

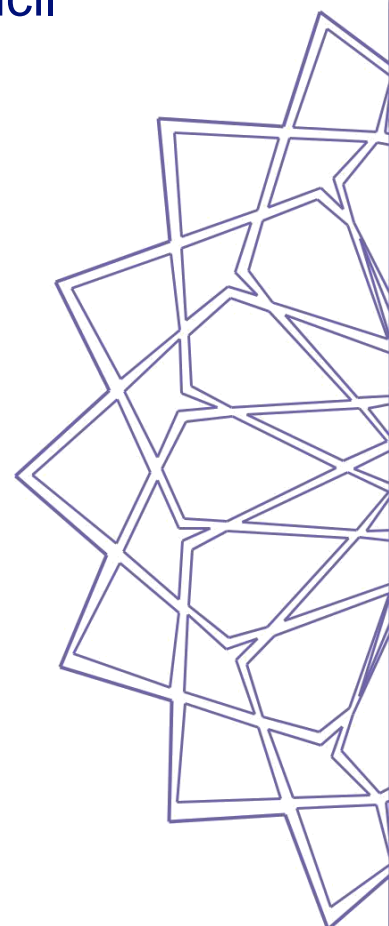


Suruhanjaya Sekuriti
Securities Commission
Malaysia

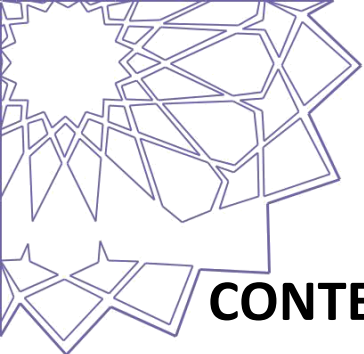
**RESOLUTIONS
OF THE SHARIAH ADVISORY COUNCIL
OF THE SECURITIES COMMISSION MALAYSIA**

31 December 2023

Resolutions of the Shariah Advisory Council of the Securities Commission Malaysia



Suruhanjaya Sekuriti
Securities Commission
Malaysia



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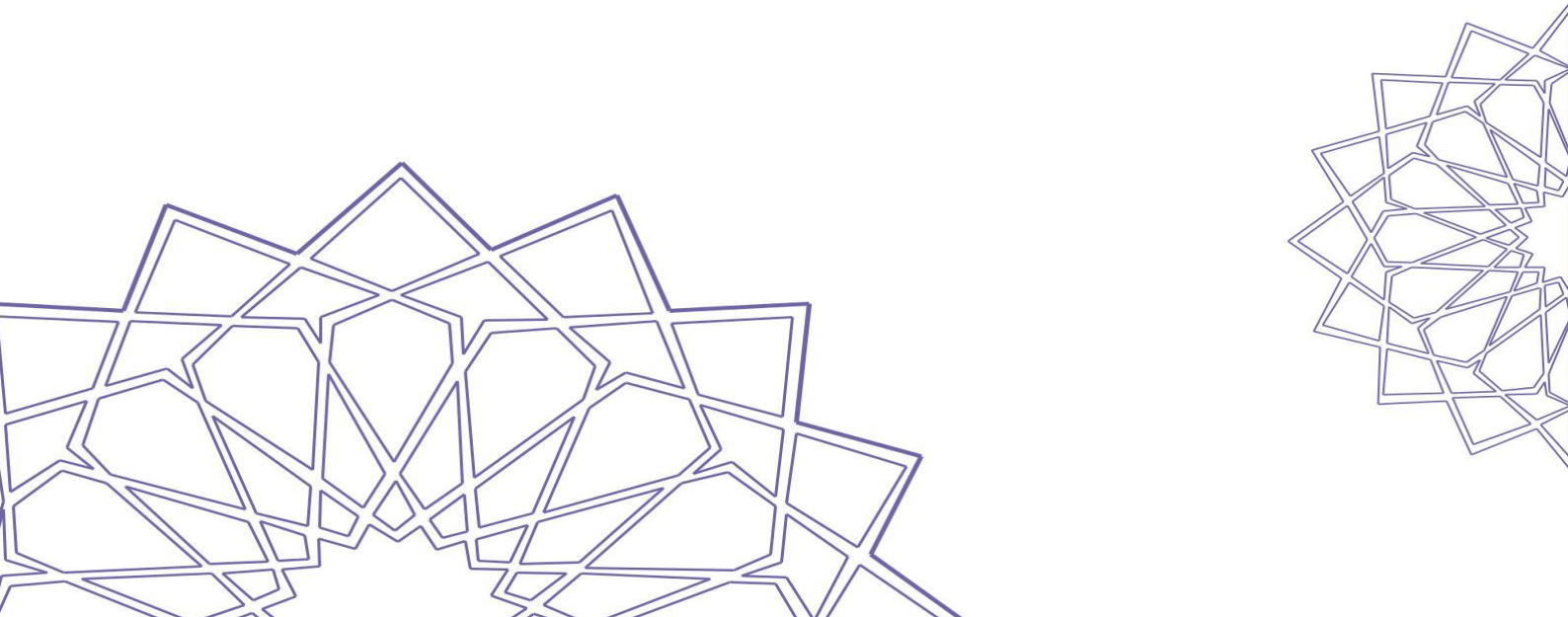
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PART A

INTRODUCTION AND OBJECTIVES



INTRODUCTION

Islamic capital market (ICM) is currently expanding rapidly. In line with this development, various issues in relation to ICM have been discussed and resolved by the Shariah Advisory Council (SAC) of the Securities Commission Malaysia (SC) through their series of meetings. As a result of this, the SC has published the SAC resolutions in relation to the concept, ICM products and the related issues for guidance and reference. However, these SAC resolutions do not include detailed Shariah clarifications and justifications. These SAC resolutions serve as an addition to the resolutions included in *the Resolutions of the Securities Commission Malaysia Shariah Advisory Council (Second Edition)*, including updates on some existing resolutions.

OBJECTIVES

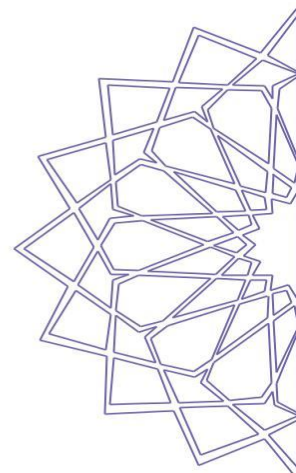
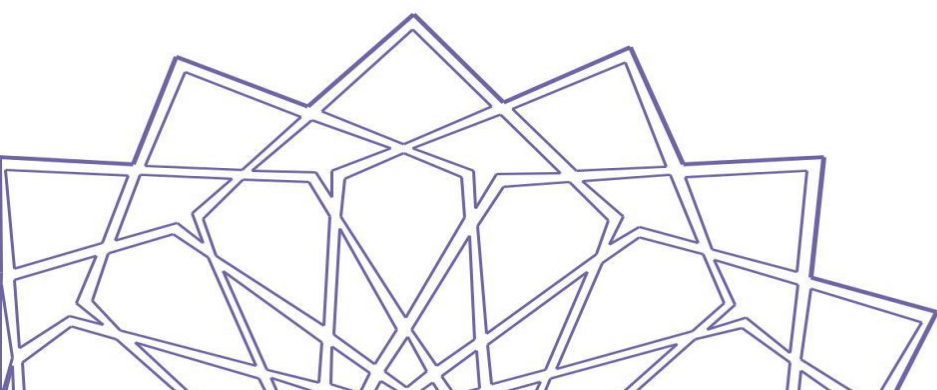
The objectives of this publication is to–

- (i) inform the public in relation to the latest SAC resolutions; and
- (ii) serve as guidance and reference to the public and practitioners in the Islamic finance industry in developing and expanding ICM products.

PART B

**RESOLUTIONS
OF THE SHARIAH ADVISORY COUNCIL
OF THE SECURITIES COMMISSION MALAYSIA**

**PRINCIPLES AND CONCEPTS OF MUAMALAT
IN THE ISLAMIC CAPITAL MARKET**



TA`WIDH

INTRODUCTION

In ICM, *ta`widh* is usually applied in the structuring of sukuk. It refers to compensation agreed by the contracting parties that can be claimed by the creditor (the financier i.e. investors/sukukholders) when the debtor (the sukuk issuer) fails or delays to perform its obligation to repay debt in relation to sukuk issuance. The SAC resolved the issue of *ta`widh* and updated such resolutions accordingly.

RESOLUTION

The SAC resolved on *ta`widh* in a series of meetings as follows:

- (1) The imposition of *ta`widh* on the late repayment of Islamic financing is permissible.
- (2) *Ta`widh* payment for (i) arrears and (ii) failure to pay after the due date, are both permissible. The *ta`widh* payment is for Islamic financing based on *`uqud mu`awadhat* including sukuk issued based on contracts of exchange.
- (3) *Ta`widh* imposed on a sukuk issuer who fails to meet its obligation to pay the principal amount and profit on the agreed date is permissible although the obligation arises based on *`uqud ishtirak* (i.e. *musharakah* or *mudharabah* contracts). In the context of *`uqud ishtirak*, *ta`widh* is limited only for failure to pay realised profit and it is not applicable for failure to pay expected profit.

- (4) *Ta`widh* is permissible under the structure of sukuk *wakalah bi al-istithmar* if the sukuk issuer/*wakil* (agent) does the following:
- (i) Breaches its fiduciary duty as an investment manager due to failure in distributing the realised profit to the investors on the agreed date; or
 - (ii) Delays the payment of any amount due and payable to the investors upon dissolution of *wakalah* agreement.

RATE OF TA`WIDH

The SAC discussed the rate of *ta`widh* permitted and the latest SAC resolutions are as follows:



Late Payment Charge on Judgment Debt

The SAC resolved the following:

- (i) Late payment charge for judgment debt may be imposed by the court from the date when the judgment is made until the date when the judgment debt is settled at the rate provided by the court rules. The implementation of this late payment charge must be based on the mechanism of *ta`widh* and *gharamah*;
- (ii) *Ta`widh* refers to the compensation on the actual loss. In considering the difficulty to determine the amount of actual loss and need for standardisation in the industry, the SAC decided that the rate of actual loss shall be based on the decision made by third party i.e. Bank Negara Malaysia. The SAC also decided that the rate of actual loss shall be based on the daily overnight Islamic Interbank rate as stated in the website of Islamic Interbank Money Market (<http://iimm.bnm.gov.my>), fixed on the date when the judgment was made and calculated monthly based on a daily rest basis;
- (iii) *Gharamah* refers to the penalty imposed as prevention for late payment by debtor. In this context, *gharamah* refers to the difference between the amount of late payment charge and *ta`widh* i.e. the excess, if the amount

of *ta`widh* is less than the amount of late payment charge. The late payment charge will be determined by the court rules;

- (iv) The amount of late payment charge for judgment debt cannot be compounded (non-compounding);
- (v) Judgment creditor is entitled to receive *ta`widh* only. If the amount of *ta`widh* is equivalent or more than the amount for late payment charge, then the judgment creditor may take the whole amount of the late payment charge. However, if the amount of late payment charge is more than *ta`widh*, the excess (*gharamah*) must be channelled to charitable bodies;
- (vi) The amount of late payment charge shall not exceed the outstanding principal amount; and
- (vii) Calculation of late payment charge for judgment debt is imposed on the basic judgment sum. Basic judgment sum is the outstanding principal amount (subject to *ibra'* if applicable). It shall not include late payment charge before judgment and other related costs.

With regard to the administration of *gharamah*, the SAC decided that the mandate is to be given to the Shariah committee/Shariah adviser to determine the suitable charitable bodies including *baitulmal* to receive *gharamah*. The *gharamah* should be channelled by the judgment creditor¹, without taking into consideration whether or not the judgment creditor is an institution under the purview of the SC. Judgment creditor will have to ensure that they will not gain any benefit howsoever and whatsoever from their action in channeling the *gharamah*.

¹ The judgment creditor refers to a party who is entitled to the amount determined by the court (judgment sum).

Late Payment Charge on Non-Judgment Debt

The SAC resolved that *ta`widh* for late payment charge which may be imposed on non-judgment debt is subject to the following conditions:

(i) For default payment before maturity date

Ta`widh may be imposed and shall not be more than 1% per annum on the outstanding amount and shall not be compounded. In addition, *gharamah* may be imposed and the combined rate of *ta`widh* and *gharamah* shall not exceed 10% of the outstanding amount or as may be determined by the SAC from time to time.

(ii) For default payment after maturity date

Ta`widh may be imposed and shall not be more than the prevailing daily overnight Islamic Interbank Money Market rate on the outstanding balance (outstanding principal and accrued profit). In addition, *gharamah* may be imposed and the combined rate of *ta`widh* and *gharamah* shall not exceed 10% of the outstanding amount or as may be determined by the SAC from time to time.

(iii) Treatment of *ta`widh* and *gharamah*

Where *ta`widh* and *gharamah* are imposed, the investors or sukukholders are only entitled to the amount of *ta`widh*. The amount of *gharamah* shall be channelled to *baitulmal* and/or charitable bodies as advised by the Shariah adviser of the issuer.

BAI` `INAH

(i) IMPLEMENTATION OF BAI` `INAH

INTRODUCTION

Bai` `inah refers to sale and purchase between two contracting parties where the owner sells the asset to the buyer on cash basis and then buys back the asset at a deferred price which is higher than the cash sale. It may also be conducted where the owner sells the asset to the buyer at a deferred sale price and subsequently buys back the asset on cash basis at a lower price than the deferred sale.

The resolution on the permissibility of *bai` `inah* was made by the SAC. Since the issue of *bai` `inah* involves differences of opinions among classical and contemporary scholars, the SAC discussed this at numerous meetings to update the resolution regarding the implementation of *bai` `inah* which is permissible by Shariah.

RESOLUTION

The SAC resolved that *bai` `inah* is a principle which is permissible in the ICM in Malaysia. However, the SAC updated its resolution on *bai` `inah* and resolved that the implementation of *bai` `inah* shall conform to and comply with the following conditions:

A The sale and purchase of asset shall be executed via two clear and separate contracts

The following requirements shall be complied with:

- (i) Both contracts shall comply with the general requirements for valid sale and purchase in accordance with Shariah;
- (ii) Transaction documents for sale or purchase of asset may be done via documentation method which is accepted by market practice (*`urf*) including via written documentation or verbal recording; and
- (iii) Transaction documents for both sale and purchase of asset in the written form shall be prepared in two separate sets of documents.

B The sale and purchase of asset shall not have the conditions for repurchase or resale of asset

Any form of conditions for repurchase or resale of asset associated with *bai` inah* contract will annul the contract.

The following requirements shall be complied accordingly:

- (i) For the purpose of the resolution, conditions for repurchase or resale of asset comprises:
 - (a) Any statement in any documents in relation to the *bai` inah* transaction which clearly states that the seller or the purchaser will repurchase or resell asset; and/or
 - (b) Any statement in any documents in relation to the *bai` inah* transaction which provides the sequence of transaction regarding the sale of asset between two parties followed by the purchase of the same asset between the same parties or vice versa.

- (ii) The conditions for repurchase or resale of asset shall not be stipulated in any documents in relation to the *bai` `inah* transaction as it will annul the transaction.

All documents related to *bai` `inah* transactions are considered as elements that form the contract where all those documents are inter-related and shall not be separated from one another.

Thus, the conditions for repurchase or resale of asset shall not be included in any documents relating to such *bai` `inah* transaction, for instance in sukuk issuance, such conditions shall not be included in the Principal Terms and Conditions, Details of the Sukuk Facility, Trust Deed, Information Memorandum, Master Agreement and other related documents.

The SAC also resolved that the practice of pre-signing¹ of legal documents for *bai` `inah* transaction is not allowed. This practice is perceived as a form of condition for the repurchase or resale of asset in *bai` `inah* transaction which is not permissible.

C Both sale and purchase contracts shall be executed at different times

The execution of both sale and purchase contracts carried out simultaneously by the contracting parties shall annul both transactions. Hence, the sale and purchase contracts shall be executed at different times.

D Sequence of execution for each sale and purchase contract shall be based on proper sequence

The sequence of execution for each sale and purchase contract shall be executed properly whereby the first sale contract shall be completely concluded before the second sale contract is executed.

¹ Pre-signing refers to signing of the sale or purchase of asset by either party to the contract in the first sale and purchase contract, followed by the signing of the repurchase or resale of asset by the same parties in the second sale and purchase contract, before the first contract is being executed by another party (counterparty).

Therefore, the following requirements shall be fulfilled:

- (i) For the sale or purchase of asset, the selling party shall sign the agreement first followed by the purchasing party;
- (ii) Similarly, for the subsequent sale or purchase transaction, the selling party shall sign the agreement first followed by the purchasing party; and
- (iii) Any contracting parties shall not provide any verbal or written promise to resell or repurchase the said asset.

E The sale and purchase of asset shall give effect to the transfer of ownership of asset and the existence of possession or holding of asset (*qabdh*) which is valid according to Shariah and customary business practice (*`urf tijari*)

The following requirements shall be observed:

- (i) The possession or holding of asset (*qabdh*) can occur either physically (*al-qabdh al-haqiqi*) or constructively (*al-qabdh al-hukmi*); and
- (ii) Such possession or holding of asset (*qabdh*) shall give the following effects:
 - (a) *Takhliyah* which means denying the right of the seller in respect of the sold asset; and
 - (b) *Tamkin* which means creating complete right of the purchaser in respect of the purchased asset.

(ii) IMPLEMENTATION OF RESOLUTION ON BAI` `INAH IN SUKUK STRUCTURING

INTRODUCTION

Pursuant to the SAC resolution pertaining to the implementation of *bai` `inah* above which took effect on 1 October 2014 (New *Bai` `Inah* Resolution), a question arises whether such resolution is applicable in the following two situations:

- (i) Revision to the terms of sukuk which was issued based on previous resolution on *bai` `inah*¹ (Previous *Bai` `Inah* Resolution); and
- (ii) Upsizing the limit of an existing sukuk programme.

