the liability or obligation owed to the pledgee by the obligor, his guarantor or through the transfer of such liability or obligation to a third party (*hiwalah al-dayn*);
  - (b) set-off (*muqassah*) of full debt obligations between the obligor and the

- pledgee;
- (c) liquidation of collateral to discharge the liability or obligation of the obligor; or
- (d) waiving of right (*ibra'*) by pledgee to claim the whole liability or obligation from the obligor.

**S** 27.2 In the event that the *rahn* contract has completed under paragraphs 27.1(a), 27.1(b) or 27.1(d), the pledgee shall return the collateral in his possession to the owner.

**S** 27.3 Upon the completion of the *rahn* contract, the contracting parties shall be absolved from further contractual obligations.

## PART C OPERATIONAL REQUIREMENTS

### 28 Governance and oversight

- S** 28.1 The requirements under this part complement the broad governance and oversight expectations specified under the relevant policy documents on governance issued by the Bank.
- S** 28.2 While the broad governance and oversight principles are applicable to *rahn* contract, an IFI must observe specific requirements on governance requirements as outlined in this policy document to address the distinct risks associated with *rahn* transaction.
- S** 28.3 An IFI must have sufficient understanding of its risk profile and ensure the availability of personnel with the appropriate knowledge and skills to implement *rahn* contract.

#### Board of directors

- S** 28.4 The board of directors of an IFI (the board) must establish sound governance structure to facilitate effective oversight on the management and implementation of *rahn*. The adequacy of the governance structure shall commensurate with the nature, complexity and risk profile of *rahn*.
- S** 28.5 The board has overall responsibility for corporate governance, Shariah governance and Shariah compliance of an IFI. As such, the board must–
- (a) approve the business and risk strategy of the IFI with regard to the application of *rahn*;
  - (b) approve and oversee the implementation of policies and procedures governing the application of *rahn* which must, at minimum, include the following aspects:
    - (i) eligibility criteria of collateral;
    - (ii) management of collateral;
    - (iii) expenses chargeable on customers;
    - (iv) utilisation of collateral, if applicable;
    - (v) monitoring of collateral;
    - (vi) concentration of collateral;
    - (vii) redemption of collateral; and
    - (viii) liquidation of collateral;
  - (c) ensure that the internal policies and procedures remain relevant, current and effective in managing the overall operational conduct and risk profile of *rahn*;
  - (d) ensure that appropriate internal controls, systems and infrastructure are in place to implement *rahn* in accordance with Shariah requirements;
  - (e) 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 *rahn*; and

- (f) ensure independent reviews<sup>4</sup> are conducted regularly to assess compliance with policy documents issued by the Bank and internal policies established by the IFI.

### Shariah committee

- S** 28.6 The Shariah committee has the responsibility to advise an IFI in ensuring its business, affairs and activities involving a *rahn* transaction comply with Shariah requirements. As such, the Shariah committee must–
  - (a) endorse the application of Shariah requirements in the relevant policies and procedures governing *rahn*;
  - (b) review the terms and conditions stipulated in legal documentation and other documents<sup>5</sup> and endorse that such terms and conditions are in compliance with Shariah;
  - (c) advise and provide clarification on relevant Shariah rulings, decisions or policy documents on Shariah matters issued by the Bank and, if relevant, any other authorities; and
  - (d) deliberate Shariah matters that are referred by Shariah review and Shariah audit and endorse any rectification measures that are needed to ensure that the *rahn* transaction complies with Shariah requirements.

### Senior management

- S** 28.7 The senior management has the responsibility to ensure that the business and operations of an IFI comply with Shariah requirements. As such, the senior management must–
  - (a) establish policies, processes and procedures with regard to proper management of the *rahn* contract;
  - (b) develop and implement relevant internal systems, infrastructure and adequate mechanisms to identify, measure, control and monitor risk inherent in the *rahn* contract;
  - (c) ensure that the IFI monitors and has proper and adequate reporting of the *rahn* contract operations and performance;
  - (d) identify, assign and train relevant officer with the appropriate skill set to manage *rahn* contract and ensure that the roles and responsibilities are assigned to the relevant functions within the IFI;
  - (e) undertake regular reviews and monitoring compliance with the approved policies; and
  - (f) ensure timely disclosure of relevant information to the board and the Shariah committee.