RESOLUTION

The SAC had resolved that the implementation of the New *Bai` `Inah* Resolution is as follows:

- (i) For sukuk proposal submitted on or after 1 October 2014, the New *Bai` `Inah* Resolution shall be applicable;
- (ii) For revision to the terms of sukuk which was issued based on the Previous *Bai` `Inah* Resolution and the revision is not considered as a new submission pursuant to the requirements under the Guidelines on Unlisted Capital Market Products under the Lodge and Launch Framework and the Guidelines on Issuance of Private Debt Securities and Sukuk to Retail Investors, the New *Bai` `Inah* Resolution shall not be applicable; and
- (iii) For upsizing the limit of an existing sukuk programme which was issued based on the Previous *Bai` `Inah* Resolution, the following requirements are applicable:

¹ The previous SAC resolution in relation to the permissibility of *bai` `inah* in Islamic capital market was made in general term and did not address in detail on its implementation.

- (a) If there is provision for upsizing in the Principal Terms and Conditions (PTC) or the Details of the Sukuk Facility, the New *Bai` Inah* Resolution shall not be applicable even though the proposal for upsizing is considered as a new submission pursuant to the requirements under the Guidelines on Unlisted Capital Market Products under the Lodge and Launch Framework and the Guidelines on Issuance of Private Debt Securities and Sukuk to Retail Investors; and
- (b) If there is no provision for upsizing of the sukuk programme limit in the PTC or the Details of the Sukuk Facility, the New *Bai` Inah* Resolution shall be applicable to the proposal for upsizing of the sukuk programme.

IBRA'

INTRODUCTION

The SAC passed a resolution on *ibra'* in ICM transactions. However, the SAC has updated the resolution on *ibra'* to clarify on the application and scope of *ibra'* in ICM.

RESOLUTION

The SAC in a series of its meetings discussed in relation to the application of *ibra'* and its scope in the ICM. The SAC had resolved to update the resolution on *ibra'* comprising the scope and definition of *ibra'* and its application in ICM transactions as follows:

1 Definition of *Ibra'*

Ibra' refers to an act of releasing absolutely or conditionally one's rights and claims on any obligation against another party which would result in the latter being discharged of his/its obligation or liabilities towards the former. The release may be either partially or in full.

2 The Application of *Ibra'*

Ibra' may be applied in *`uqud mu`awadhat* including:

(a) *Murabahah* and *Musawamah*

Ibra' refers to release of rights on debts or amount due and payable under the said contract.

(b) *Ijarah*

Ibra' refers to release of rights on accrued rental.

In ICM transactions, *ibra'* may be applied in the following situations:

(a) Early redemption

- (i) Sukukholders may offer *ibra'* to the issuer based on the application made by the issuer for early redemption of sukuk upon occurrence of any event of default, call option, regulatory redemption, tax redemption, etc.
- (ii) The formula for the computation of early settlement may be stated as a guide to the issuer.
- (iii) The *ibra'* clause and the formula for the computation of early settlement may be stated in the main agreement of sukuk which is based on *`uqud mu`awadhat*. However, the *ibra'* clause in the main agreement shall be separated from the part related to the price of the transacted asset. The *ibra'* clause shall only be stated under the section for mode of payment or settlement in the said agreement.

(b) Other event(s)

Sukukholders may offer *ibra'* to the issuer in specific event(s) that requires them to release their rights and claims on any obligation, for example in the event of a write-off at the point of non-viability for Tier 2 sukuk based on Shariah principle of *murabahah*.¹

¹ For more details on this issue, please refer to the SAC resolution on "Waiver of Sukukholders' Right on the Capital and/or Any Payment Obligation in Additional Tier 1 Sukuk and Tier 2 Sukuk".

WA`D AND MUWA`ADAH

INTRODUCTION

The principles of *wa`d* and *muwa`adah* were discussed in a series of SAC meetings to seek its decision. Among the issues discussed on the aforementioned principles were:

- (i) Definition of *wa`d*;
- (ii) Binding effect of *wa`d*;
- (iii) Permissibility of *wa`d mulzim*;
- (iv) Implication of breach of *wa`d*;
- (v) Definition of *muwa`adah*;
- (vi) Binding effect of *muwa`adah*;
- (vii) Permissibility of *muwa`adah mulzimah*; and
- (viii) Implication of breach of *muwa`adah*.

RESOLUTION

The SAC had resolved on *wa`d* and *muwa`adah* as follows:

1 PRINCIPLE OF WA`D

(i) Definition of *Wa`d*

Wa`d is a promise by a person or a party to perform certain task in the future.

(ii) Binding Effect of *Wa`d*

Wa`d is *mulzim* (unilaterally binding) on the promisor if the *wa`d* is attached to any of the following:

- (a) A particular action which is done by a party including the promisee in the future;
- (b) A particular time or date; or
- (c) A particular situation which will occur in the future.

The bindingness of *wa`d* shall take effect at the time when the *wa`d* is expressed.

(iii) Permissibility of *Wa`d Mulzim*

Wa`d mulzim is permissible based on the view of *fuqaha'* that *wa`d* which is attached to conditions is binding. The types of conditions include a particular action, date/time and situation.

This ruling may clarify the types and categories of conditions attached to *wa`d* that lead to the binding effect of *wa`d*, especially in the financial instruments that involve promise to enter into contract that is attached to a particular date/time in the future.

(iv) Implication of Breach of *Wa`d*

The promisor who breaches his *wa`d* is liable to pay *ta`widh* based on actual loss suffered (if any) by the aggrieved promisee due to the breach of the *wa`d*.

PRINCIPLE OF *MUWA`ADAH*

(i) Definition of *Muwa`adah*

Muwa`adah is a bilateral promise between two persons or two parties to enter into a contract in the future.

(ii) Binding Effect of *Muwa`adah*

Muwa`adah is *mulzimah* (bilaterally binding) on the promisors if the *muwa`adah* is attached to any of the following:

- (a) A particular action which is done by a party including the promisee in the future;
- (b) A particular time or date; or
- (c) A particular situation which will occur in the future.

The bindingness of *muwa`adah* shall take effect at the time when the *muwa`adah* is expressed.

(iii) Permissibility of *Muwa`adah Mulzimah*

Muwa`adah mulzimah is permissible because *muwa`adah* is merely a promise and does not tantamount to a contract. Since the contract is yet to be entered into, it does not have the effect of a contract.

For example, when *muwa`adah* is expressed in relation to sale and purchase contract, there is no requirement on the delivery of the counter values between the respective promisors because the contract will only be entered into at a time which have been agreed in the future in the *muwa`adah* arrangement.

(iv) Implication of breach of *Muwa`adah*

The promisor who breaches his promise in the *muwa`adah* is liable to pay *ta`widh* based on the actual loss suffered (if any) by the aggrieved promisee due to the breach of the promise.

TAWARRUQ

INTRODUCTION

Tawarruq refers to purchasing a commodity or asset on deferred price and subsequently selling it to a third party at a lower price than the purchase price on cash basis. This mechanism is an alternative to avoid from dealing with *riba* via an interest-bearing loan. Hence, this issue has been discussed with the SAC whether Shariah allows *tawarruq* to be applied in Islamic capital market or not.

RESOLUTION

The SAC had resolved that *tawarruq* is permissible to be applied in Islamic capital market.

`AQD AL-TAWRID

INTRODUCTION

`Aqd al-tawrid is a modern trade contract that is widely discussed by contemporary scholars nowadays. It is one of the transaction contracts which is available and has become a *hajah* nowadays due to the rapid development of the current economic and trade sectors.

RESOLUTION

SAC had resolved that *`aqd al-tawrid* is permissible. The SAC resolutions on *`aqd al-tawrid* are as follows:

1 DEFINITION OF `AQD AL-TAWRID

`Aqd al-tawrid is a contract between customer/purchaser and supplier/seller for supply of goods or services where its features have been specified to be delivered to the customer/purchaser on certain period of time and at certain payment of price as agreed by the contracting parties. There are various forms of *`aqd al-tawrid* based on the need and agreement of the contracting parties. Usually the delivery and payment of goods or services will be made either upon execution of contract or at the end of the contract period either in lump sum or on instalment basis according to the stage of the delivery of goods, services or payment made respectively.

2 TA'JIL AL-BADALAIN IN `AQD AL-TAWRID

*Ta'jil al-badalain*¹ is permissible in *`aqd al-tawrid* subject to the following conditions:

- (i) There are specific terms in the contract on the period/date of delivery of goods or provision of services and payment of the price that have to be carried out on the specified time in the future.
- (ii) It shall be stated specifically in the contract in relation to the types, features, rates, period, price and place of delivery of goods or provision of services on the specified time.

3 GUARANTEE OF PAYMENT BY CUSTOMER

Guarantee of payment by customer/purchaser is permissible if the guarantee is Shariah-compliant based on *kafalah* principle. If guarantee based on *kafalah* principle cannot be procured from Islamic banks or *kafalah* provider, then conventional guarantee is allowed.

4 DELAY OR DEFAULT IN THE PAYMENT OF PRICE ON AGREED DATE

In the event of delay or default in the payment of price by customer/purchaser on the mutually agreed date, the supplier/seller is allowed to impose *ta`widh* on the customer/purchaser based on actual loss incurred either for late payment charge on non-judgement debt or late payment charge on judgement debt. The *ta`widh* charge can be recognised as income by the supplier/seller.

5 DELAY OR FAILURE IN DELIVERY OF GOODS OR SERVICES ON THE AGREED DATE

In the event of delay or failure in delivery of goods or services by the supplier/seller on the mutually agreed date, both contracting parties (i.e. the supplier/seller and

¹ Delivery of goods or preparation of services and the payment of the price are deferred to a future time.

the customer/purchaser) may agree to include a clause to impose a charge for delay or failure in delivery of goods or services (*syart jaza'i*) either:

- (i) upon the execution of *`aqd al-tawrid*; or
- (ii) throughout the contract provided that there has not been any delay or failure in delivery of goods or services by the supplier/seller on the mutually agreed date.

Both contracting parties must fulfill all conditions that have been agreed in *syart jaza'i* as long as the conditions set do not contradict with Shariah. The charge that could be imposed on the supplier/seller is subject to the agreement of both contracting parties and it is not subject to the actual loss borne by the customer/purchaser. The charge can be recognised as income by the customer/purchaser.

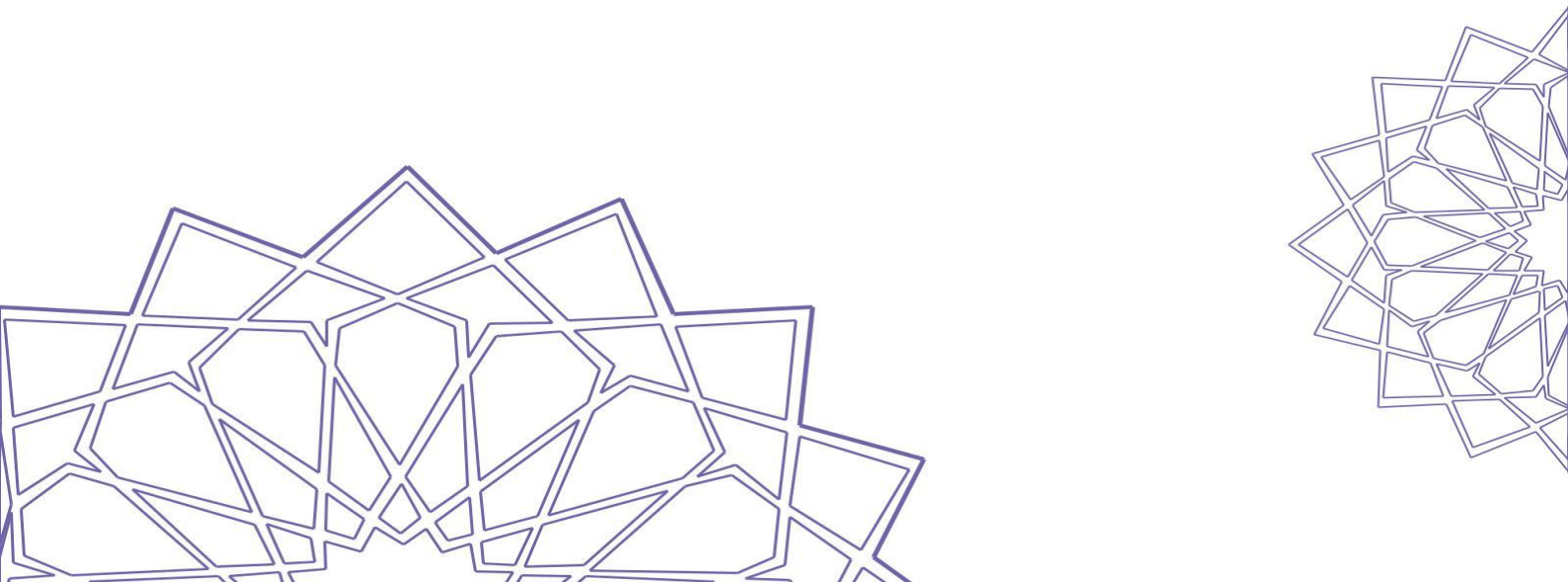
PART B

RESOLUTIONS

OF THE SHARIAH ADVISORY COUNCIL

OF THE SECURITIES COMMISSION MALAYSIA

**ISLAMIC CAPITAL MARKET PRODUCTS
FROM SHARIAH PERSPECTIVE**



NATURE OF SHARES

INTRODUCTION

Shares are units of ownership interest of the shareholders in a corporation or financial asset that provide for an equal distribution in any profits, if any are declared, in the form of dividends. The two main types of shares are ordinary shares and preferences shares.

Since shares are part of the capital market instruments, the SAC had discussed on it to determine the status or nature of shares from the perspective of asset category in Shariah whether it resembles currency, debt, *`ayn* of the company or an asset in its own category.

RESOLUTION

The SAC resolved that shares are asset which can be categorised as *mal mithli*¹ that represent the right of ownership of the shareholders in the company. Shares do not resemble currency, debt and *`ayn* of the company.

¹ *Mal mithli* refers to something that is easy to obtain in the market and is similar in physical form. Even if there are any differences, they are not too obvious and normally people do not take into consideration on those particular differences.

CRUDE PALM KERNEL OIL FUTURES CONTRACT (FPKO)

INTRODUCTION

Commodity futures contract refers to an agreement to buy or to sell commodity which has been fixed at a specified price and on specified date in the future. In Malaysia, among the commodity futures contracts which are traded in the market are Crude Palm Oil Futures (FCPO) and Crude Palm Kernel Oil Futures (FPKO).

The SAC had resolved that FCPO contract is one of the products that is Shariah-compliant. However, FPKO contract requires the determination of its Shariah-complaint status whether it is permitted by Shariah or not.

RESOLUTION

The SAC had resolved that FPKO contract is permissible because it complies with Shariah principles.

SINGLE STOCK FUTURES (SSFs) CONTRACT

INTRODUCTION

Single Stock Futures (SSFs) contract refers to future contract on selected individual stocks which are listed on Bursa Malaysia. Among the features of SSFs are as follows:

(i) Standardised contract

SSFs have a standard specification of contract as determined by Bursa Malaysia.

(ii) Exchange Traded

SSFs are traded and cleared on Bursa Malaysia.

(iii) Standard quantity for specific underlying asset

Each SSFs is equivalent to 1,000 units of shares of the underlying asset.

(iv) Expiry date of futures contract is predetermined earlier

SSFs expire on the last day of transaction on the contract month and are cash settled.

When a person buys or sells an SSFs contract, it is equivalent to buying or selling 1,000 units of shares that become the underlying asset for the said contract. The price of the SSFs contract for delivery or final settlement in the future when it reach the maturity date is based on mutual agreement by both parties upon purchasing or selling the SSFs contract. However, a person may close the SSFs contract which was bought or sold at any time before the contract matures.

Since the SSFs contract is one of the instruments that are traded on Bursa Malaysia, therefore this matter was presented to the SAC for decision on whether SSFs contract is permissible or not.

RESOLUTION

The SAC resolved that SSFs contract is in line with Shariah subject to the following conditions:

- (i) The underlying assets for the SSFs contract are Shariah-compliant shares as approved by the SAC.

- (ii) Investors are given the option to make a final settlement for the SSFs contract either through cash settlement or physical delivery of the underlying assets.

ISLAMIC BUSINESS TRUST

INTRODUCTION

Business trust is a unit trust scheme where the operation or management of the scheme and property scheme or asset are managed by a manager as a trustee. A business trust has specific features whereby among these features are as follows:

- (i) There is no restriction on the type of assets which a business trust may hold. The activities undertaken may be in respect of any property or asset and the investment mandate is usually narrow or focused;
- (ii) The property or asset is managed as a whole by a trustee-manager or by another person on behalf of the trustee-manager;
- (iii) There is no capital maintenance requirements; and
- (iv) There is no restriction to pay dividends out of accounting profits. The business trusts can pay distribution to investors out of operating cash flows, subject to solvency test.

Shariah requirements for the Islamic business trust were provided in the *Business Trusts Guidelines*. The provision in the *Business Trust Guidelines* was a result from the discussion with the SAC. Hence, the SAC had resolved certain Shariah requirements relating to Islamic business trust.

RESOLUTION

The SAC discussed issues relating to the Islamic business trust in a series of meetings. The SAC resolved that the requirements for the Islamic business trust are as follows:

- (i) It must be structured based on the approved Shariah principles and concepts or other Shariah principles and concepts approved by the SAC from time to time;
- (ii) At least three individual Shariah advisers must be appointed to form a Shariah Committee;
- (iii) The businesses or assets must be Shariah-compliant as determined by the Shariah adviser;
- (iv) The Shariah adviser may employ the SAC's Shariah screening methodology in determining the Shariah-compliant status of business activities;
- (v) The Shariah adviser must ensure that all forms of investment, deposit and financing instruments comply with Shariah principles and requirements; and
- (vi) Where the Islamic business trust intends to insure its assets or properties, it must procure the takaful scheme. If the takaful scheme is unable to provide the required and/or sufficient coverage, the Islamic business trust may procure conventional insurance scheme to ensure sufficient coverage of the same.