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<sup>4</sup> Independent review is undertaken by compliance function.

<sup>5</sup> Such as information published in promotional materials product manuals or other publications.

## 29 Structuring

### Purpose

- S** 29.1 An IFI must clearly specify–
- (a) the purpose of the financial product and services that apply *rahn* contract; and
  - (b) the subject matter of the *rahn* contract.
- S** 29.2 An IFI must also ensure that the overall structure and outcome of the financial product and services do not contravene Shariah requirements as provided in this policy document.

### Contracting parties

- S** 29.3 An IFI shall identify parties in a *rahn* contract as the pledgor, pledgee or obligor.
- G** 29.4 In relation to paragraph 29.3, the contracting parties in a *rahn* contract may be identified in the following manner:

No	Scenario	Pledgor	Pledgee	Obligor
(a)	Customer pledges his collateral to secure his obligation to the IFI	Customer	IFI	Customer
(b)	Customer pledges another party's collateral to secure his obligation to the IFI	Customer	IFI	Customer
(c)	Customer and third party pledge their jointly owned collateral to secure a customer's obligation to the IFI	Customer and third party	IFI	Customer
(d)	Third party pledges his collateral to secure a customer's obligation to the IFI	Third party	IFI	Customer
(e)	Third party pledges collateral owned by another party to secure customer's obligation to the IFI	Third party	IFI	Customer

Illustration on the identification of pledgor, pledgee and obligor in *rahn* contract is provided under Appendix 3.

- S** 29.5 Where applicable, an IFI shall identify the person appointed as an agent to appraise, safekeep or liquidate the collateral.

**Offer and acceptance**

- S** 29.6 In entering into a *rahn* contract, an IFI must ensure that an offer and acceptance is clearly evidenced by appropriate documentation or record.

**Asset as collateral**

- S** 29.7 An IFI shall identify and ensure the asset used as collateral is in line with the internal policy on eligibility criteria of collateral as specified in paragraph 28.5(b)(i).
- G** 29.8 An IFI may consider the following aspects in developing an internal policy on the eligibility criteria of collateral:
- (a) marketability of the collateral;
  - (b) measurability of the collateral value;
  - (c) time taken for liquidation of the collateral;
  - (d) correlation between collateral value and credit quality of customer; and
  - (e) restriction or priority of claims on the collateral.
- G** 29.9 In relation to paragraph 14.2(a) an IFI may–
- (a) refer to the Shariah screening criteria or List of Shariah-Compliant Securities by the Shariah Advisory Council of the Securities Commission Malaysia;
  - (b) refer to other Shariah screening criteria or list of Shariah-compliant financial instrument as set out by the respective regulatory or supervisory authority that is in line with the Shariah resolutions issued by the Shariah Advisory Council of Bank Negara Malaysia or Shariah Advisory Council of the Securities Commission Malaysia to ascertain the core business of a company issuing a financial instrument e.g. share; or
  - (c) develop internal screening criteria that is endorsed by the Shariah committee, in the absence of the Shariah screening criteria or list of Shariah compliant financial instrument as described under paragraphs 29.9(a) and 29.9(b).

**Utilisation of collateral**

- S** 29.10 An IFI shall ensure the utilisation of collateral is in line with the internal policy on utilisation of collateral as specified in paragraph 28.5(b)(iv).
- S** 29.11 At minimum, an IFI shall include the following in the internal policy on utilisation of collateral:
- (a) use or purpose of the utilisation;
  - (b) rights and responsibilities of contracting parties; and
  - (c) tenure of the utilisation.

**Expenses on collateral**

- S** 29.12 In relation to paragraph 28.5(b)(iii), an IFI shall specify the parameters of expenses to be borne by the IFI, customer or third party pledgor.