ISLAMIC EXCHANGE-TRADED FUND BASED ON GOLD AND SILVER

INTRODUCTION

Islamic exchange-traded fund based on gold and silver (Islamic ETF Gold and Silver) is an ETF which uses gold and silver (such as gold and silver bullions/bars) as the underlying asset. The Islamic ETF Gold and Silver units represent the unitholders' undivided ownership of the gold and silver on a pro-rata basis. The gold and silver will be held by the custodian during the tenure of the fund. Since this product involves *ribawi* item i.e. gold and silver as underlying asset, hence it was presented and discussed in the SAC meeting to seek their opinion on this matter.

RESOLUTION

The SAC, in a series of its meetings, discussed the issues relating to the Islamic ETF Gold and Silver. The SAC resolved that gold and silver (such as gold and silver bullions/bars) may be used as underlying asset for Islamic ETF. The SAC also resolved that the concept of Islamic ETF based on gold and silver are acceptable by *Syara`* and it is Shariah-compliant subject to the following conditions:

CONDITIONS FOR ESTABLISHMENT, STRUCTURING AND TRADING OF ISLAMIC ETF BASED ON GOLD AND SILVER AS THE UNDERLYING ASSET

- (i) The Islamic ETF units represent an equivalent amount of physical gold and silver held by the custodian on behalf of the Islamic ETF. Hence, the Islamic ETF units represent the unitholders' ownership of the gold and silver on a pro-rata basis. The creation and redemption of the Islamic ETF units must be backed by physical gold and silver with specified quantity and quality. Therefore, at the inception and

creation of the Islamic ETF units, the fund manager and Shariah adviser of the Islamic ETF Gold and Silver must verify that:

- (a) The gold and silver, with the correct quantity and quality as per the specification, are in existence;
 - (b) The gold and silver which forms the underlying assets for the creation of the Islamic ETF units are allocated and segregated; and
 - (c) The gold and silver can be delivered to the unitholders when they redeem the Islamic ETF units.
- (ii) The trading of the Islamic ETF units between the buyer and the seller must be carried out in cash and on spot basis¹.
- (iii) Since the trading of the Islamic ETF must be carried out on cash basis, the Islamic ETF units can only be traded if the buyers have cash accounts or margin facility (via third-party financing).
- (iv) The Shariah adviser of the Islamic ETF must provide detailed reasoning on the Shariah compliance of the Islamic ETF in the Shariah pronouncement on the following:
- (a) Structure, creation and redemption of the Islamic ETF units; and
 - (b) Trading of the Islamic ETF units in the secondary market.
- (v) The Shariah adviser of the Islamic ETF must conduct an annual audit (including a site visit to the place where the gold and silver are kept) to confirm its existence, quantity and other details such as record of its movement. This is to ensure that

¹ The current trading and settlement system of the stock exchange supports the spot transaction, even though settlement is only made on T+2 day. At the broker level, once an order is executed (T-day), the amount of money in the buyer's account will be transferred out for the payment to the seller and consequently the buyer no longer has rights to that amount of money. Thereafter, the number of units or shares will be transferred into the buyer's account. On T-day, the buyer has full ownership, resulting in him having all rights and liabilities pertaining to the units or shares. From the Shariah perspective, this constitutes constructive possession.

the Islamic ETF units created are backed by the actual gold and silver kept in the vault in a segregated and allocated manner.

- (vi) The Shariah adviser of the Islamic ETF must also prepare a report on the annual audit, to be included in the Shariah adviser's compliance report to the unitholders.
- (vii) The unitholders are entitled to redeem the Islamic ETF units in physical gold and silver or its equivalent in cash.

STAPLED SECURITIES

INTRODUCTION

Stapled securities refers to a situation where investors own two or more securities which are generally related to each other and contractually bound together through a single vehicle that cannot be traded separately. For example, shares of listed companies attached to the real estate investment trust (REIT) thus, becomes a new product.

In relation to stapled securities, a proposal from the industry has been presented to the SAC involving shares of a company that are classified as Shariah-compliant securities by the SAC. The shares are stapled with the units of Islamic real estate investment trust (Islamic REIT) and listed on Bursa Malaysia as “stapled securities” replacing the existing shares of the company.

RESOLUTION

The SAC resolved that in general, for any stapled securities to be classified as Shariah-compliant, each of the securities stapled must be Shariah-compliant.

ISSUANCE OF REDEEMABLE CONVERTIBLE UNSECURED ISLAMIC DEBT SECURITIES (RCUIDS) WITH FREE DETACHABLE WARRANTS BASED ON SHARIAH PRINCIPLE OF MURABAHAH (VIA TAWARRUQ ARRANGEMENT)

INTRODUCTION

The SAC deliberated on a proposed issuance of redeemable convertible unsecured Islamic debt securities (RCUIDS), together with free detachable warrants by a company listed on Bursa Malaysia, based on the Shariah principle of *murabahah* (via *tawarruq* arrangement).

DEFINITION OF RCUIDS

RCUIDS is a type of Islamic debt securities which is an alternative to its counterpart of conventional loan stocks. Basically, RCUIDS is redeemable, convertible and unsecured securities issued by a company in exchange for the financing by the investors.

RCUIDS is also a type of fixed income securities. The RCUIDS holders are deemed as the company's creditors rather than shareholders. Apart from that, the RCUIDS holders do not have any rights over the company other than rights to the repayment of the financing and the fixed profit according to the terms of issuance.

PURPOSE OF ISSUANCE

RCUIDS is issued as an alternative to obtain funding at a lower rate than a normal financing offered by banks or other financial institutions. The feature of RCUIDS which is convertible to mother shares of the company is intended to attract subscription by the existing shareholders. Apart from that, it is also an investment opportunity for the existing shareholders to gain better returns than a bank's fixed deposit.

FEATURES OF RCUIDS

Among the features of RCUIDS are as the follows:

- (1) **Redeemable:** It ensures that the company will fulfill its repayment obligation to the investors on the maturity date.
- (2) **Convertible:** It gives the rights to the investors to convert RCUIDS to ordinary shares of the issuing company.
- (3) **Unsecured:** This means that even if the investors are entitled to the payment of the fixed profit rate, they have no rights to the company's assets in the event that the company defaulted or goes into liquidation.

In relation to the proposed RCUIDS, there were few issues presented to the SAC for deliberation. These issues in deliberation were the following:

- (1) The status of the RCUIDS and warrants in the event of reclassification of the Shariah status of the issuer's securities from Shariah-compliant to Shariah non-compliant by the SAC, during the tenure of the RCUIDS; and
- (2) The options available for the RCUIDS holders in the event of the Shariah status reclassification of the issuer's securities from Shariah-compliant to Shariah non-compliant by the SAC, during the tenure of the RCUIDS.

RESOLUTION

The SAC had resolved the following:

- 1 **In the event the RCUIDS has been issued and no conversion has been made**

If the RCUIDS has yet to be converted into new shares of the issuer and the issuer's securities has been reclassified from Shariah-compliant to Shariah non-compliant by the SAC, the RCUIDS holders have the rights to do the following:

- (i) The RCUIDS holders have the discretion to convert the RCUIDS into new shares of the issuer. In the event the RCUIDS is converted into new shares of the issuer, then the guidance on timing for disposal of Shariah non-compliant securities as provided in the List of Shariah-Compliant Securities by the Shariah Advisory Council of the Securities Commission Malaysia (Guidance on Disposal of Shariah Non-Compliant Securities) may be applicable;
- (ii) The RCUIDS holders may sell the RCUIDS to third parties; or
- (iii) The RCUIDS holders may require the issuer to redeem the RCUIDS in cash based on a formula to be agreed between the issuer and the RCUIDS holders.

2 In the event that the RCUIDS has been issued and converted into new shares of the issuer

If the RCUIDS has been converted into new shares of the issuer and the issuer's securities have been reclassified from Shariah-compliant to Shariah non-compliant by the SAC, the Guidance on Disposal of Shariah Non-Compliant Securities may be applicable.

3 Warrants

If the warrants have not been exercised and the issuer's securities have been reclassified from Shariah-compliant to Shariah non-compliant, the Guidance on Disposal of Shariah Non-Compliant Securities may be applicable.

The above requirements must be disclosed in the disclosure documents pertaining to the issuance of the RCUIDS and the Shariah pronouncement.

The SAC further resolved that the above resolution is also applicable for any redeemable convertible secured instruments proposals which have similar convertibility features and structured based on the Shariah principle of *murabahah* (via *tawarruq* arrangement).

ISLAMIC SECURITIES SELLING AND BUYING-NEGOTIATED TRANSACTION (iSSB-NT) MODEL

INTRODUCTION

Islamic Securities Selling and Buying-Negotiated Transaction (iSSB-NT) Model is an alternative Shariah-compliant model to the conventional Securities Borrowing and Lending-Negotiated Transaction (SBL-NT) Model¹. The iSSB-NT Model is developed to address the needs to further grow the Shariah-compliant securities market in particular the Islamic exchange traded fund.

Among the issues in deliberation were on the permissibility of the proposed iSSB-NT Model which is structured based on two outright *bai`* transactions that includes the feature of *wa`dan*, *khiyar al-shar`*² and the provision of collateral as security for the indebtedness.

RESOLUTION

The SAC resolved that the proposed iSSB-NT Model is permissible.

¹ SBL is a term used to describe a transaction where securities are transferred from the owner (the lender) to another party (the borrower). The borrower is obliged to return the securities to the lender either on demand or at the end of the loan term. As a fully collateralised transaction, securities lending is considered a low-risk activity and it usually operates within a stringent legal and regulated framework.

² *Khiyar al-shar`* is an option to cancel a previous agreed sale within a specific number of days.

ISLAMIC REAL ESTATE INVESTMENT TRUSTS (ISLAMIC REIT)

INTRODUCTION

Real Estate Investment Trusts (REIT) or property trust fund refers to the unit trust scheme that invests or plans to invest in the real estate that generates income. It is one of the forms of collective investment related to the real estate that has quite similar characteristics with unit trust funds. Meanwhile, Islamic Real Estate Investment Trusts (Islamic REIT) refers to a form of collective investment related to real estate sector that complies with Shariah principles.

The function of REIT is to raise funds from the investors for the purpose of ownership in real estate (through purchase), and then generate main income from rental. REIT also gains income from the sale of real estate and investment. Usually REIT assets cover various real estate sectors such as offices, shopping malls, hospital, hotel and industrial buildings.

For investors, the return that they will get is in the form of dividend and capital gain. In addition, the investors will also get benefit from capital appreciation of real estate assets managed by Islamic REIT managers during the period of holding the units that leads to the increment in the value of the unit.

In order to enable consistent and comprehensive development of the Islamic REIT industry, the SAC has outlined certain Shariah requirements for the purpose of initial listing of the Islamic REIT. The SAC also considers the process that conforms to Shariah principles in the conversion of conventional REIT to Islamic REIT. The applied Shariah principles involve compliance in stages from conventional to Shariah compliance and it also involve certain benchmarks.

Hence, the issues with regard to Islamic REIT investment and the conversion of conventional REIT to an Islamic REIT were discussed in the SAC meeting for its decision.

RESOLUTION

The SAC had resolved on Islamic REIT as follows:

(A) INVESTMENT IN ISLAMIC REIT

In this context, the following requirements must be fulfilled:

1 Investments in Real Estate for the Purposes of Initial Listing

(i) Permissible Investment in Real Estate

An Islamic REIT may invest in real estate where:

- (a) all of its tenants carry out fully Shariah-compliant activities; or
- (b) some of the tenants carry out Shariah non-compliant activities, provided the percentage of rental received from all Shariah non-compliant activities¹ (Shariah Non-Compliant Rental) is less than 20% of the total turnover of the Islamic REIT (the 20% Threshold).

(ii) Investment in a Real Estate where All the Tenants Carry Out Fully Shariah Non-Compliant Activities

An Islamic REIT must not invest in a real estate where all tenants carry out fully Shariah non-compliant activities, even if the percentage of the Shariah Non-Compliant Rental is less than the 20% Threshold.

¹ List of the Shariah non-compliant activities as determined by the SAC were stated under Appendix 1.

(iii) Investment in a Real Estate where the Tenant’s Activities Comprise Both Shariah-Compliant and Shariah Non-Compliant Activities

If the tenant’s activities comprise both Shariah-compliant and Shariah non-compliant activities, the following requirements apply for the purposes of ensuring that the percentage of Shariah Non-Compliant Rental is less than the 20% Threshold:

- (a) The calculation of the Shariah Non-Compliant Rental must be based on the percentage of area occupied for Shariah non-compliant activities to the total area occupied by such tenant; and
- (b) For activities that do not involve the usage of space such as service-based activities, the Shariah adviser may apply *ijtihad* (intellectual reasoning) in assessing the Shariah Non-Compliant Rental for such tenant.

(iv) Reduction of the Percentage of Shariah Non-Compliant Rental

An Islamic REIT must reduce the percentage of the Shariah Non-Compliant Rental from less than the 20% Threshold to less than 5% of the Islamic REIT’s total turnover (the 5% Threshold) by the end of the 10th financial year post listing.

2 Acceptance of New Tenancy and Renewal of Existing Tenancy for Islamic REIT

(i) Acceptance of New Tenancy and Renewal of Existing Tenancy for Islamic REIT Up to the End of the 10th Financial Year

Prior to an Islamic REIT reaching the end of the 10th financial year post listing, the Islamic REIT may accept new tenants and renew tenancy agreements of existing tenants whose activities are Shariah non-compliant, subject to the following requirements:

(a) Comply with the 20% Threshold

The percentage of the Shariah Non-Compliant Rental after such acceptance of new tenants and renewal of existing tenants is less than the 20% Threshold; and

(b) Comply with the 5% Threshold

The Islamic REIT reduces the percentage of the Shariah Non-Compliant Rental to less than the 5% Threshold by the end of the 10th financial year.

(ii) Acceptance of New Tenants and Renewal of Existing Tenants for Islamic REIT after the End of the 10th Financial Year

(a) Comply with the 5% Threshold

After the end of the 10th financial year post listing, an Islamic REIT may accept new tenants and renew tenancy agreements of existing tenants whose activities are Shariah non-compliant, provided that the percentage of Shariah Non-Compliant Rental after such acceptance of new tenants and renewal of existing tenants is less than the 5% Threshold.

3 Acquisition of Real Estate Post Listing

(i) Acquisition of Real Estate by Islamic REIT Up to the End of the 10th Financial Year

Prior to an Islamic REIT reaching the end of the 10th financial year post listing, the Islamic REIT may acquire real estate subject to the following requirements:

(a) Comply with the 20% Threshold

The percentage of the Shariah Non-Compliant Rental after such acquisition is less than the 20% Threshold; and

(b) Comply with the 5% Threshold

The Islamic REIT reduces the percentage of the Shariah Non-Compliant Rental to less than the 5% Threshold by the end of the 10th financial year.

(ii) Acquisition of Real Estate by Islamic REIT after the End of the 10th Financial Year

(a) Comply with the 5% Threshold

After the end of the 10th financial year post listing, an Islamic REIT may acquire real estate provided that the percentage of the Shariah Non-Compliant Rental after such acquisition is less than the 5% Threshold.

(iii) Acquisition of Real Estate Where All the Tenants Carry Out Fully Shariah Non-Compliant Activities

An Islamic REIT must not acquire real estate where all tenants carry out fully Shariah non-compliant activities, even if the percentage of the Shariah Non-Compliant Rental after such acquisition is less than the 20% Threshold or less than the 5% Threshold, whichever applicable.

4 Non-Compliance with the Less than the 5% Threshold

In the event that an Islamic REIT fails to reduce the percentage of the Shariah Non-Compliant Rental to less than the 5% Threshold by the end of the 10th financial year pursuant to subparagraphs 1(iv), 2(i)(b) and 3(i)(b) above, the excess amount of the Shariah Non-Compliant Rental must be channelled to *baitulmal* or charitable bodies as advised by the Shariah adviser.

The excess amount must be channelled within 1 year from the end of each financial year for as long as the Islamic REIT is unable to reduce its Shariah Non-Compliant Rental to less than the 5% Threshold.

5 Takaful Coverage on Real Estate of an Islamic REIT

All real estate of an Islamic REIT must be covered by takaful scheme. However, if the takaful scheme is not available to cover the real estate or is not commercially viable, such real estate may be covered under conventional insurance.

If a real estate is already covered under an existing conventional insurance policy, the said insurance policy may still be used until its expiry. Once the insurance policy expires, such real estate must be covered by takaful scheme. However, if the takaful scheme is not available or is not commercially viable, such real estate may be covered under the conventional insurance.

6 Usage of Islamic Derivatives

In the situation where REIT may use derivatives instrument for the sole purpose of hedging the REIT's existing risk exposure, an Islamic REIT must use Islamic derivatives. However, if Islamic derivatives are not available or are not commercially viable, the Islamic REIT may use conventional derivatives subject to prior approval from the Shariah adviser being obtained.

7 Permissible Investments Other Than Real Estate and Financing Facilities for Islamic REIT

An Islamic REIT must ensure compliance with Shariah principles for the following:

- (i) Investments in non-real estate assets, deposits and money market instruments; and
- (ii) Financing facilities.

(B) CONVERSION OF CONVENTIONAL REIT TO AN ISLAMIC REIT

A listed conventional REIT may convert to an Islamic REIT provided that it complies with the following requirements:

1 Shariah Non-Compliant Rental

(i) Comply with 40% Threshold for Shariah Non-Compliant Rental

For the purpose of conversion of the conventional REIT to an Islamic REIT, the percentage of the Shariah Non-Compliant Rental must be less than 40% of the total turnover of the conventional REIT (the 40% Threshold) upon submission of information and documents to the SC.

(ii) Comply with Less than the 40% Threshold to the 20% Threshold

Upon conversion, the Islamic REIT must reduce the percentage of the Shariah Non-Compliant Rental to less than the 20% Threshold by the end of the 5th financial year post conversion.

(iii) Comply with Less than the 20% Threshold to the 5% Threshold

By the end of the 10th financial year post conversion, the Islamic REIT must further reduce the percentage of the Shariah Non-Compliant Rental to less than the 5% Threshold.

(iv) Investment in Real Estate Where All the Tenants Carry Out Fully Shariah Non-Compliant Activities

Notwithstanding paragraph (B)(1)(i) above, the Islamic REIT must not invest in a real estate where all the tenants carry out fully Shariah non-compliant activities, even if the percentage of the Shariah Non-Compliant Rental is less than the 40% Threshold.

2 Acceptance of New Tenants and Renewal of Existing Tenants for Islamic REIT Post Conversion

(i) Acceptance of New Tenants and Renewal of Existing Tenants for Islamic REIT Up to the End of the 5th Financial Year Post Conversion

Prior to an Islamic REIT reaching the end of the 5th financial year post conversion, the Islamic REIT may accept new tenants and renew tenancy agreements of existing tenants whose activities are Shariah Non-Compliant, subject to the following requirements:

(a) Comply with the Threshold less than the percentage of the Shariah Non-Compliant Rental At the Point of Conversion

The percentage of the Shariah Non-Compliant Rental after such acceptance of new tenants and renewal of existing tenants is less than the percentage of the Shariah Non-Compliant Rental at the point of conversion; and

(b) Comply with the 20% Threshold

The Islamic REIT reduces the percentage of the Shariah Non-Compliant Rental to less than the 20% Threshold by the end of the 5th financial year.

(ii) Acceptance of New Tenants and Renewal of Existing Tenants for Islamic REIT Up to the End of the 10th Financial Year Post Conversion

Prior to an Islamic REIT reaching the end of the 10th financial year post conversion, the Islamic REIT may accept new tenants and renew tenancy agreements of existing tenants whose activities are Shariah Non-Compliant, subject to the following requirements:

(a) Comply with the 20% Threshold

The percentage of the Shariah Non-Compliant Rental after such acceptance of new tenants and renewal of existing tenants is less than the 20% Threshold; and

(b) Comply with the 5% Threshold

The Islamic REIT reduces the percentage of the Shariah Non-Compliant Rental to less than the 5% Threshold by the end of the 10th financial year.

(iii) Acceptance of New Tenants and Renewal of Existing Tenants for Islamic REIT after the End of the 10th Financial Year Post Conversion

(a) Comply with the 5% Threshold

After the end of the 10th financial year post conversion, an Islamic REIT may accept new tenants and renew tenancy agreements of existing tenants whose activities are Shariah non-compliant. However, the percentage of Shariah Non-Compliant Rental after such acceptance of new tenants and renewal of existing tenants is less than the 5% Threshold.

3 Acquisition of Real Estate by an Islamic REIT Post Conversion

(i) Acquisition of Real Estate by an Islamic REIT Up to the End of the 5th Financial Year Post Conversion

Prior to an Islamic REIT reaching the end of the 5th financial year post conversion, the Islamic REIT may acquire real estate, subject to the following requirements:

(a) Comply with the Threshold Less than the Percentage of the Shariah Non-Compliant Rental at the Point of Conversion

The percentage of the Shariah Non-Compliant Rental after such acquisition of the real estate is less than the percentage of Shariah Non-Compliant Rental at the point of conversion; and

(b) Comply with the 20% Threshold

The Islamic REIT reduces the percentage of the Shariah Non-Compliant Rental to less than the 20% Threshold by the end of the 5th financial year.

(ii) Acquisition of Real Estate by an Islamic REIT Up to the End of the 10th Financial Year Post Conversion

Prior to an Islamic REIT reaching the end of the 10th financial year post conversion, the Islamic REIT may acquire real estate, subject to the following requirements:

(a) Comply with the 20% Threshold

The percentage of the Shariah Non-Compliant Rental after such acquisition is less than the 20% Threshold; and

(b) Comply with the 5% Threshold

The Islamic REIT reduces the percentage of the Shariah Non-Compliant Rental to less than the 5% Threshold by the end of the 10th financial year post conversion.

(iii) Acquisition of Real Estate by an Islamic REIT after the End of the 10th Financial Year Post Conversion

(a) Comply with the 5% Threshold

After the end of the 10th financial year post conversion, an Islamic REIT may acquire real estate, provided that the percentage of Shariah Non-Compliant Rental is less than the 5% Threshold.

Note: For the purpose of calculation of the financial year on the conversion of the conventional REIT to an Islamic REIT, the calculation of the 1st financial year shall commence on the next financial year after the deed to effect the conversion has been registered with the SC.

(iv) Acquisition of Real Estate Where All the Tenants Carry Out Fully Shariah Non-Compliant Activities

Notwithstanding paragraphs (B)(3)(i), (ii) and (iii) above, an Islamic REIT must not acquire real estate in which all the tenants carry out fully Shariah non-compliant activities, even if the percentage of the Shariah Non-Compliant Rental after such acquisition is less than the respective thresholds mentioned in the said paragraphs.

4**Non-Compliance with the Reduction to Less than the 20% Threshold or the 5% Threshold**

In the event that an Islamic REIT fails to reduce the percentage of the Shariah Non-Compliant Rental to less than the 20% Threshold or the 5% Threshold, whichever applicable, the excess amount of the Shariah Non-Compliant Rental must be channelled to *baitulmal* or charitable bodies as advised by the Shariah adviser. The excess amount must be channelled within 1 year from the end of each financial year for as long as the Islamic REIT is unable to reduce its Shariah Non-Compliant Rental to less than the 20% Threshold or the 5% Threshold, whichever applicable.

5**Borrowings for Conventional REIT**

For the purpose of conversion to an Islamic REIT, a listed conventional REIT which has existing conventional borrowings must, as soon as practicable, refinance such borrowings with Islamic financing facilities.

6**Takaful Coverage on Real Estate at the Point of Conversion**

At the point of conversion, where a real estate is already covered under an existing conventional insurance policy, the said conventional insurance policy may still be used until its expiry. Once the policy expires, such real estate must be covered by *takaful* scheme. However, if the *takaful* scheme is not available or is not commercially viable, such real estate may be covered under the conventional insurance.

7 Usage of Islamic Derivatives

Upon conversion, the Islamic REIT may continue to use its existing conventional derivatives. However, all new derivatives for the purpose of hedging the REIT's existing risk exposure must be Islamic derivatives.

If Islamic derivatives are not available or are not commercially viable, an Islamic REIT may use conventional derivatives subject to prior approval from the Shariah adviser being obtained.

8 Permissible Investments other than Real Estate

At the point of conversion, all investments in non-real estate assets, deposits and money market instruments must comply with Shariah principles.

Appendix 1

- (i) Conventional banking and lending;
- (ii) Conventional insurance;
- (iii) Gambling;
- (iv) Liquor and liquor-related activities;
- (v) Pork and pork-related activities;
- (vi) Non-halal food and beverages;
- (vii) Tobacco and tobacco-related activities;
- (viii) Stockbroking or share trading in Shariah non-compliant securities;
- (ix) Shariah non-compliant entertainment; and
- (x) Other activities deemed non-compliant according to Shariah principles as determined by the SAC.

SHARIAH-COMPLIANT PREFERENCE SHARES

INTRODUCTION

Issuance of preference shares (PS) is one of the methods for a company to raise capital and obtain funding. Based on the provision in Section 2(1) of the Companies Act 2016, preference shares are defined as follows:

“a share by whatever name called, which does not entitle the holder to the right to vote on a resolution or to any right to participate beyond a specified amount in any distribution whether by way of dividend, or on redemption, in a winding up, or otherwise”.

As an alternative to the existing conventional PS in the market, there are efforts by companies listed on Bursa Malaysia Securities Berhad (Bursa Malaysia) to issue PS that complies with the principles of Shariah.

In order to ensure that the PS that will be issued in the market complies with the principles of Shariah, the SAC had comprehensively discussed the features of PS as well as issues related to PS from Shariah perspective. The resolutions made by the SAC also took into account the current practice of issuing PS in Malaysia and the relevant legal provisions in the Companies Act 2016.

If there are new proposals from the industry on Shariah-compliant PS based on other Shariah principles which are not prescribed in this resolution, the SAC will consider the suitability of such principle to be applied in Shariah-compliant PS.

RESOLUTION

SAC in a series of meetings had discussed the features of PS and its related Shariah issues. The SAC had resolved on the following resolutions on Shariah-compliant PS which are applicable for the issuance of Shariah-compliant PS by companies listed on Bursa Malaysia.

(A) Shariah Principle and Related Matters

1 Shariah Principle Applied in Shariah-compliant PS

(a) *Takyif Fiqhi* (Adaptation of *Fiqh*)

The appropriate *takyif fiqhi* for Shariah-compliant PS is the principle of *musharakah*.

(b) Contracting Parties in *Musharakah*

- (i) *Musharakah* in Shariah-compliant PS is between PS holders and ordinary shares (OS) holders where both parties contribute capital to the company.
- (ii) PS holders are treated as new *musharik* (partner) in the existing *musharakah* (i.e. *musharakah* among OS holders), whereby they invest in an existing *musharakah* venture (i.e. general business of the same company). PS holders are subject to different terms as compared to OS holders.

(c) Execution of the *Musharakah* Contract

The execution of the *musharakah* contract in PS is done through subscription of the PS by the PS holders after they have agreed to the terms and conditions in the relevant document of the PS.

2 Entitlement of PS Holders to Dividend up to the Declared Profit

From Shariah perspective, it is permissible for PS holders to receive dividend up to the declared profit by the company based on the concept of *taradhi* (mutual consent).

3 Implementation of Waiver of Right in PS

(a) Waiver of Right by the OS holders to the PS holders

Waiver of right by the OS holders to the PS holders may be implemented through several mechanisms in the following events:

(i) Distribution of Dividend

(aa) *Tanazul*

The OS holders waive their right to receive dividend after profit is realised by giving preference to the PS holders. *Tanazul* takes place via ratification by the Board of Directors of the company based on the mandate given by the OS holders.

(bb) *al-Wa`d bi al-Hibah*

The OS holders promise to waive their right through *hibah* to receive dividend after profit is realised by giving preference to the PS holders. *Hibah* contract takes place via ratification by the Board of Directors of the company based on the mandate given by the OS holders.

(ii) Dissolution or Winding-up of Company

(aa) *Tanazul*

The OS holders waive their right to receive any amount pursuant to the dissolution or winding-up of the company by giving preference to the PS holders. *Tanazul* takes place via ratification by the Board of Directors of the company based on the mandate given by the OS holders.

(bb) *al-Wa`d bi al-Hibah*

The OS holders promise to waive their right through *hibah* to receive any amount pursuant to the dissolution or winding-up of the company by giving preference to the PS holders. *Hibah* contract takes place via ratification by the Board of Directors of the company based on the mandate given by the OS holders.

(b) Waiver of Right by the PS holders to the OS holders

Waiver of right by the PS holders to the OS holders may be implemented through *tanazul* principle in the following situations:

(i) Dividend Declared by the Company in Excess of the Expected Dividend Rate

The PS holders waive their right to receive dividend in excess of the expected rate once the profit is realised.

(ii) Partially-participating PS

The PS holders waive their right to participate entirely in the excess profit on a pro-rata basis and will only be entitled to receive the dividend up to the rate stipulated in the terms of the PS issuance.

(iii) Zero dividend PS

The PS holders waive their right to receive dividend during the tenure of the PS issuance.

(B) Features of PS

1 Voting Right

PS holders are not entitled to the voting right as provided under the Companies Act 2016. From Shariah perspective, it is permissible since PS holders have agreed to such arrangement during subscription of PS.

2 Dividend

(a) Types of Dividend Distribution

The company will offer certain dividend rate that will be received by the PS holders every year. Such rate is known as expected preferential dividend rate. However, the rate is indicative and can only be declared out of available profits of the company on condition that the company is

solvent¹ as provided under the Companies Act 2016. The dividend distribution shall be made based on the approval given by the Board of Directors of the company.

In general, there are three (3) types of dividend distribution or payment that are permissible from Shariah perspective as follows:

(i) Cumulative Dividend

PS with cumulative dividend feature refers to PS where its dividend rate (partly or wholly) will be carried forward to the following years and accumulated until its maturity date or as long as the PS is not redeemed. This happens when the company could not or did not declare the dividend on the specified dividend distribution date. The rate that can be accumulated and carried forward is as follows:

- (aa) Up to the expected preferential dividend rate; or
- (bb) Difference between dividend paid and expected preferential dividend rate.

However, the amount of dividend to be paid is subject to the availability of profit and declared by the company on the financial year of the dividend payment. If there is no available profit on the maturity or redemption date of PS, the company will not declare any dividend and will not pay such accumulated dividends to PS holders.

(ii) Non-cumulative Dividend

PS with non-cumulative dividend feature refers to PS where its undeclared dividend rate are not accumulated or carried forward. The company is only required to pay the dividend declared in the current year to PS holders.

¹ Section 132 (3) of the Companies Act 2016 provides that a company is regarded as solvent if the company is able to pay its debts as and when the debts become due within twelve months immediately after the distribution is made.

(iii) Zero Dividend

PS with zero dividend feature refers to PS that do not distribute any dividend to its holders. Nevertheless, usually for issuance of this type of PS, the company will offer certain incentives to attract investors to subscribe such PS.

From Shariah perspective, as long as such incentives do not have the element of capital and/ or profit guarantee by the contracting parties, it is permissible. Among the incentives allowed include but not limited to the following:

- (aa) Determination of certain redemption method that is subject to the SAC resolution in relation to redemption of PS;
- (bb) Determination of certain conversion method that is subject to the SAC resolution in relation to conversion of PS;
- (cc) Offering of discount on the issue price of the PS; and
- (dd) Offering of detachable company warrants.

(b) Distribution of Dividend at a Lower Rate than the Available Profit

In the event that the available profit earned by the company is lower than the expected dividend rate, the distribution of dividend to PS holders at a lower rate than the available profit earned is permissible based on the terms and conditions of the PS that has been agreed upon the subscription of PS.

3

Participating PS

PS with participating feature refers to the right of PS holders to participate in the surplus profit of the company after the distribution of dividend is made. This type of PS is divided into three (3) categories as follows:

(a) Non-participating

In general, PS is considered as non-participating unless otherwise stated clearly in the terms of issuance of PS. Non-participating PS

holders are not entitled to participate in the surplus profit earned by the company.

(b) Partially-participating

PS holders and OS holders will participate in the surplus profit earned by the company after the distribution of dividend is made between them. However, the participation of PS holders in the surplus profit is only limited to a rate that has been set out in the terms and conditions of the PS issuance.

(c) Fully-participating

PS holders and OS holders will participate in the surplus profits earned by the company on a pro-rata basis after the distribution of dividend is made between them.

From Shariah perspective, all three (3) categories of PS as stated above are permissible.

4

Conversion

(a) Convertible PS

This type of PS entitles its holders the right or option to convert the PS to OS. From Shariah perspective, this type of PS is permissible based on the concept of *istبدال* (substitution).

Among the conversion methods which are permissible include but not limited to the following:

- (i) Conversion ratio;
- (ii) Conversion ratio and conversion price; and
- (iii) Cash paid for the difference between the PS surrendered and the conversion ratio.

Conversion method used must be agreed by the contracting parties and has no element of capital guarantee by the company to PS holders, such

as the price of OS to be received must be subjected to the market value at the point of conversion.

(b) Non-Convertible PS

This type of PS cannot be converted to OS. From Shariah perspective, this type of PS is permissible.

5 Redemption

(a) Redeemable PS

This type of PS can be redeemed by the company or PS holders at a specified date. This type of PS entitles its holders and the company the right or option to determine the redemption method (either partly or wholly). The same would be applicable in determining the parties that can opt to redeem the PS (either PS holders or company).

From Shariah perspective, this type of PS is permissible based on the terms and conditions of the PS which have been agreed upon during subscription of PS. The redemption of PS can be executed through purchase and sale undertakings as long as it does not guarantee the capital and/ or profit of PS holders.

For sale undertaking, any redemption method can be determined based on the agreement by the contracting parties. Meanwhile for purchase undertaking, the redemption method that can be implemented is limited to the following:

- (i) Redemption of PS based on the market value of PS on the redemption date;
- (ii) Redemption of PS based on the current performance of the company; or
- (iii) Redemption of PS through ratification by the Board of Director of the company.

For PS with cumulative dividend feature, the redemption price of PS can only take into account the available profit made by the company at the

time when the redemption is made and the dividend rate that has been declared but unpaid to PS holders.

(b) Non-Redeemable PS

This type of PS cannot be redeemed by the company or PS holders either before or on the maturity date of such PS. From Shariah perspective, this type of PS is permissible.

6 Dissolution or Winding-up of the Company

PS holders will get preference as compared to OS holders in the distribution of company's asset or any amount upon the occurrence of dissolution or winding-up of the company based on the mechanism of waiver of rights as resolved by the SAC in item (A)(3) above.

The determination of the company's dissolution or winding-up formula which have been agreed upon the subscription of PS through disclosure in the terms and conditions of the PS is permissible.

(C) Other Related Matters

1 Shariah Status of PS where its underlying shares are Shariah-compliant

The underlying shares of PS must be classified as Shariah-compliant securities.

2 Utilisation of PS Proceeds

Proceeds from PS issuance must be utilised for Shariah-compliant purposes only.

3 Change of Shariah-compliant Status for Securities of Company related to PS

If the securities of a company are re-classified as Shariah non-compliant by the SAC, the status of PS for such company is also classified as Shariah non-compliant.

Therefore, the PS holders of the company are entitled to dispose such PS or OS (after the conversion to OS is made) by following the guide on the timing for the disposal of securities that have been classified as Shariah non-compliant securities by the SAC.

In the event of redemption, PS holders may also request the company to redeem such PS that has changed status to Shariah non-compliant subject to the SAC resolution in relation to redemption of PS.

4 SAC Endorsement on Shariah-compliant Status of PS

For PS issuers that would like to obtain the status of Shariah-compliant PS, such PS must obtain the endorsement from the SAC.