- S** 29.13 In relation to paragraph 29.12, an IFI shall ensure the expenses borne by the customer or third party pledgor are based on direct cost associated with the provision of collateral.

### **Redemption and liquidation of collateral**

- S** 29.14 An IFI shall ensure the process and procedure of redemption and liquidation of collateral are in line with the internal policy on redemption and liquidation of collateral as specified in paragraphs 28.5(b)(vii) and 28.5(b)(viii).
- S** 29.15 At minimum, an IFI shall include the following in the internal policy on redemption of collateral:
- (a) events of redemption of collateral e.g. fulfilment of customer's obligation with the IFI such as full settlement of outstanding financing; and
  - (b) where applicable, process and procedure on redemption of physical collateral that is safekept by the IFI as follows:
    - (i) verification that the event of redemption has been fulfilled;
    - (ii) verification that the person redeeming the collateral is the pledgor or any person authorised by the pledgor; and
    - (iii) treatment of any unredeemed collateral.
- S** 29.16 With respect to the internal policy on liquidation of collateral, the IFI must ensure that at minimum, the internal policy includes the following:
- (a) events of liquidation of collateral e.g. default, insolvency or bankruptcy of customer;
  - (b) process or method of liquidation of collateral e.g. public auction or private offer;
  - (c) methodology for valuation of collateral for the purpose of the liquidation of such collateral;
  - (d) identification of collateral to be liquidated in full or in part, in line with paragraph 17.4;
  - (e) mechanism<sup>6</sup> to provide notification to the customer or third party pledgor prior to the liquidation of collateral; and
  - (f) treatment and disclosure to customer or third party pledgor on excess or shortfall of the liquidated collateral to settle the customer's liability or obligation owed to the IFI.
- S** 29.17 An IFI must ensure the redemption and liquidation of collateral are documented in writing.

### **Documentation**

- S** 29.18 An IFI must ensure comprehensive and legally enforceable documentations<sup>7</sup> that clearly stipulate the terms and conditions in the *rahn* contract which are in compliance with Shariah and regulatory requirements are in place.

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<sup>6</sup> For example, letter, email, notices or website announcement.

<sup>7</sup> Legally enforceable documentations covers contracts, agreements, master agreements and commercial documents such as invoices, delivery notes, trade confirmation and other generally acceptable documents in trade and financial transactions.

- S** 29.19 At minimum, an IFI must ensure the legal documentation reflects the salient features of *rahn* contract as follows:
- (a) contractual relationship between the various contracting parties;
  - (b) rights, roles and responsibilities of the contracting parties in the *rahn* contract;
  - (c) description of collateral;
  - (d) liability or obligation secured by collateral;
  - (e) tenure of *rahn* contract;
  - (f) terms on redemption and liquidation of collateral; and
  - (g) where applicable—
    - (i) expenses claimable from customer or third party pledgor including the corresponding payment terms;
    - (ii) description of trigger events that requires IFI's mitigation action in relation to paragraph 30.15(a);
    - (iii) rights of the IFI to undertake mitigation action upon occurrence of the trigger event in relation to paragraph 30.15(b); and
    - (iv) terms on utilisation of collateral in line with paragraph 29.11.
- S** 29.20 Where applicable, an IFI must ensure that the relevant consent in a *rahn* contract is documented including the consent from—
- (a) the pledgee for the revocation of the *rahn* contract, in line with paragraph 9.2;
  - (b) the owner of the collateral that is used to secure customer's liability or obligation owed to the IFI in line with paragraph 14.5;
  - (c) the joint owners of undivided collateral in relation to paragraph 14.6(b);
  - (d) the IFI to—
    - (i) accept delayed possession of collateral, in line with paragraph 14.7; and
    - (ii) allow the owner to transfer the collateral's ownership *via* sale, *hibah* or *waqf* in line with paragraph 26.1(d);
  - (e) the owner of the collateral to allow—
    - (i) IFI to utilise the collateral in line with paragraph 15.3; and
    - (ii) a person to perform liquidation of collateral in line with paragraph 17.3;
  - (f) the pledgees if the collateral is used to secure multiple obligations where claims to the collateral is ranked *pari passu* and right to each other in line with paragraph 14.12(a); and
  - (g) the succeeding pledgees if the collateral is used to secure multiple liability or obligations where the pledgees are ranked in a way that the right of claim of a preceding pledgee is prioritised over a subsequent pledgee in line with paragraph 14.12(b).
- G** 29.21 For the avoidance of doubt, existing documentation may be used by the IFI subject to fulfilling the documentation requirements set forth under this policy document.
- S** 29.22 An IFI shall adequately clarify or translate the use of Arabic terminology in the legal documents to facilitate understanding of the contracting parties. Any translation shall be consistent with the rulings of the Shariah Advisory Council of Bank Negara Malaysia.