PART B

RESOLUTIONS

OF THE SHARIAH ADVISORY COUNCIL

OF THE SECURITIES COMMISSION MALAYSIA

**SHARIAH ISSUES IN RELATION TO THE
ISLAMIC CAPITAL MARKET**

IJARAH MUDHAFAH ILA MUSTAQBAL

INTRODUCTION

Ijarah mudhafah ila mustaqbal refers to an *ijarah* contract in respect of existing asset whereby upon execution of the *ijarah* contract, both contracting parties (asset owner and lessee) agreed that the delivery of the usufruct of the leased asset will take effect on a specified future date. It differs from *ijarah mawsufah fi zimmah*, among others, in terms of existence of the *ijarah* asset. In *ijarah mawsufah fi zimmah*, the *ijarah* asset that will be leased to the lessee is yet to exist upon execution of the *ijarah* contract, while in *ijarah mudhafah ila mustaqbal*, the *ijarah* asset that will be leased to the lessee already exist when the *ijarah* contract is executed. This *ijarah* principle and its related issues were presented to the SAC for their decision.

RESOLUTION

The SAC had resolved that *ijarah mudhafah ila mustaqbal* is a permissible contract. The SAC had also resolved several issues related to such *ijarah* contract as follows:

1 Lease Period

The lease period in *ijarah mudhafah ila mustaqbal* shall be clearly specified in the *ijarah* contract. The lease period does not commence from the date of execution of the *ijarah* contract but it commence on a future date as mutually agreed between the contracting parties.

2 Lease Payment Method

The lease payment method in *ijarah mudhafah ila mustaqbal* shall be based on the agreement made between the contracting parties.

Failure of the Asset Owner to Deliver the *Ijarah* Asset

If the asset owner fails to deliver the *ijarah* asset to the lessee on the agreed time as specified in the *ijarah* contract whereas the lessee has already made rental payment on the date as stipulated in the *ijarah* contract, the asset owner shall therefore:

- (i) Reduce the rental payment for the entire lease period based on the amount paid by the lessee;
- (ii) Extend the lease period based on the amount paid by the lessee; or
- (iii) Comply with the terms other than the aforementioned Items (i) and (ii) as mutually agreed by the contracting parties.

IJARAH MAWSUFAH FI ZIMMAH

INTRODUCTION

Ijarah mawsufah fi zimmah refers to an *ijarah* contract in respect of an asset which will exist in the future. This *ijarah* principle and its related issues were presented to the SAC for their decision.

RESOLUTION

The SAC had resolved that *ijarah mawsufah fi zimmah* is permissible. The SAC had also resolved the following issues:

1 Components in *Ijarah Mawsufah Fi Zimmah* Contract

In *ijarah mawsufah fi zimmah* contract, there are several components that shall be specified clearly as follows:

- (i) The rate of lease;
- (ii) The specification of the asset to be leased;
- (iii) The lease period; and
- (iv) The method of lease payment.

All of the components above shall be mutually agreed between the contracting parties based on the agreement made by them.

2 Failure to Fulfill the Required Specification

If the leased asset delivered to the lessee does not fulfill the required specification, the lessee has the following rights:

- (i) To ask the lessor to replace the asset with other asset which fulfills the agreed specification; or

- (ii) To terminate the *ijarah* contract and if the lessee has made the advance rental payment, the lessor shall refund the advance rental payment to the lessee.

IJARAH MUNTAHIYAH BI TAMLIK

INTRODUCTION

The mechanism of *ijarah muntahiyah bi tamlik* relates to the concept of finance lease. It is a Shariah principle which begins with an *ijarah* contract and ends with a transfer of ownership of the asset to the lessee at the end of the *ijarah* contract either via sale and purchase transaction or *hibah*. This principle is different from the original *ijarah* principle (operating lease) which involves the leasing of usufruct of the asset only and does not involve any transfer of ownership of the leased asset to the lessee at the end of the lease period.

There were several Shariah issues related to the contract of *ijarah muntahiyah bi tamlik* as follows:

- (i) Whether the principle of *wa`d* to sell or to give the *ijarah* asset as *hibah* at the end of the lease period is binding on one party in the contract only?; and
- (ii) How does the transfer of ownership of the *ijarah* asset be effected in the contract of *ijarah muntahiyah bi tamlik*?

These issues were presented to the SAC for their decision.

The SAC resolved several issues related to the contract of *ijarah muntahiyah bi tamlik* as follows:

1 Whether the principle of *wa`d* to sell or to give *ijarah* asset as *hibah* at the end of the lease period is binding on one party in the contract only?

The *wa`d* to sell or give the *ijarah* asset as *hibah* at the end of the lease period shall be unilaterally binding on the promisor only.

2 How does the transfer of ownership of the *ijarah* asset be effected in the contract of *ijarah muntahiyah bi tamlik*?

The transfer of ownership of the *ijarah* asset in the contract of *ijarah muntahiyah bi tamlik* may be affected via any one of the following manners:

- (i) By way of promise to sell the *ijarah* asset in the future. The sale and purchase contract shall be executed separately at the end of the lease period.
- (ii) By way of promise to give the *ijarah* asset as *hibah* in the future. The *hibah* may be effected during or at the end of the lease period and it shall be executed in a new contract separately.
- (iii) By way of *hibah* contract provided that the lessee has fully paid the installment of the rental payment. The *hibah* contract may be executed on the same date with the *ijarah* contract but it shall be executed in separate agreement. The transfer of ownership of the *ijarah* asset shall be affected automatically upon fulfillment of the stipulated conditions in *hibah* contract.

SUBLEASE

INTRODUCTION

Sublease of an *ijarah* asset refers to the following situations:

- (i) Sublease of the *ijarah* asset by the lessee to a third party; and
- (ii) Sublease of the *ijarah* asset by the lessee to the owner of the asset.

These two issues were presented to the SAC for their decision.

RESOLUTION

The SAC resolved issues in relation to subleasing of an *ijarah* asset as follows:

1 Sublease of the *Ijarah* Asset by the Lessee to a Third Party

The lessee may sublease the *ijarah* asset to a third party provided that:

- (i) there is no objection from the owner of the asset and the lessee has the right over the usufruct of the asset; and
- (ii) the sublease period does not exceed the period of the initial or primary lease.

2 Sublease of the *Ijarah* Asset by the Lessee to the Owner of the Asset

The lessee may lease back the *ijarah* asset to the owner of the asset provided that the sublease period does not exceed the period of the initial or primary lease.

IMPLIED SUBLEASE

INTRODUCTION

Implied sublease refers to a situation where if an *ijarah* asset that is still being leased out is sold to a third party, then implied sublease will exist on the existing *ijarah* contract between the original owner of the asset and the existing lessee. Upon completion of the sale and purchase transaction of the asset, if the third party who purchase the asset subleases the asset back to the seller (i.e the original owner of the asset), the *ijarah* contract which is executed between them will be considered as the head lease. Meanwhile, the existing *ijarah* contract between the original owner of the asset and the existing lessee will be considered as implied sublease. Hence, question arises on whether such kind of transaction is permissible or not according to Shariah.

RESOLUTION

The SAC had resolved that implied sublease is permissible.¹ The SAC also had resolved on the following issues which are related to implied sublease:

1 Notification to the Existing Lessee

If the original owner of an *ijarah* asset that is still being leased out wants to sell the said asset to the third party, the original owner must provide prior written notification to the existing lessee in relation to the sale of the *ijarah* asset. The notification provided does not terminate the existing *ijarah* contract between the original owner of the *ijarah* asset and the existing lessee.

¹ This SAC resolution has also taken into account the SAC resolution on Sublease, where relevant.

If the asset purchased by the third party is leased back to the original owner of the asset (i.e the seller), the new *ijarah* contract which was executed between them will be considered as the head lease. Meanwhile, the existing *ijarah* contract between the original owner of the asset and the existing lessee will be considered as implied sublease.

ASSET AND USUFRUCT AS MAHAL AL-'AQD IN IJARAH CONTRACT

INTRODUCTION

Ijarah is one of the contracts recognised by Shariah. It is a contract between a lessor and a lessee to own usufruct of an asset which is permissible by Shariah for a specified period with a specified rental payment. In order for an *ijarah* contract to be Shariah-compliant, it must fulfill the pillars and requirements of *ijarah* such as the contracting parties (lessor and lessee), rental payment, *mahal al-'aqd* (asset and usufruct that forms the subject matter of lease) and *sighah* [the expression of offer (*ijab*) and acceptance (*qabul*)]. This issue was deliberated in the SAC meeting with the focus to discuss the extent of how an asset and usufruct can be used as *mahal al-'aqd* in an *ijarah* contract. The issue was presented to the SAC for their decision.

RESOLUTION

The SAC resolved several issues in relation to *mahal al-'aqd* for an *ijarah* contract as follows:

1 Forms of Asset and Usufruct that can be Leased

- (i) Tangible asset, such as house; and
- (ii) Intangible asset, such as rights (e.g. right of intellectual properties) and usufruct (e.g. usufruct of an asset).

2 Conditions of *Ijarah* Asset

- (i) *Ijarah* asset shall be fully owned by the owner of the asset;
- (ii) *Ijarah* asset shall be clearly identified; and

- (iii) *Ijarah* asset shall maintain its substance (non-perishable) even after the usufruct is used.

3

Conditions for the Usage of *Ijarah* Asset

- (i) The usage of the *ijarah* asset shall be in accordance with Shariah;
- (ii) The lessee shall use the *ijarah* asset in line with what was mutually agreed in the contract;
- (iii) The lessee shall obtain prior approval from the lessor if it intends to use the *ijarah* asset for other than what has been mutually agreed upon; and
- (iv) If the purpose of the usage of the *ijarah* asset is not specified in the *ijarah* contract, the lessee may use the *ijarah* asset for any purpose which is permitted in accordance with *`urf*.

MAINTENANCE OF IJARAH ASSET

INTRODUCTION

Ijarah asset is owned by the lessor while the lessee only owns the usufruct of that asset. Consequently, the lessee is entitled to the usage of the usufruct of the asset within the lease period as has been mutually agreed between the contracting parties. When there is damage to the *ijarah* asset, the following questions arise:

- (i) Whether the lessor is solely liable for the maintenance and repair of the *ijarah* asset including to bear its cost; or
- (ii) Whether the lessee is jointly liable with the lessor (depending on the types or forms of damage) for the maintenance of the *ijarah* asset and to bear its cost.

Therefore, these issues were presented to the SAC for their decision.

RESOLUTION

The SAC had resolved several issues relating to the maintenance of the *ijarah* asset as follows:

1 Maintenance of an *Ijarah* Asset to be Jointly Borne by Lessor and Lessee

Primarily, the lessor is responsible for maintenance which involves the fundamental structure of the *ijarah* asset. Meanwhile, the lessee is responsible for the operational maintenance such as the maintenance to ensure the sustainability of the *ijarah* asset. However, maintenance of *ijarah* asset may also be determined based on the agreement of the contracting parties (i.e. the lessor and the lessee) based on the terms and conditions as specified in the *ijarah* contract.

2 Assignment by the Lessor for the Lessee to Bear the Costs of Maintenance Which Involves the Fundamental Structure of the *Ijarah* Asset

Any maintenance in relation to the fundamental structure of the *ijarah* asset which is basically the responsibility of the lessor may be assigned to the lessee. Accordingly, the lessee shall be entitled to claim for reimbursement on the costs incurred for such maintenance of the *ijarah* asset from the lessor.

3 Maintenance of the *Ijarah* Asset Due to the Lessee's Negligence

The lessee shall be liable for the maintenance of the *ijarah* asset which results from his negligence or intentional action. In relation to this, the lessee is required to substitute or repair the damaged *ijarah* asset or pay compensation for such damage according to the agreement between the contracting parties.

TAKAFUL OR CONVENTIONAL INSURANCE COVERAGE OVER THE IJARAH ASSET

INTRODUCTION

The issue concerning whether to use *takaful* or conventional insurance coverage over the underlying asset of an *ijarah* contract should be given proper attention. This is due to the reason that it involves the following issues:

- (i) Whether an *ijarah* asset can be covered by conventional insurance?;
- (ii) Whether the owner of the asset is liable for the cost of maintaining *takaful* or conventional insurance coverage over the *ijarah* asset?;
- (iii) What should the owner of the asset do if the existing *ijarah* asset is still under the coverage of conventional insurance upon execution of the *ijarah* contract?; and
- (iv) Is it permissible for the owner of the *ijarah* asset to obtain compensation from *takaful* or conventional insurance if the *ijarah* asset which was covered by *takaful* or conventional insurance suffers damage?

Therefore, the above issues were presented to the SAC for their decision.

RESOLUTION

The SAC had resolved these issues regarding the coverage of *takaful* or conventional insurance over the *ijarah* asset as follows:

1 Whether the *ijarah* asset can be covered by conventional insurance?

An *ijarah* asset shall be covered by *takaful* coverage. However, if the *takaful* company does not have the capacity for such coverage or if the *takaful* coverage

is not commercially viable, the *ijarah* asset may be covered by conventional insurance.

2 Whether the owner of the asset is liable for the costs of maintaining *takaful* or conventional insurance coverage over the *ijarah* asset?

The owner of the asset shall be liable for the costs of maintaining *takaful* or conventional insurance coverage over the *ijarah* asset. This is based on the owner's liability to ensure that his asset is protected. However, the owner may appoint the lessee to obtain *takaful* or conventional insurance coverage on his behalf and the lessee may claim for reimbursement for the costs incurred.

3 What should the owner of the asset do if the existing *ijarah* asset is still under the coverage of conventional insurance upon execution of the *ijarah* contract?

The conventional insurance coverage may continue to be maintained until maturity. After the maturity of the conventional insurance, the owner shall obtain *takaful* coverage upon renewal of coverage over the *ijarah* asset by taking into account the aforementioned item (1).

4 Is it permissible for the owner of the *ijarah* asset to obtain compensation from *takaful* or conventional insurance if the *ijarah* asset which was insured by *takaful* or conventional insurance suffers damage?

If the *ijarah* asset which was covered by *takaful* or conventional insurance suffers damage, the owner of the asset can obtain compensation from *takaful* or conventional insurance.

LEASING OF IJARAH ASSET BY THE OWNER TO A THIRD PARTY

INTRODUCTION

Leasing of *ijarah* asset by the owner to a third party is referring to a situation where the owner who has leased out the *ijarah* asset to a particular lessee simultaneously leases out the same *ijarah* asset to a third party. The issue is whether it is permissible for the owner to do so. Therefore, this issue was presented to the SAC for their decision.

RESOLUTION

The SAC had resolved that the owner of the *ijarah* asset could not lease the *ijarah* asset to a third party if the *ijarah* asset is currently being leased out to a particular lessee.

FORMS AND MECHANISMS OF RENTAL PAYMENT IN IJARAH CONTRACT

INTRODUCTION

Ijarah is a form of *`uqud mu`awadhat* that involves exchange of usufruct of an asset with rental payment made according to certain method. In this context, an issue was raised as to the applicable forms and mechanisms of rental payment that can be used in an *ijarah* contract.

RESOLUTION

The SAC had resolved that the rental payment must be clearly determined at the inception of an *ijarah* contract. Among the forms of rental payment are as follows:

- (i) Cash;
- (ii) In-kind, such as goods that can be weighed and measured, animals or business items;
- (iii) Usufruct; and
- (iv) Service.

Meanwhile, the mechanisms of rental payment may be done based on mutual agreement of the contracting parties via the following manners:

- (i) Lump sum payment at the inception of the *ijarah* contract;
- (ii) Lump sum payment at the end of the lease period; or
- (iii) Payment on monthly or annual basis or at such other intervals.

DETERMINATION OF RENTAL RATE BASED ON FIXED AND/OR FLOATING RATE IN SUKUK IJARAH

INTRODUCTION

Normally the rental rate of an asset is determined based on a fixed rate. However, the rental rate based on the floating rate may be applied whereby the rate is changed after a certain period as mutually agreed by the contracting parties. Sukuk *ijarah* with such feature is known as floating rate sukuk *ijarah*. There are several benchmarks used to determine the floating rental rate such as Kuala Lumpur Interbank Offered Rate (KLIBOR) or London Interbank Offered Rate (LIBOR) and its equivalent.

In this context, a question arises whether the following matters are permissible by Shariah or not to be applied in such sukuk:

- (i) Determination of the rental rate based on fixed and/ or floating rate; and
- (ii) Use of benchmark as a reference to determine the floating rental rate.

RESOLUTION

The SAC had resolved that the rental payment based on fixed and/or floating rate which is mutually agreed between the contracting parties is permissible. If the rental payment is based on floating rate, it shall comply with the following conditions:

- (i) The amount of the rental payment for the first lease period shall be fixed; and
- (ii) The rental payment for the subsequent lease period may be based on floating rate based on mutually agreed benchmark or formula.

With regard to the determination of such benchmark, there is no Shariah impediment to refer to any suitable benchmark to determine the floating rental rate for Sukuk *ijarah* based on the floating rate.

APPLICATION OF HAMISY JIDDIYYAH IN IJARAH CONTRACT

INTRODUCTION

Hamisy jiddiyyah is a payment made by a person (prospective buyer) who undertakes to purchase certain goods from a seller in the future. The payment made is intended to prove the commitment of the prospective buyer to the seller that he will purchase such goods. However, an issue was raised whether the concept of *hamisy jiddiyyah* is applicable in an *ijarah* contract whereby the payment is made by a prospective lessee who undertakes to rent an asset at a predetermined date in the future to prove his commitment to rent such asset in the future.

RESOLUTION

The SAC had resolved that the payment of *hamisy jiddiyyah* is permissible to support the undertaking (*wa`d*) by a prospective lessee to rent an asset in the future. This payment is also meant to ensure that the asset which will be leased by the prospective lessee will not be leased out to others. The SAC had also resolved the following issues with regards to *hamisy jiddiyyah*:

1 Whether the payment of *hamisy jiddiyyah* made by a prospective lessee is a commitment payment to the owner of the asset?

The payment of *hamisy jiddiyyah* made by the prospective lessee is a form of commitment payment to the owner of the asset. The payment is made to avoid losses that may be suffered by the owner of the asset in the event that the prospective lessee breach the undertaking to rent the asset in the future. However, this is subject to the following situations:

(i) If the cost of the actual loss suffered by the owner of the asset does not exceed the payment of *hamisy jiddiyyah*

If the cost of the actual loss suffered by the owner of the asset does not exceed the payment of *hamisy jiddiyyah*, the owner of the asset shall be entitled to claim for compensation up to the amount of the actual loss suffered only. If there is any excess payment of *hamisy jiddiyyah*, the owner of the asset shall return it to the prospective lessee.