**30 Risk management**

- S** 30.1 An IFI must establish comprehensive risk management policies and procedures, processes, systems and internal control in line with the IFI's risk appetite and shall include the following:
- (a) the identification, measurement, monitoring, control and reporting of risks including, where applicable, risk arising from movement of the collateral value or change in quality of the collateral accepted;
  - (b) the establishment of appropriate valuation methodology of the collateral and as applicable, establishing controls to ensure valuations are obtained in an independent and objective manner;
  - (c) the establishment of risk exposure limits including concentration limits on the collateral, as applicable, in line with the IFI's risk appetite; and
  - (d) the risk mitigation techniques including establishing—
    - (i) appropriate eligibility criteria and review process in identifying a list of approved collateral type to be used in the *rahn* contract;
    - (ii) where applicable, clear segregation of roles and duties to be performed by appointed agents to safekeep or liquidation of collateral; and
    - (iii) where applicable, business continuity plan on the safekeeping of physical collateral.

**Concentration risk**

- S** 30.2 An IFI shall assess the concentration level of collateral to a particular type of asset, single geographical location or others. In this regard, the IFI must establish an internal policy governing concentration risk on collateral in line with paragraph 28.5(b)(vi).
- G** 30.3 In relation to paragraph 30.2, the internal policy governing concentration risk on the collateral may include—
- (a) setting out internal limits (e.g. collateral concentration limit on specific type of asset, a single geographical location or others) that are reflective of the IFI's risk appetite and risk bearing capacity; and
  - (b) monitoring and reporting mechanism to ensure adherence to the internal limit.
- S** 30.4 An IFI shall have in place adequate process and procedures to ensure the collateral accepted is in line with the internal policy on collateral in paragraphs 28.5(b)(i) and 30.3.
- S** 30.5 In relation to paragraph 30.4, an IFI must take into consideration the value of collateral that is permissible to fulfil customer's liability or obligation as provided in paragraphs 17.5.
- S** 30.6 An IFI shall have in place an appropriate valuation methodology for the type of collateral accepted.

- G** 30.7 In relation to paragraphs 30.4 and 30.6, an IFI may appoint another party<sup>8</sup> to–
- (a) support the acceptance process and procedure of the collateral; and
  - (b) determine the appropriate valuation methodology.

### **Management of collateral**

- S** 30.8 An IFI must ensure collateral is managed in accordance to the terms and conditions of the *rahn* contract in line with paragraph 29.19(b).
- S** 30.9 In relation to the paragraphs 28.5(b)(ii) and 30.8, an IFI must establish an internal policy on the management of collateral. At minimum, the IFI shall include the following in its internal policy:
- (a) identification of collateral that requires safekeeping by the IFI or third party e.g. safekeeping of collateral documentation or safe-keeping of physical collateral; and
  - (b) roles and responsibility of the person involved in the management of collateral.
- S** 30.10 In relation to paragraph 30.9 and where an IFI safekeeps a physical collateral, the IFI must ensure the internal policy on management of collateral includes the following:
- (a) location of safekeeping;
  - (b) maintenance of the physical collateral; and
  - (c) business continuity plan, including–
    - (i) identification of events that require business continuity plan e.g. force majeure or theft; and
    - (ii) mechanism to manage the events identified under paragraph 30.10(c)(i) e.g. secondary safekeeping facility in a different location.
- S** 30.11 In relation to paragraph 30.10 and where a third party safekeeps physical collateral, an IFI must–
- (a) document the safekeeping arrangement including the appointment of third party to safekeep the collateral; and
  - (b) monitor the movement of the collateral.

### **Monitoring of collateral**

- S** 30.12 An IFI shall assess and monitor the value of the collateral to ensure the sufficiency<sup>9</sup> of the collateral value to secure customer's obligation to the IFI in accordance to the IFI's risk management strategies.
- S** 30.13 In relation to paragraphs 28.5(b)(v) and 30.12, an IFI must establish an internal policy on the monitoring of collateral. At minimum, the internal policy shall include the following:
- (a) scope of monitoring e.g. value of collateral, physical condition of collateral and legal enforceability of the collateral documentation;

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<sup>8</sup> For example, the IFI may appoint a property valuer to appraise the value of property as collateral.

<sup>9</sup> For example, sufficiency of collateral value to partially or fully secure customer's obligation to the IFI in accordance with IFI's risk management strategies.

- (b) method of monitoring e.g. monitor changes in market value, physical inspection on collateral or monitor changes in laws and regulation impacting legal enforceability of the collateral documentation; and
- (c) frequency of monitoring.

**G** 30.14 An IFI may appoint an agent to appraise the collateral.

**S** 30.15 An IFI must identify the following with respect to the result of monitoring of collateral:

- (a) trigger events that invoke IFI's mitigation actions e.g. trend in collateral value or marketability of collateral; and
- (b) mitigation actions arising from the trigger events e.g. requiring additional or substitution of collateral from customer or third party pledgor.

## **31 Business and market conduct**

**S** 31.1 An IFI shall ensure that the *rahn* contract is conducted in a fair, transparent, responsible and professional manner.

### **Fair dealings**

**S** 31.2 An IFI must ensure the internal policies and procedures on business and market conduct for the *rahn* contract reflect transparency and fair dealing practices to all contracting parties. At minimum, the IFI shall include the following in its internal policies and procedures:

- (a) information provided is accurate, clear, not misleading and provided in timely manner to contracting parties; and
- (b) fees and charges are in line with paragraphs 16, 29.12 and 29.13.

### **Disclosure of information**

**S** 31.3 An IFI shall provide the following information to the customer in product disclosure sheet or any other relevant materials at the pre-contractual stage as follows:

- (a) where applicable, the IFI shall inform the customer that consent will be sought upon entering the contract in the event where the IFI will utilise the collateral; or
- (b) where the IFI offers Islamic pawnbroking<sup>10</sup> product, the IFI shall disclose the description of the following:
  - (i) roles and responsibilities of the contracting parties;
  - (ii) *rahn* contract including arrangement with other Shariah contracts or concepts;
  - (iii) expenses borne by customer, if applicable;
  - (iv) tenure of the *rahn* contract; and
  - (v) redemption and liquidation of collateral.

<sup>10</sup> Based on market practice and for the purpose of this policy document, Islamic pawnbroking refers to the provision of loan (*qard*) that is secured by collateral which is safekept by the IFI with fee.

- S** 31.4 Where the pledgor is a third party pledgor, an IFI shall disclose information to the third party pledgor in line with paragraph 31.3(a).

## **32 Financial disclosure**

- S** 32.1 An IFI shall observe the requirements stipulated under the relevant Malaysian Financial Reporting Standards and Financial Reporting for Islamic Banking Institutions.