(ii) If the cost of the actual loss suffered by the owner of the asset exceeds the payment of *hamisy jiddiyyah*

If the cost of the actual loss suffered by the owner of the asset exceeds the payment of *hamisy jiddiyyah*, the owner of the asset shall be entitled to claim for compensation up to the actual loss suffered and not limited to the payment of *hamisy jiddiyyah*. This is because the prospective lessee (the promisor) had breached the undertaking (*wa`d*) to the owner of the asset (the promisee) to rent the asset in the future.

2

Whether the payment of *hamisy jiddiyyah* can be considered as part of the rental payment?

Initially the payment of *hamisy jiddiyyah* is not considered as part of the rental payment. However, it may be considered as part of the rental payment if it is mutually agreed by both contracting parties.

3

Whether the payment of *hamisy jiddiyyah* can be utilised by the owner of the asset for investment purpose?

The payment of *hamisy jiddiyyah* made by the prospective lessee may be treated as follows:

(i) Trust for safekeeping/custody

Owner of the asset may only keep the payment of *hamisy jiddiyah* in its custody and shall not utilise it for any other purposes; or

(ii) Trust for investment

The payment of *hamisy jiddiyah* may be utilised for investment purpose as mutually agreed by both contracting parties.

APPLICATION OF `URBUN IN IJARAH CONTRACT

INTRODUCTION

Payment of *`urbun* in the *ijarah* contract refers to payment of a certain amount of deposit by the lessee to the owner of the asset at the inception of the *ijarah* contract which gives the right to the lessee within a certain period of time to decide whether to proceed with the *ijarah* contract or not. This issue was presented to the SAC for their decision.

RESOLUTION

The SAC had resolved that the principle of *`urbun* in the *ijarah* contract is permissible. The SAC had also resolved the following issues:

- (i) If the *ijarah* contract is cancelled by the lessee, the owner of the asset shall be fully entitled to the payment of *`urbun*; and
- (ii) If the *ijarah* contract is proceeded, the payment of *`urbun* shall be treated as part of the rental payment.

ISSUES IN RELATION TO TERMINATION OF IJARAH CONTRACT

INTRODUCTION

In the context of termination of an *ijarah* contract, there are several issues related to it. Among the issues presented to the SAC for their decision were:

- (i) Termination of an *ijarah* contract due to the expiry of the lease period;
- (ii) Termination of an *ijarah* contract due to loss or damage of the *ijarah* asset; and
- (iii) Termination of an *ijarah* contract involving contracting parties.

RESOLUTION

The SAC resolved several issues related to termination of an *ijarah* contract as follows:

1 Termination of an *ijarah* contract due to the expiry of the lease period

In an operating lease, in principle the *ijarah* contract will expire upon the end of the lease period.

However, in certain circumstances, the lease period may be extended and the lessee shall pay the rental based on the current rental rate (i.e market rate) or any rate as mutually agreed by the contracting parties. The contracting parties may extend the *ijarah* contract based on the following methods:

- (i) Normal *ijarah*

The extension of *ijarah* contract may be made by entering into a new agreement before the expiry of the initial *ijarah* contract; or

(ii) *Ijarah* by phase

An *ijarah* contract is extended immediately after the expiry of the lease period for the first phase in accordance with the terms and conditions of the contract.

For finance lease, the lease period will expire upon the transfer of ownership of the *ijarah* asset to the lessee either through sale transaction or *hibah*.

2

Termination of an *ijarah* contract due to the damage of the *ijarah* asset

(i) Partial damage of the *ijarah* asset

Partial damage of an *ijarah* asset may occur in the following circumstances:

(a) Damage that does not affect the usage of usufruct of the *ijarah* asset

The lessee shall not terminate the *ijarah* contract since it is a bilaterally binding contract that binds both contracting parties.

(b) Damage that affects the usage of usufruct of the *ijarah* asset

If the damage of the *ijarah* asset affects the usage of the usufruct of the *ijarah* asset, the following actions may be done:

- (aa) The lessee shall be entitled to terminate the *ijarah* contract;
- (bb) Both contracting parties may mutually agree to revise the rental payment rate; or
- (cc) The owner of the *ijarah* asset shall replace the affected *ijarah* asset with other suitable *ijarah* assets as mutually agreed by the contracting parties.

(ii) Total loss of an *ijarah* asset

If there is total loss of the *ijarah* asset, the following actions may be taken:

- (a) The lessee shall be entitled to terminate the *ijarah* contract. This is due to the non-existence of usufruct of the *ijarah* asset; or
- (b) The owner of the asset shall replace the affected *ijarah* asset with other suitable *ijarah* assets as mutually agreed by the contracting parties.

3

Dissolution of an *ijarah* contract involving contracting parties

An *ijarah* contract may be terminated based on the following methods:

(i) Mutual agreement of the contracting parties

An *ijarah* contract may be terminated based on a mutual agreement of both contracting parties.

(ii) Exercise of option to terminate the *ijarah* contract by any contracting parties

If any of the contracting parties has an option to terminate the contract within a specified period, then he may exercise the option to terminate the contract.

(iii) The lessee who has paid the *`urbun* does not exercise the option to proceed with the *ijarah* contract within the specified time

If the lessee who has paid the *`urbun* does not exercise the option to proceed with the *ijarah* contract within the specified time, then the *ijarah* contract shall be terminated.

(iv) Demise of any contracting parties during the *ijarah* contract period

An *ijarah* contract shall not be automatically terminated upon the demise of the owner of the asset or the lessee. The *ijarah* asset or its usufruct may be passed on to the heirs of any of the deceased (either the heirs of the owner of the asset or the lessee). However, the heirs of the lessee may opt to terminate the *ijarah* contract.

(v) Breach of mutually agreed terms of the *ijarah* contract by the lessee

The owner of the asset shall be entitled to terminate the *ijarah* contract if there is any breach of the mutually agreed terms and conditions of the *ijarah* contract by the lessee.

KAFALAH IN SUKUK STRUCTURING

INTRODUCTION

Kafalah generally means guarantee. It is defined as a contract which combines one's *zimmah* with another person's *zimmah*. In sukuk structuring, there are sukuk which involve guarantee from certain parties as follows:

- (i) third party;
- (ii) *wakil* (i.e sukuk issuer) or sub-*wakil*¹ appointed by sukuk issuer;
- (iii) party related to the sukuk issuer such as parent company [which is also known as a holding company], subsidiary² and sister companies³; or
- (iv) associate company⁴ of the sukuk issuer.

With the existence of guarantor, the credit capacity of the sukuk can be upgraded.

The issue of *kafalah* in sukuk structuring does not only involve parties who can and cannot guarantee as well as amount to be guaranteed, however it also involves some other issues that require the SAC's decision.

¹ Sub-*wakil* refers to *wakil* who is appointed by sukuk issuer (whereby sukuk issuer is a *wakil* of sukukholders).

² The definition of parent company and subsidiary is as defined in the Companies Act 2016.

³ Sister companies refer to the subsidiaries under the same parent company.

⁴ The definition of associate company has the meaning given to "associate" under the accounting standards issued or adopted by the Malaysian Accounting Standards Board (MASB).

The SAC had resolved that *kafalah* in sukuk structuring is permissible with regard to the following resolutions:

A Shariah Principle for Guarantee in Sukuk Structuring

The application of the principle of *kafalah* for guarantee facility by the guarantor in sukuk structured based on *`uqud mu`awadhat*, *`uqud ishtirak* and *`aqd wakalah bi al-istithmar* is permissible. *Kafalah* may be provided either with or without the imposition of fee.

B Application of *Kafalah* in Sukuk Structuring

The principle of *kafalah* that is permissible in sukuk structuring must be executed separately from the underlying contract of sukuk whereby any termination of the underlying contract would not affect the *kafalah* and vice-versa.

C Parties who can Guarantee and Amount to be Guaranteed

Parties who can guarantee and amount to be guaranteed in sukuk structuring are as follows:

(1) Sukuk Structured Based on *`Uqud Mu`awadhat*

(i) Parties who Can Guarantee

For sukuk structured based on *`uqud mu`awadhat*, *kafalah* may be provided by any party.

(ii) Amount to be Guaranteed

The amount that may be guaranteed by any party is the amount due and payable under any obligation arising from the relevant contracts including *ta`widh*, fees and expenses imposed on the sukuk.

The guarantee on such amount is permissible since it is related to the financial liability.

(2) Sukuk Structured Based on `Uqud Ishtirak

(i) Parties who Can Guarantee and Amount to be Guaranteed

For sukuk structured based on *`uqud ishtirak*, *kafalah* may be provided by the following parties:

(a) Third Party and Amount to be Guaranteed

- (1) Third party must fulfil the following criteria:
 - (aa) Not a contracting party;
 - (bb) Separate in terms of legal entity and financial liability; and
 - (cc) Not in the category of related party in terms of majority ownership of shares, whereby the third party has majority ownership over the guaranteed party or the guaranteed party has majority ownership over the guarantor i.e. parent company and subsidiary.
- (2) Amount that may be guaranteed by the third party is as follows:
 - (aa) The capital and profit amount arising from contracts under *`uqud ishtirak*;
 - (bb) The payment of any amount due and payable to the sukukholders upon dissolution of *`aqd musharakah* and *mudharabah*; or

(cc) *Ta`widh*, fees and expenses imposed on the sukuk.

The guarantee on the amount as stated in items (bb) and (cc) above is permissible since the guarantee is related to the financial liability.

(b) Party related to the Sukuk Issuer and Amount to be Guaranteed

(aa) Parent Company or Subsidiary of the Sukuk Issuer

Basically, parent company or subsidiary of the sukuk issuer cannot guarantee sukuk issuer⁵ in terms of capital and profit of *musharakah* and *mudharabah*. This is because both companies are related parties to each other based on full ownership or majority ownership of shares between both of them.

However, those companies are allowed to guarantee the sukuk issuer but the amount that may be guaranteed is limited to the following amount only:

(aaa) The payment of any amount due and payable to the sukukholders upon dissolution of *`aqd musharakah* and *mudharabah*; or

(bbb) *Ta`widh*, fees and expenses imposed on the sukuk.

The guarantee on the amount as stated in items (aaa) and (bbb) above is permissible since the guarantee is related to the financial liability.

(bb) Sister Companies of the Sukuk Issuer

In the context of *kafalah*, although sister companies are included under the category of related party to the sukuk

⁵ In this context, if the sukuk issuer is a parent company, then its subsidiary cannot guarantee the sukuk issuer. Likewise, if the sukuk issuer is a subsidiary company, then its parent company also cannot guarantee the sukuk issuer.

issuer, it may guarantee the sukuk issuer⁶. This is because sister companies are separate from other sister companies in terms of entity and financial liability. Therefore, sister companies fulfil the third party criteria and the amount that may be guaranteed is as stated in item (2)(i)(a) above, i.e. in relation to the amount that may be guaranteed by the third party.

(c) Associate Company of the Sukuk Issuer and Amount to be Guaranteed

Associate company may provide guarantee to the sukuk issuer. This is because the ownership of shares in associate company would not render the associate company to be related to the sukuk issuer. Therefore, the associate company is considered as a third party and the amount that may be guaranteed is as stated in item (2)(i)(a) above, i.e. in relation to the amount that may be guaranteed by the third party.

(3) Sukuk Structured Based on `Aqd Wakalah bi al-Istithmar

(i) Parties who can Guarantee and Amount to be Guaranteed

For sukuk structured based on `aqd wakalah bi al-Istithmar, kafalah may be provided by the following parties:

(a) Third Party, Sister Companies and Associate Company of the Sukuk Issuer and Amount to be Guaranteed

Kafalah may be provided by a third party, sister companies and associate company of the sukuk issuer.⁷ The amount that may be guaranteed by the relevant parties are as follows:

⁶ In this context, if the sukuk issuer is a subsidiary of a parent company, then other subsidiaries of the same parent company (i.e. sister companies) may guarantee the sukuk issuer.

⁷ Clarification in relation to the third party, sister companies and associate company of the sukuk issuer are as stated in items 2(i)(a), 2(i)(b)(bb) and 2(i)(c) above.

- (aa) The nominal amount of sukuk, profit or rental arising from contracts under *`uqud mu`awadhat*;
- (bb) The capital and profit amount arising from contracts under *`uqud ishtirak* and *`aqd wakalah bi al-istithmar*;
- (cc) Any amount due and payable to the sukukholders upon dissolution of *`aqd wakalah bi al-istithmar*; or
- (dd) *Ta`widh*, fees and expenses imposed on the sukuk.

The guarantee on the amount as stated in items (aa), (cc) and (dd) above is permissible since the guarantee is related to the financial liability.

(b) *Wakil* (i.e. Sukuk Issuer) or Sub-*Wakil* Appointed by the Sukuk Issuer and Amount to be Guaranteed

Kafalah may be provided by a *wakil* (i.e. sukuk issuer) or sub-*wakil* appointed by the sukuk issuer. The amount that may be guaranteed by the relevant parties is limited to the following amount only:

- (aa) Amount due and payable under any obligation arising from contracts under *`uqud mu`awadhat*;
- (bb) The payment of any amount due and payable to the sukukholders upon dissolution of *`aqd wakalah bi al-istithmar*; or
- (cc) *Ta`widh*, fees and expenses imposed on the sukuk.

The guarantee on the amount as stated in items (aa), (bb) and (cc) above is permissible since the guarantee is related to the financial liability.

However, *wakil* or sub-*wakil* cannot guarantee the capital and profit amount arising from *`aqd wakalah bi al-istithmar*.

(c) Parent Company or Subsidiary of the Sukuk Issuer and Amount to be Guaranteed

Basically, parent company or subsidiary of the sukuk issuer cannot guarantee sukuk issuer⁸ in terms of capital and profit of *wakalah bi al-istithmar*. This is because both companies are related parties to each other based on full ownership or majority ownership of shares between both of them.

However, those companies are allowed to guarantee the sukuk issuer but the amount that may be guaranteed is limited to the following amount only:

- (aa) Amount due and payable under any obligation arising from contracts under *`uqud mu`awadhat*,
- (bb) The payment of any amount due and payable to the sukukholders upon dissolution of *`aqd wakalah bi al-istithmar*, or
- (cc) *Ta`widh*, fees and expenses imposed on the sukuk.

The guarantee on the amount as stated in items (aa), (bb) and (cc) above is permissible since the guarantee is related to the financial liability.

D

Conventional Guarantee If *Kafalah* Cannot Be Procured

If the guarantee based on the principle of *kafalah* cannot be procured from Islamic banks or *kafalah* providers, then conventional guarantee is allowed to be procured.

⁸ In this context, if the sukuk issuer (i.e. as *wakil*) is the parent company, then its subsidiary cannot guarantee the sukuk issuer. Likewise, if the sukuk issuer is a subsidiary company, then its parent company also cannot guarantee the sukuk issuer.

QALB AL-DAYN IN SUKUK RESTRUCTURING

INTRODUCTION

In general, *qalb al-dayn* refers to the conversion of an existing debt into a new debt and it can occur in the following situations:

- (i) Restructuring of debt or amount payable via an extension of the payment period which results in an increase of the original amount payable without terminating the existing contract; or
- (ii) Restructuring of debt or amount payable via termination of the existing contract and entering into a new contract with a new amount payable and an extended payment period.

Based on the two situations above, question arises whether *qalb al-dayn* in the restructuring of sukuk is permissible or not in the eye of Shariah.

RESOLUTION

The SAC had resolved that *qalb al-dayn* in the restructuring of sukuk is permissible subject to the following conditions:

- (i) Execution of a new contract where it creates a new payment obligation and a revised payment period;
- (ii) Proceeds from the new contract may be used to pay the original outstanding debt which consequently results in the termination of the existing contract; and
- (iii) The debtor is categorised as *musir* (solvent) as determined by the sukuk trustee or the sukukholders.

REVISION TO TERMS AND CONDITIONS RELATING TO SUKUK

INTRODUCTION

Revision to terms relating to sukuk refers to the revision made to principal terms and conditions (PTC) for sukuk issuance. The application for the revision is made after the sukuk was issued. All revisions to the terms must obtain the approval of the majority of the sukukholders in a meeting held between the issuer and the sukukholders.

There are several types of revisions to terms that may give rise to Shariah issues such as revision to the profit rate and extension of maturity date of the sukuk. This situation usually happens when the issuer faces problem in fulfilling its obligation in paying the periodic distribution amount, the profit or fails to redeem a sukuk at maturity date. Therefore, in order to solve this problem, the issuer usually will propose to the sukukholders to extend the maturity date of the sukuk which involves revision to the profit rate. Hence, this issue was presented to the SAC to seek their decision.

RESOLUTION

The SAC, at its series of meetings had discussed the issue of revision to terms and conditions relating to sukuk issuance. Among the issues resolved by the SAC were revisions to the profit rate and maturity date. These issues were resolved by the SAC as follows:

A Revision to the Profit Rate

(i) *Sukuk bai` bithaman ajil (BBA), sukuk murabahah and sukuk istisna`*

A revision to reduce the profit rate may be implemented by applying the principle of *ibra`* without the need to execute a supplemental contract.

However, a revision to increase the profit rate through selling price may only be implemented by executing a new and separate contract from the initial contract of BBA, *murabahah* and *istisna`* to incorporate the new profit rate, after which the outstanding obligation under the initial contract will be settled and terminated. This arrangement must be carried out before the maturity of the initial contract.

(ii) Sukuk *musharakah*, sukuk *mudharabah* and sukuk *wakalah bi al-istithmar*

The revision to the expected profit rate (either increasing or reducing the profit rate) in sukuk *musharakah*, sukuk *mudharabah* and sukuk *wakalah bi al-istithmar* may be effected by executing supplemental contract without cancelling the initial contract of *musharakah*, *mudharabah* and *wakalah bi al-istithmar*. However, this is subject to mutual agreement between the contracting parties.

(iii) Sukuk *ijarah*

The revision to the rental payment (either increasing or reducing the rental payment) in sukuk *ijarah* may be effected by executing supplemental contract without cancelling the initial contract of *ijarah*. However, this is subject to mutual agreement between the contracting parties.