## **33 Submission requirement**

- S** 33.1 An IFI that offers financial products or services which apply *rahn* contract is required to submit an implementation plan to comply with this policy document to Jabatan Perbankan Islam dan Takaful no later than three (3) months after the issuance date of this policy document. In ensuring compliance with this policy document, the IFI shall–
- (a) ascertain the existing policies, procedures and internal limits compliance to the requirements<sup>11</sup> under this policy document;
  - (b) clarify roles and accountabilities;
  - (c) where applicable, undertake enhancement to the existing policies, procedures or system to address the requirements of *rahn* contract; and
  - (d) establish appropriate monitoring and reporting mechanisms to ensure compliance with this policy document.
- S** 33.2 The board and the Shariah committee must respectively approve and endorse the IFI's implementation plan to ensure compliance with this policy document by the effective date of this policy document.
- S** 33.3 An IFI must immediately notify Jabatan Perbankan Islam dan Takaful if the IFI identifies any cause that will affect full compliance of the requirements set forth under this policy document at least six (6) months prior to the effective date.

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<sup>11</sup> These among others include the requirement to ensure the expenses borne by customer or third party pledgor are based on direct cost incurred in relation to the provision of collateral.

## APPENDICES

### Appendix 1 Legitimacy of *rahn* contract

The legitimacy of the *rahn* contract is derived from the Quran and founded on the Sunnah of Prophet Muhammad (peace be upon him), and further supported by the consensus of Muslim jurists (*ijma`*).

#### The Quran

- (i) The following verse of the Quran implies the permissibility of the *rahn* contract:

وَإِنْ كُنْتُمْ عَلَى سَفَرٍ وَلَمْ تَجِدُوا كَاتِبًا فَرِهَانٌ مَّقْبُوضَةٌ فَإِنْ أَمِنَ بَعْضُكُم بَعْضًا فَلْيُؤَدِّ  
الَّذِي أَوْثِقَ أَمَانَتَهُ وَلْيَتَّقِ اللَّهَ رَبَّهُ وَلَا تَكْتُمُوا الشَّهَادَةَ وَمَنْ يَكْتُمْهَا فَإِنَّهُ آتَمٌ قَلْبُهُ وَاللَّهُ  
بِمَا تَعْمَلُونَ عَلِيمٌ

“If you are on a journey and cannot find a scribe to write the document, then [transact your business on the security of] a pledge in hand, but if you decide to trust one another, then let the one who is trusted fulfil his trust; let him be mindful of God, his Lord. Do not conceal evidence: anyone who does so has a sinful heart, and God is fully aware of everything you do” (Surah al-Baqarah, 2: 283).

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

- (ii) The following *hadith* implies the general permissibility of the *rahn*.

عَنْ عَائِشَةَ رَضِيَ اللَّهُ عَنْهَا أَنَّ النَّبِيَّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ اشْتَرَى طَعَامًا مِنْ يَهُودِيٍّ إِلَى  
أَجَلٍ وَرَهْنَهُ دِرْعًا مِنْ حَدِيدٍ.

“Aishah (r.a.) narrated that the Prophet (peace be upon him) bought some grain from a Jew on deferred payment, and he pledged steel armour as security for it” (Bukhari and Muslim).

#### The Consensus of Muslim Jurists (*Ijma`*)

- (iii) Muslim jurists have reached *ijma`* on the permissibility of the *rahn* in general, as cited by Ibn Qudamah (*Al-Mughni* 4/362).

## Appendix 2 Glossary

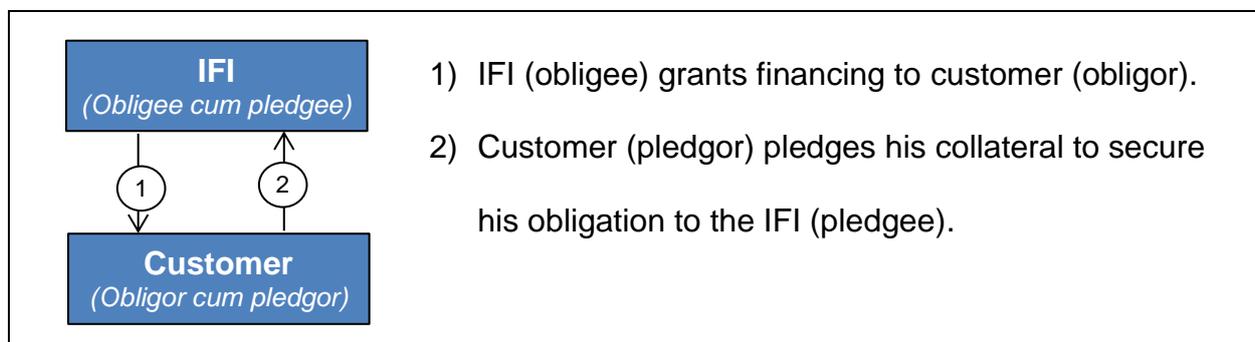
Terms	Definition
<i>Hibah</i>	Transfer of ownership of an asset from a donor to a recipient without any consideration; a form of benevolent contract.
<i>Hiwalah al-dayn</i>	Assignment/transfer of debt from the liability of the original debtor to the liability of a third person so that the original debtor becomes free of liability.
<i>Ibra'</i>	Rebate
<i>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>Istisna`</i>	A contract by 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.
<i>Kafalah</i>	A contract of conjoining guarantor's liability to the guaranteed party's liability in a way that the obligation of the guaranteed party is established as a joint liability of the guarantor and guaranteed person.
<i>Mudarabah</i>	Profit-sharing contract
<i>Murabahah</i>	A sale and purchase of an asset where the acquisition cost and the mark-up are disclosed to the purchaser.
<i>Musyarakah</i>	A partnership between two or more parties, whereby all parties will share the profit and bear the loss from the partnership.
<i>Qabd haqiqi</i>	Physical possession. It refers to a state where a person has actual possession and the rights to control an asset.
<i>Qabd hukmi</i>	Constructive possession. It refers to a state where a person does not have actual possession but has the legal rights to control an asset.
<i>Qard</i>	A contract of lending money by a lender to a borrower where the latter is bound to repay an equivalent replacement amount to the lender.
<i>Tawarruq</i>	Two sale and purchase contracts where the first involves the

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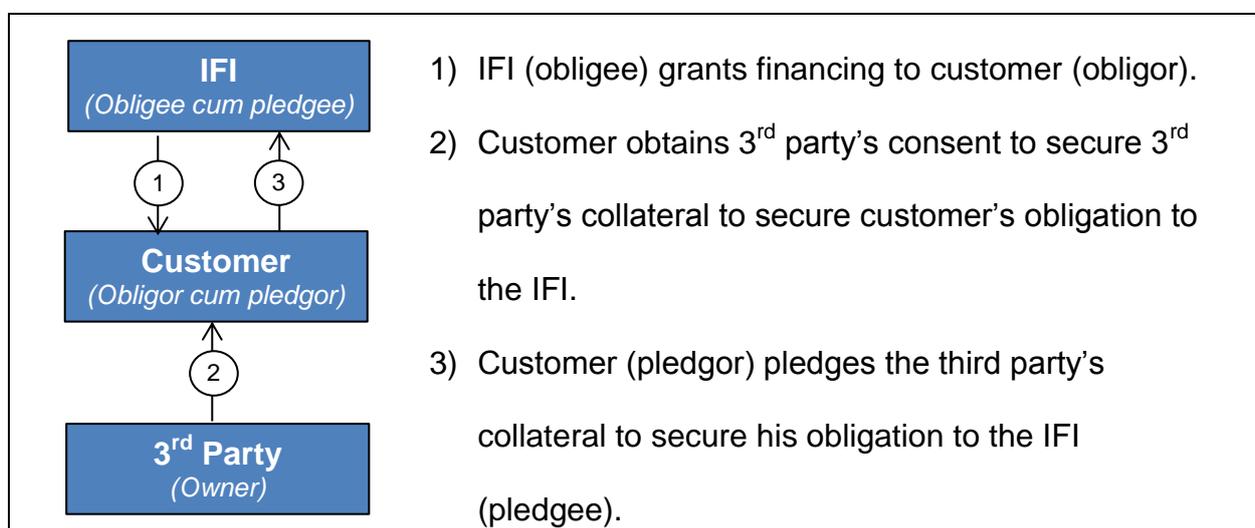
	sale of an asset to a purchaser on a deferred basis and the subsequent sale involves sale of the asset to a third party on a cash basis.
<i>Wa`d</i>	An expression of commitment given by one party to another to perform certain action(s) in the future.
<i>Wakalah bi al-istithmar</i>	Agency contract for investment
<i>Waqf</i>	Endowment