B

Revision to Profit Sharing Ratio

The revision to the profit sharing ratio (either increasing or reducing the profit sharing ratio) in sukuk *musharakah* and sukuk *mudharabah* may be effected by executing supplemental contract without cancelling the initial contract of *musharakah* and *mudharabah*. However, this is subject to mutual agreement between the contracting parties.

C**Revision to Maturity Date****(i) Sukuk BBA, sukuk *murabahah* and sukuk *istisna`***

Revision to the maturity date in sukuk BBA, sukuk *murabahah* and sukuk *istisna`* may be effected by executing supplemental contract without cancelling the initial contract of BBA, *murabahah* and *istisna`*, subject to the following conditions:

- (a) The revision is agreed by all contracting parties; and
- (b) There is no revision to increase the selling price.

(ii) Sukuk *musharakah*, sukuk *mudharabah*, sukuk *wakalah bi al-istithmar* and sukuk *ijarah*

Revision to the maturity date in sukuk *musharakah*, sukuk *mudharabah*, sukuk *wakalah bi al-istithmar* and sukuk *ijarah* may be effected by executing supplemental contract without cancelling the initial contract of *musharakah*, *mudharabah*, *wakalah bi al-istithmar* and *ijarah*. However, this is subject to mutual agreement between the contracting parties.

UTILISATION OF SUKUK PROCEEDS

INTRODUCTION

Utilisation of sukuk proceeds raised by an issuer from investors is an important issue and which should be given proper attention where it must be utilised for Shariah-compliant activities only.

Several issues relating to the utilisation of sukuk proceeds were discussed in a series of SAC meeting whether:

- (i) the utilisation of the sukuk proceeds raised from any issuance of sukuk for various specified purposes is considered as Shariah-compliant or otherwise; and
- (ii) the SAC resolution on the utilisation of sukuk proceeds are applicable to the issuer only or it is also applicable to the issuer's group of companies.

RESOLUTION

The SAC has resolved that as a general ruling, the proceeds raised from any issuance of sukuk must be utilised for Shariah-compliant purposes only.

The SAC also resolved that the SAC resolution on utilisation of sukuk proceeds are applicable to the issuer and the issuer's group of companies.

Besides that, the SAC has further resolved that the utilisation of the sukuk proceeds by the issuer and the issuer's group of companies for the following purposes are Shariah-compliant:

1

Refinancing or Repayment of Outstanding Conventional Borrowings

The sukuk proceeds may be utilised to refinance or repay (wholly or partly) outstanding conventional borrowings provided that the outstanding conventional borrowings, which were used for activities or purposes that are prohibited by Shariah is not more than 49% of the total outstanding conventional borrowings.

Notwithstanding the above, if a company that carries out Shariah non-compliant business activities is in the process of converting its business into a fully Shariah-compliant business, the sukuk proceeds may be utilised to refinance or repay (wholly or partly) its outstanding conventional borrowings.

2

General Business

The sukuk proceeds may be utilised for general business of the issuer and/or the issuer's group of companies including for general corporate purposes, working capital requirements and capital expenditures provided that the principal activities of the issuer and/or the issuer's group of companies are Shariah-compliant based on the following business activity benchmarks:

- (i) 5% in respect of businesses/activities as specified in Appendix 1; or
- (ii) 20% in respect of businesses/activities as specified in Appendix 2.

For the purpose of screening the Shariah status of the issuer and/or the issuer's group of companies, the Shariah adviser may rely on the audited financial statement or other financial statements (whichever acceptable by the Shariah adviser) of the respective entity(ies) which will be utilising the sukuk proceeds for its general business.

The aforementioned benchmarks must be determined at the point of each issuance of the sukuk every time the relevant entity(ies) intends to utilise the sukuk proceeds for its general business.

3 Construction of Building Consisting of Shariah-Compliant and Shariah Non-Compliant Activities (Building with Mixed Activities)

The sukuk proceeds may be utilised for construction of the Building with Mixed Activities provided that the floor area to be used for the Shariah non-compliant activities is less than 49% of the total floor area.

If the construction involves Building with Mixed Activities as well as building with fully Shariah-compliant activities, the denominator for computing the 49% benchmark shall be based on the total floor area of the Building with Mixed Activities only.

4 Refurbishment, Expansion, Repair and/or Maintenance of the Building with Mixed Activities

The sukuk proceeds may be utilised for refurbishment, expansion, repair and/or maintenance of the Building with Mixed Activities subject to the following conditions:

- (i) If the revenue received from the Shariah non-compliant activities in the Building with Mixed Activities could be determined, the said revenue computed against the total revenue from the Building with Mixed Activities must be less than the following business activity benchmarks:
 - (a) 5% in respect of businesses/activities as specified in Appendix 1; or
 - (b) 20% in respect of businesses/activities as specified in Appendix 2;
or
- (ii) If the said revenue could not be determined, the issuer and the issuer's group of companies must ensure and confirm that the section/area used for Shariah non-compliant activities must be less than 20% of the total floor area of the Building with Mixed Activities.

The refurbishment, expansion, repair and/or maintenance of the Building with Mixed Activities must be done on a general basis and not on any specific area where Shariah non-compliant activities are carried out in the said Building with Mixed Activities.

5 Operation and Management of the Building with Mixed Activities

The sukuk proceeds may be utilised for the operation and management of the Building with Mixed Activities by the issuer and the issuer's group of companies provided that the revenue received from the Shariah non-compliant activities in the said Building with Mixed Activities, computed against the total revenue from the Building with Mixed Activities must be less than the following business activity benchmarks:

- (i) 5% in respect of businesses/activities as specified in Appendix 1; or
- (ii) 20% in respect of businesses/activities as specified in Appendix 2.

6 Acquisition of the Building with Mixed Activities

The sukuk proceeds may be utilised for acquisition of the Building with Mixed Activities provided that the revenue received from the Shariah non-compliant activities in the said Building with Mixed Activities to be acquired by the issuer and the issuer's group of companies, computed against the total revenue from the Building with Mixed Activities must be less than the following business activity benchmarks:

- (i) 5% in respect of businesses/activities as specified in Appendix 1; or
- (ii) 20% in respect of businesses/activities as specified in Appendix 2.

The benchmarks as specified in items (3), (4), (5) and (6) above are only applicable at the point of issuance of the sukuk.

Appendix 1

- (i) Conventional banking and lending;
- (ii) Conventional insurance;
- (iii) Gambling;
- (iv) Liquor and liquor-related activities;
- (v) Pork and pork-related activities;
- (vi) Non-halal food and beverages;
- (vii) Shariah non-compliant entertainment;
- (viii) Tobacco and tobacco-related activities; and
- (ix) Other activities deemed non-compliant according to Shariah principles as determined by the SAC.

Appendix 2

- (i) Share trading;
- (ii) Stockbroking business;
- (iii) Rental received from Shariah non-compliant activities; and
- (iv) Other activities deemed non-compliant according to Shariah principles as determined by the SAC.

UTILISATION OF SUKUK PROCEEDS FOR INTER-COMPANY ADVANCES

INTRODUCTION

The SAC had discussed on the issue of the sukuk proceeds raised from any issuance of sukuk that will be advanced to the parent company and/or its subsidiaries, group of companies or other parties as inter-company advances.

The issue in deliberation by the SAC was on whether inter-company advances of sukuk proceeds from the issuer to parent company, its subsidiaries, group of companies or other parties may be undertaken either through Shariah-compliant mode of financing or conventional loan with interest.

RESOLUTION

The SAC had resolved that inter-company advances of sukuk proceeds between the issuer and the parent company, its subsidiaries, group of companies or other parties should be executed via Shariah-compliant mechanism only.

However, in the event that there are unavoidable constraints in providing the inter-company advances via Shariah-compliant mechanism such as legal and tax implications, the execution of the inter-company advances through conventional loan with interest is permissible subject to certain conditions such as:

- (1) The interest is only imposed on portion of loan amount proportionate to the ownership percentage of the issuer in its subsidiary.

- (2) The effective interest rate¹ to be charged on the said portion of the loan amount should be limited to portion of the issuer's ownership in its subsidiary only and should not be ballooned to achieve the interest income as if the interest rate is charged on the whole amount of the inter-company advance. Thus, the yield that would be derived from the interest charged on the conventional inter-company advance should be based on the standard commercial terms and on arm's length transaction.

¹ Effective interest rate is the interest rate that is actually earned or paid on an investment, loan or other financial product due to the result of compounding over a given time period.

ASSET PRICING FOR SUKUK ISSUANCE

INTRODUCTION

For sukuk issuance, there are sukuk which are structured based on sale and purchase of identified assets. To curb the activity of manipulating the price of assets which are purchased in sukuk issuance, the SAC had discussed the issue of asset purchase pricing for the benefit of all parties involved.

Therefore, this issue was presented to the SAC for their decision.

RESOLUTION

The SAC had resolved as follows:

- 1 The asset purchase pricing of an identified asset for sukuk issuance that involve the sale and purchase of identified assets which are structured based on any Shariah principles is permissible subject to the requirements in item (2) below.
- 2 The asset purchase pricing of an identified asset in sukuk issuance must not exceed 1.51 times of:
 - (i) the fair value of the asset; or
 - (ii) any other appropriate value of such asset.
- 3 The asset pricing requirements in item (2) above are not applicable for sukuk which are structured based on any Shariah principles that does not involve sale and purchase of identified assets including but not limited to sukuk ijarah that involves the lease and lease-back of the identified assets.

UNDERLYING ASSETS, VENTURES AND INVESTMENTS IN SUKUK STRUCTURING

INTRODUCTION

In sukuk structuring which is based on *`uqud mu`awadhat*, *`uqud ishtirak* and *`aqd wakalah bi al-istithmar*, the underlying assets, ventures and investments in *wakalah* respectively are considered as assets that become the basis for structuring such sukuk structure. However, a question arose regarding to what extent such assets can be accepted by Shariah.

RESOLUTION

The SAC had resolved as follows:

A **Sukuk based on *`Uqud Mu`awadhat*, *`Uqud Ishtirak* and *`Aqd Wakalah bi al-Istithmar***

The underlying assets in *`uqud mu`awadhat*, ventures in *`uqud ishtirak* and investments in *wakalah bi al-istithmar* which become the basis for these sukuk structuring must comply with Shariah.

B **Sukuk based on *`Uqud Mu`awadhat***

(1) Types of Underlying Assets

Underlying assets can be classified to tangible assets such as building and land, and intangible assets such as receivables, usufruct of an asset, rights of intellectual property, etc.

(2) Underlying Asset Used for Shariah Non-Compliant Activities

Asset that is used for Shariah non-compliant activities cannot be used as an underlying asset in sukuk structuring.

(3) Receivables as Underlying Asset in Sukuk Structuring

Receivables are allowed to be used as an underlying asset in sukuk structuring provided that the receivables must be *mustaqir* (established and certain)¹ and transacted on spot basis either in the form of cash or commodities.

(4) Encumbered Asset as Underlying Asset

Encumbered asset is allowed to be used as an underlying asset in sukuk structuring such as an asset that is pledged to financial institution or jointly-owned with other parties. However, consent by the chargee or the joint-owner of the asset must be obtained prior to using the asset as an underlying asset of sukuk.

(5) Mixed Asset² as Underlying Asset for Sukuk *Ijarah*

Mixed asset is allowed to be used as an underlying asset for Sukuk *ijarah* subject to the following requirements:

- (i) If rentals received from Shariah non-compliant business or activities in the Mixed Assets could be determined, such rentals must be less than 20% of the total rentals received; or
- (ii) If the rentals could not be determined, the lettable area to be used for Shariah non-compliant business or activities in the Mixed Asset must be less than 20% of the total lettable area.

¹ *Mustaqir* refers to something that is certain in term of payment obligation.

² Mixed Asset refers to an asset which is used for business or activity that is Shariah-compliant and Shariah non-compliant.

FORM AND SOURCE OF PAYMENT FOR REDEMPTION OF SUKUK

INTRODUCTION

For redemption of sukuk by the issuer, a question arises on the form and source of payment as follows:

- (1) Whether the form of payment in redemption of sukuk must be in the form of cash only or otherwise?; and
- (2) Whether the source of payment for redemption of sukuk is limited to Shariah-compliant source only?

RESOLUTION

The SAC had resolved the following issues related to the form and source of payment for redemption of sukuk by the issuer:

(1) Form of Payment for Redemption of Sukuk

Redemption of sukuk may be done in the form of cash, in-kind or combination of both.

(2) Source of Payment for Redemption of Sukuk

Redemption of Sukuk may be done by any source of fund.

VARIOUS ROLES OF SUKUK ISSUER IN ISSUANCE OF SUKUK

INTRODUCTION

In the issuance of sukuk, there are certain situations where the sukuk issuer undertakes various roles such as *wakeel*, purchaser and others.

Therefore, a question arises from Shariah perspective whether the sukuk issuer is allowed to undertake various roles.

RESOLUTION

The SAC had resolved that the sukuk issuer is allowed to undertake various roles in sukuk issuance provided that each roles and its functions are clearly stated in separate contracts for each roles.

WAIVER OF SUKUKHOLDERS' RIGHT ON THE CAPITAL AND/OR ANY PAYMENT OBLIGATION IN ADDITIONAL TIER 1 SUKUK AND TIER 2 SUKUK

INTRODUCTION

The industry proposals relating to Additional Tier 1 Sukuk ("AT1 Sukuk") and Tier 2 Sukuk were presented to the SAC. Among the issues discussed were on the following matters which relate to the relevant policy document on Capital Adequacy Framework for Islamic Banks ("Capital Components") issued by Bank Negara Malaysia:

- (i) Whether there is any Shariah concept that may be applied in the situation that may require the AT1 Sukuk structured based on the Shariah principles of *musharakah*, *mudharabah* or *wakalah bi al-istithmar*, whichever is applicable, to be written-off at the point of non-viability or loss absorption events;
- (ii) Whether there is any Shariah concept that may be applied in the situation that may require the Tier 2 Sukuk structured based on the Shariah principles of *wakalah bi al-istithmar*, *murabahah* or *ijarah*, whichever is applicable, to be written-off at the point of non-viability event; and
- (iii) Whether there is any Shariah concept that may be applied in the situation whereby the payment of profit arising from the AT1 Sukuk structured based on the Shariah principles of *musharakah*, *mudharabah* or *wakalah bi al-istithmar*, whichever is applicable, to be waived at the periodic distribution date.

The SAC has resolved as follows:

(1) Write-off of AT1 Sukuk at the point of non-viability or loss absorption events

AT1 Sukuk structured based on the Shariah principles of *musharakah*, *mudharabah* or *wakalah bi al-istithmar*, whichever is applicable, may be written-off (in whole or in part) at the point of non-viability or loss absorption events based on the following Shariah concepts (whichever applicable):

- (a) *tanazul*, whereby the sukukholders waive their rights or interests on the capital payment or profit payment (if any); or
- (b) *ibra'*, whereby the sukukholders release their rights of claim on any amounts due,

arising from the AT1 Sukuk.

(2) Write-off of Tier 2 Sukuk at the point of non-viability event

(a) Tier 2 Sukuk structured based on the Shariah principle of *wakalah bi al-istithmar* may be written-off (in whole or in part) at the point of non-viability event based on the following Shariah concepts (whichever applicable):

- (i) *tanazul*, whereby the sukukholders waive their rights or interests on the capital payment or profit payment (if any) or
- (ii) *ibra'*, whereby the sukukholders release their rights of claim on any amounts due,

arising from the Tier 2 Sukuk;

- (b) Tier 2 Sukuk structured based on the Shariah principle of *murabahah* may be written-off (in whole or in part) at the point of non-viability event based on the Shariah concept of *ibra'*, whereby the sukukholders release their rights of claim on any amounts due arising from the Tier 2 Sukuk; and
- (c) Tier 2 Sukuk structured based on the Shariah principle of *ijarah* may be written-off (in whole or in part) at the point of non-viability event based on the following Shariah concept and principle:
 - (i) the Shariah concept of *ibra'*, whereby the sukukholders release their rights of claim on any amounts due arising from the Tier 2 Sukuk; and
 - (ii) the Shariah principle of *hibah*, whereby the sukukholders give away their rights in the asset under the Tier 2 Sukuk (from the principal amount, in whole or in part) without any consideration.

(3) Cancellation of discretionary payment by the issuer of AT1 Sukuk

The payment of profit arising from the AT1 Sukuk structured based on the Shariah principles of *musharakah*, *mudharabah* or *wakalah bi al-istithmar*, whichever is applicable, that is due on the periodic distribution date may be waived (in whole or in part) by the sukukholders based on the Shariah concept of *tanazul*.

PROFIT RATE MECHANISMS IN SUKUK STRUCTURING BASED ON 'UQUD MU'AWADHAT APART FROM SUKUK IJARAH

INTRODUCTION

In sukuk structuring based on `uqud mu`awadhat such as *bai` bithaman ajil (BBA)*, *murabahah* and *istisna`*,¹ there are several profit rate mechanisms that are being applied such as:

- (i) Fixed profit rate;
- (ii) Floating profit rate; and
- (iii) A combination of fixed and floating profit rate.

For sukuk structured based on floating profit rate mechanism, or a combination of fixed and floating profit rate, normally certain benchmark would be used as a reference to determine the floating profit rate of such sukuk. Among the benchmarks used are Kuala Lumpur Interbank Offered Rate (KLIBOR), London Interbank Offered Rate (LIBOR) and its equivalent.

Hence, question arises whether the following matters are permissible by Shariah or not to be applied in such sukuk:

- (i) Profit rate mechanism as stated above; and
- (ii) Benchmark used as a reference to determine the floating profit rate.

¹ This resolution is not applicable for *ijarah* contract as the resolution pertaining to such contract is made separately. Please refer to the SAC resolution on "Determination of Rental Rate Based on Fixed and/or Floating Rate".

The SAC had resolved as follows:

1 Profit Rate Mechanisms

The permitted profit rate mechanisms to be applied in a sukuk structuring based on *`uqud mu`awadhat* such as BBA, *murabahah* and *istisna`* are as follows:

- (i) Fixed profit rate;
- (ii) Floating profit rate; and
- (iii) A combination of fixed and floating profit rate.