### Appendix 3 Illustration on the identification of parties in the *rahn* contract

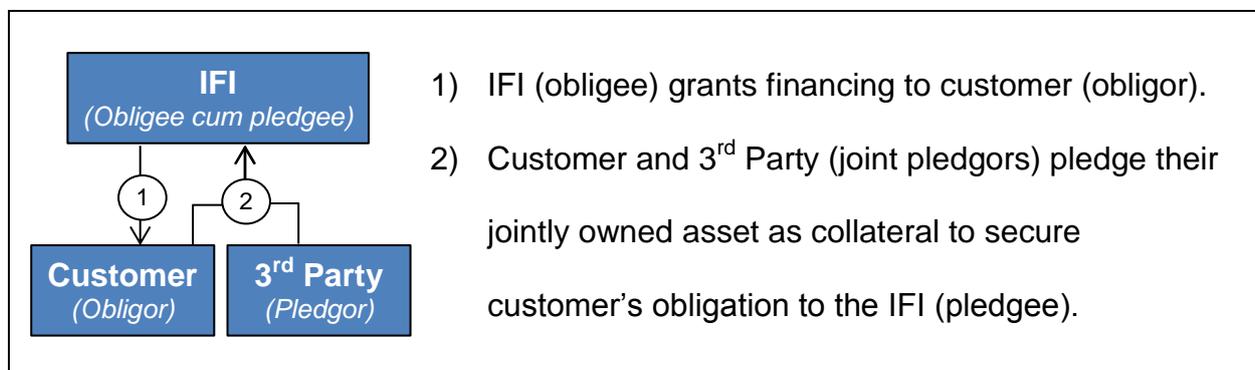
#### A. Customer pledges his collateral to secure his obligation to the IFI



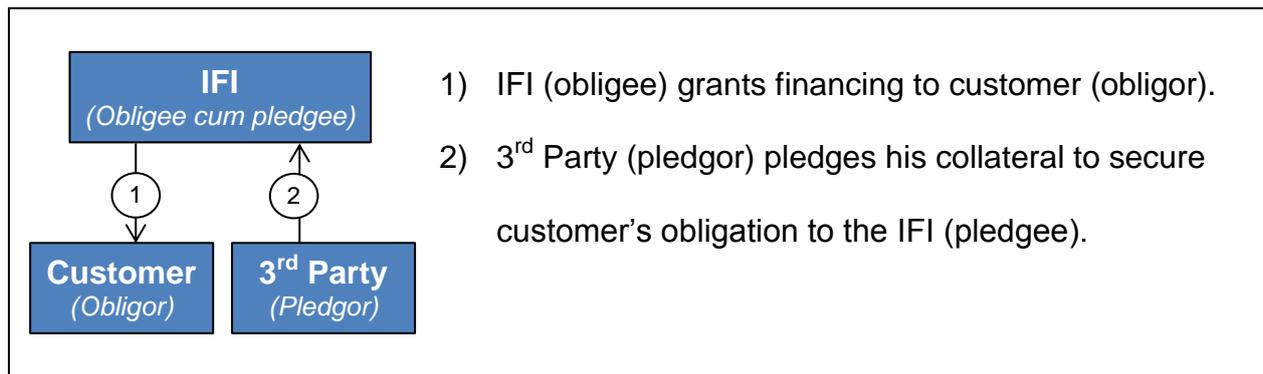
#### B. Customer pledges another party's collateral to secure his obligation to the IFI



#### C. Customer and third party pledge their jointly owned collateral to secure a customer's obligation to the IFI



D. Third party pledges his collateral to secure a customer's obligation to the IFI



E. Third party pledges collateral owned by another party to secure customer's obligation to the IFI