For the implementation of the floating profit rate and combination of fixed and floating profit rate mechanisms, the SAC had resolved that both mechanisms are based on the application of principle of *ibra`*.

The sukuk issuer should state the following matters in the relevant documents:

- (i) The floating profit rate and the combination of fixed and floating profit rate mechanisms that are used in the sukuk structuring; and
- (ii) The clause and formula on *ibra`*.

2 Use of Benchmark as Reference to Determine Floating Profit Rate or Combination of Fixed and Floating Profit Rate

There is no Shariah impediment to refer to any suitable benchmarks to determine the floating profit rate of a sukuk structured based on floating profit rate mechanism or a combination of fixed and floating profit rates.

DEFERMENT OF PROFIT DISTRIBUTION TO JUNIOR SUKUKHOLDERS OF SUKUK STRUCTURED BASED ON `UQUD MU`AWADHAT

INTRODUCTION

A proposal from the industry has been presented to the SAC on the structure of sukuk *murabahah* (via *tawarruq* arrangement) involving the profit distribution to senior and junior sukukholders. The proposal is in relation to the issue on the deferment of the profit payment to junior sukukholders.

In the context of principal and profit payment, senior sukukholders will be given priority before payment is made to junior sukukholders. Based on the mutually-agreed terms by the sukukholders, if the sukuk issuer is unable to pay profit to junior sukukholders, the issuer will defer the payment of profit until the next payment date which is on a cumulative and non-compounding basis.

RESOLUTION

The SAC resolved that the deferment of the profit distribution to junior sukukholders for sukuk structured based on *`uqud mu`awadhat* is permissible by Shariah. It is permissible based on the concept of *tanazul* and *taradhi* between senior and junior sukukholders as follows:

- (i) If there is a *musharakah* arrangement between senior and junior sukukholders, the concept of *tanazul* is applicable; and
- (ii) If there is no *musharakah* arrangement between senior and junior sukukholders, the concept of *taradhi* between them is applicable.

ISSUANCE OF SUKUK MURABAHAH BEFORE THE EXECUTION OF COMMODITY MURABAHAH TRANSACTION

INTRODUCTION

A sukuk structure based on the principle of *murabahah* (via *tawarruq* mechanism) was presented to the SAC. In the structure, the sukuk was issued based on the existence of the purchase order of commodity which was given by the sukuk issuer to the investors or its agent although the commodity *murabahah* transaction has yet to be executed. In the purchase order, the sukuk issuer promised to purchase the commodity from the investors or its agent at sale price (i.e. sale price with profit margin as agreed by the contracting parties) on deferred payment basis.

Based on the structure above, question arises whether Shariah permits or not if sukuk *murabahah* is issued based on purchase order although the commodity *murabahah* transaction has yet to take place.

RESOLUTION

The SAC had resolved that sukuk *murabahah* (via *tawarruq* mechanism) which is issued before commodity *murabahah* transaction occurs is permissible. This is due to the existence of the purchase order from the sukuk issuer to the investors or its agent based on *wa`d mulzim* and there is an element of certainty whereby all transactions which are managed by *Bursa Suq al-Sila`* occurs on the same day.

The SAC had also specified several conditions which are required to be disclosed in the documents for such sukuk structuring as follows:

- (i) *Wa`d* that is applied in the sukuk structure shall be *wa`d mulzim* on the sukuk issuer; and
- (ii) The sukuk cannot be traded on the secondary market until the commodity *murabahah* transaction is completed.

ISSUES RELATING TO SUKUK IJARAH: IJARAH AGREEMENT AND MAL MUSHA`

INTRODUCTION

Issues relating to *ijarah* agreement and *mal musha`*¹ arose from an industry proposal relating to sukuk *ijarah*. In that proposal, the issuer proposed to issue sukuk *ijarah* in one lump sum with multiple series (bullet issuance with multiple series) on the issue date with different maturities. Hence, this issue was presented to the SAC to seek their decision.

RESOLUTION

The SAC resolved as follows:

- 1 For sukuk *ijarah* with either bullet issue or multiple issues under sukuk programme with multiple series and maturities, the execution of Master *Ijarah* Agreement is allowed. However, the following particulars should be stated in details in the Master *Ijarah* Agreement or in the schedules attached to the Master *Ijarah* Agreement:
 - (a) the proportionate interest in the leased assets;
 - (b) the maturity period; and
 - (c) the rental payments.

If the Master *Ijarah* Agreement only provides the general terms of the *ijarah* and does not constitute a contract while the schedules provide the specific terms relating to *ijarah*, the SAC further agreed that each schedule must be signed by

¹ *Musha`* from the perspective of *fuqaha`* refers to joint ownership over an asset in proportion and physically undivided. For details, refer to Nazih Hammad, *Mu`jam al-Mustalahat al-Maliyyah wa al-Iqtisadiyyah fi Lughah al-Fuqaha`*, Dar al-Qalam, Damsyik, 2008, First Edition, pp. 417-418.

the lessor (or lessor via the trustee) and the lessee to constitute the schedules as contract between two parties for the specific series of sukuk.

However, if the Master *Ijarah* Agreement is considered as a contract, the SAC agreed that there is no requirement to sign each schedule which provided the specific terms relating to *ijarah* since the schedule will be deemed as part of the contract.

- 2 There is no Shariah impediment if the proportionate interest in the asset is only specified via percentage (*mal musha`*).
- 3 For the purpose of the redemption/retirement of the sukuk, it is allowed to have a single purchase undertaking for all series of the sukuk *ijarah* and the redemption for each series via an individual sale agreement specific to the relevant proportionate interest of the leased assets.

The SAC also decided that for *ijarah* structure which does not provide purchase undertaking, there should be a mechanism, such as *hibah*, etc., to give effect to the ownership transfer of the asset to the issuer or owner. This mechanism is required to facilitate retirement or redemption of the sukuk at each maturity.

EARLY REDEMPTION CHARGES

INTRODUCTION

Issue of imposing early settlement charges pursuant to early redemption arises in the context of Islamic capital market (ICM) particularly in sukuk issuance/structuring based on *`uqud mu`awadhat*.

The issue in deliberation by the SAC was on the permissibility of imposing early settlement charges in the form of additional amount which shall be payable by the issuer to the sukukholders that may be considered as redemption premium in relation to early redemption.

RESOLUTION

The SAC had resolved that the sukukholders may impose early settlement charges pursuant to early redemption up to the unearned profit within the deferred sale price subject to mutual agreement.

FORM OF STRUCTURING SUKUK MUSHARAKAH

INTRODUCTION

Musharakah is a partnership arrangement between two or more parties to finance a project whereby all partners will contribute capital either in the form of cash, in-kind or combination of both. Any profit derived from the partnership will be distributed based on a pre-agreed profit sharing ratio. Meanwhile any loss will be borne together based on the respective parties capital contribution.

In the context of structuring sukuk *musharakah*, the basic principle of *musharakah* must be fulfilled. However, issue on the form of structuring sukuk *musharakah* arose in relation to the parties who become partners in the sukuk structuring, whether the partnership is between sukuk issuer and investors, or partnership among investors only.

RESOLUTION

The SAC had resolved that there are two forms of structuring sukuk *musharakah* as follows:

1

First Form: *Musharakah* Between Sukuk Issuer and Investors

Under this form, sukuk issuer and investors act as *musharik* who contribute certain amount of capital in the *musharakah* venture. In this context, the sukuk issuer who is also a partner will at the same time acts as a manager on behalf of the investors to manage the *musharakah* venture.

Second Form: *Musharakah* Among Investors

Under this form, *musharakah* is formed among investors only (at least two investors) where each investor contribute certain amount of capital in the *musharakah* venture. Normally sukuk issuer will only act as a manager on behalf of the investors.

If the issuance of sukuk *musharakah* is made in tranches and under separate *musharakah* contracts, then each *musharakah* contract shall has at least two investors or more at all times.

NUMBER OF PARTNERS IN MUSHARAKAH AMONG INVESTORS

INTRODUCTION

A sukuk *musharakah* structure that involves *musharakah* which is formed among investors has been tabled to the SAC. In this structure, the issuer does not become the partner but only act as a manager for the *musharakah* venture. Among the issues raised in relation to this structure was whether Shariah allows or not partnership in such sukuk structure that involves only one investor in the sukuk structure.

RESOLUTION

The SAC had resolved that at the initial stage of sukuk *musharakah* issuance that was formed among investors, there shall be at least two partners among them in order to form the *musharakah*.

However, for the secondary market, it is not required to comply with the minimum requirements of the partners. This is because at the secondary market it only involves normal sale and purchase on the sukuk holding and not on the formation of *musharakah* contract.

RESTRUCTURING OF SUKUK MUSHARAKAH: EXISTING SUKUK MUSHARAKAH AS CAPITAL CONTRIBUTION IN NEW SUKUK MUSHARAKAH

INTRODUCTION

There was an industry proposal on the restructuring of sukuk *musharakah* by issuing a new sukuk *musharakah*. In such proposal, the existing sukuk *musharakah* was terminated through constructive liquidation¹ and the existing sukuk *musharakah* was used as the capital contribution in-kind for the new sukuk *musharakah*.

Among the Shariah issues discussed in such proposal on restructuring of sukuk *musharakah* were as follows:

- (i) Whether the existing sukuk *musharakah* may be used as capital contribution in the new sukuk *musharakah*?; and
- (ii) Whether the issue of *qalb al-dayn*² arises in the situation where the existing sukuk *musharakah* which is terminated through constructive liquidation is converted into the new sukuk *musharakah*?

¹ Constructive liquidation refers to the actual valuation of the *musharakah* venture to be terminated on a specified date. From Shariah perspective, it is viewed in the context of *tandhidh hukmi* (constructive liquidation).

² *Qalb al-dayn* is referring to the conversion of an existing debt into a new debt.

The SAC had resolved on the issue of restructuring of sukuk *musharakah* as follows:

1 Existing sukuk *musharakah* as capital contribution in the new sukuk *musharakah*

The existing sukuk *musharakah* which represents the identified assets under the existing *musharakah* venture may be used as capital contribution in-kind to form a new *musharakah* venture in the new sukuk *musharakah* subject to the following conditions:

- (i) The identified assets under the existing *musharakah* venture shall be assessed in monetary value; and
- (ii) The existing *musharakah* venture is terminated through constructive liquidation.

2 The issue of *qalb al-dayn* in the situation where the existing sukuk *musharakah* which is terminated through constructive liquidation is converted into the new sukuk *musharakah*

In the restructuring of sukuk *musharakah*, the issue of *qalb al-dayn* does not arise since it does not involve the conversion of an existing debt into a new debt. In such circumstance, the conversion only involves contribution of asset from the *musharakah* venture in the existing sukuk *musharakah* which is terminated through constructive liquidation into the *musharakah* venture in the new sukuk *musharakah*.

PURCHASE AND SALE UNDERTAKINGS IN SUKUK STRUCTURING

INTRODUCTION

Purchase undertaking refers to a promise from one party to repurchase an asset in the future. Meanwhile, sale undertaking refers to a promise from one party to sell back an asset in the future. These two undertakings are among the common features applied in sukuk structuring based on *musharakah*, *mudharabah*, *wakalah bi al-istithmar* and *ijarah*.

Hence, this concept has been presented to the SAC to obtain a decision whether it is permissible by Shariah or not.

RESOLUTION

The SAC had resolved that purchase and sale undertakings are permissible. The SAC had also resolved on other matters in relation to both undertakings as follows:

- (i) Purchase and sale undertakings are based on *wa`d mulzim* on the promisor;
- (ii) Purchase and sale undertakings associated with specific events such as event of default, dissolution event, early redemption and redemption at the maturity of sukuk are permissible based on *wa`d mu`allaq*.
- (iii) Purchase and sale undertakings are not considered as a condition in a contract executed between investors and sukuk issuer. This is because both undertaking clauses are outside of the main contract of sukuk. These undertakings are merely *wa`d* to purchase or sell an asset. Hence, sale and purchase contracts will be executed when the party's involved exercises the purchase undertaking or the sale undertaking.

- (iv) Exercise price is due and payable by the sukuk issuer to sukukholders or its agent in the event of default, dissolution of sukuk, early redemption or redemption at the maturity of sukuk. The exercise price may be determined in the purchase undertaking or sale undertaking based on mutually agreed calculation formula or it may be determined upon the execution of an asset sale and purchase contract.

ADVANCE PART PAYMENT WHEN THE REALISED PROFIT RATE IS LESS THAN THE EXPECTED PROFIT RATE (SHORTFALL)

INTRODUCTION

In the issuance of sukuk, a situation called a “shortfall” will happen when the realised profit rate did not achieve the expected profit rate. In general, in sukuk *musharakah*, *mudharabah* and *wakalah bi al-istithmar*, profit distribution will be made based on the profit distribution ratio which was agreed by both contracting parties (i.e. between sukuk issuer and investors/sukukholders). The contracting parties agree with the expected profit rate that may be derived from *musharakah* and *mudharabah* ventures or investment made through a *wakil* under the *wakalah bi al-istithmar* principle.

In the event where the realised profit rate is less than the expected profit rate (this situation is called shortfall), there is a current practice among industry practitioners where the difference between the two profit rates will be paid by the sukuk issuer in the form of *qardh* as an advance part payment. However, a question arises whether this practice is allowed from the Shariah perspective in the above sukuk structuring.

RESOLUTION

The SAC had resolved that the sukuk issuer is allowed to make advance part payment to the sukukholders when the realised profit rate is less than the expected profit rate (this situation is called shortfall) in sukuk issuance structured under the principles of *musharakah*, *mudharabah* and *wakalah bi al-istithmar*.

The advance part payment may be implemented in the form of *qardh* provided by the issuer. This payment is not a guarantee of profit on *musharakah*, *mudharabah* and *wakalah bi al-istithmar*. This is due to the reason that the advance part payment made by the sukuk issuer will be set off from the exercise price under the contract of sale and purchase of asset pursuant to the purchase undertaking or sale undertaking upon the occurrence of default, dissolution or upon the maturity of sukuk.

APPLICATION OF TANAZUL IN SUKUK STRUCTURING

INTRODUCTION

Tanazul refers to the waiver of a person's rights over a matter to other party. In the context of sukuk issuance, *tanazul* is applied in sukuk which are structured under the principles of *musharakah*, *mudharabah* and *wakalah bi al-istithmar*. Such sukuk are usually associated with expected profit. In the current practice, the contracting parties agree with the expected profit that could be received from *musharakah* and *mudharabah* ventures or investment made through *wakil* under the *wakalah bi al-istithmar* principle.

For sukuk *musharakah* and *mudharabah*, *tanazul* is applied in a situation where the sukukholders [*musharik* or *rabb al-mal*] want to waive their right on the profit which is obtained from the venture to the sukuk issuer [*musharik* or *mudharib*]. Meanwhile in the context of sukuk *wakalah bi al-istithmar*, *tanazul* is applied where the sukukholders (*muwakkil*) waive their right on the profit which is obtained from an investment made through the sukuk issuer as a *wakil* and give the said profit to the *wakil*.

Normally, when the actual profit rate exceeds the expected profit rate, the excess will be given to the sukuk issuer in a form of incentive fee for his roles as a manager in the *musharakah* and *mudharabah* ventures or a *wakil* for making investment under the *wakalah bi al-istithmar* principle.

Therefore, based on the explanation above, several questions arose whether Shariah permits the following matters:

- (i) Application of *tanazul* on the profit gained from:
 - (a) *musharakah* or *mudharabah* ventures (in the issuance of sukuk *musharakah* or sukuk *mudharabah*); and
 - (b) investment made through a *wakil* (in the issuance of sukuk *wakalah bi al-istithmar*).

- (ii) Sukuk issuer receives an incentive fee if the actual profit rate obtained exceeds the expected profit rate.

RESOLUTION

The SAC had resolved that the application of *tanazul* in sukuk issuance structured based on the principles of *musharakah*, *mudharabah* and *wakalah bi al-istithmar* is permissible.

The SAC had also resolved that the sukukholders may waive their rights on the actual profit rate which exceeds the expected profit rate and give it to the sukuk issuer as an incentive fee for his roles as follows:

- (i) Manager in the *musharakah* or *mudharabah* ventures (for sukuk *musharakah* or sukuk *mudharabah*); or
- (ii) *Wakil* in managing the investment (for sukuk *wakalah bi al-istithmar*).

WAIVER BY THE SUKUKHOLDERS OF CERTAIN PERCENTAGE FROM THE NOMINAL VALUE OF SUKUK UNDER THE SUSTAINABLE AND RESPONSIBLE INVESTMENT (SRI) SUKUK FRAMEWORK

INTRODUCTION

The issuance of sukuk under the Sustainable and Responsible Investment (SRI) framework signifies an important accomplishment in the innovation of Islamic capital market products. The SRI sukuk has social impact by adopting a new concept that brings together certain sectors such as education and Islamic financial sectors through innovative structures in the industry.

PURPOSE OF ISSUANCE

Essentially, the proceeds from sukuk issued under the SRI framework will be ultimately used to fund Shariah-compliant eligible SRI projects such as to preserve and protect the environment and natural resources, to conserve the use of energy, to promote the use of renewable energy, to reduce greenhouse gas emission or to improve the quality of life for the society and development of *waqf* asset. The purpose of issuance of SRI sukuk is to promote the investment and funding of activities related to social responsibility.

There was an industry proposal on the issuance of SRI sukuk. The proposed sukuk structure was based on the Shariah principle of *wakalah bi al-istithmar* whereby the investment portfolio comprised tangible assets and commodity *murabahah*. The proceeds of the issuance were utilised to fund public educational project in steering the transformation of students' achievement in the government schools.

KEY UNIQUE FEATURES OF THE SRI SUKUK STRUCTURE

The proposed SRI sukuk has unique features. Among others is the 'Pay-for-Success' feature whereby the sukukholders will waive their right on a certain percentage of the nominal sukuk value if the achievement of the schools are met based on certain determined Key Performance Index (KPI). The waiver by the sukukholders on the nominal value is deemed part of their social responsibility in recognition of the positive social effect as a result of the achievement by the government schools.

This feature would, encouragingly, be a push factor for the management of the school to endeavour for excellent achievement apart from having conducive educational facilities and infrastructure. Conversely, in the event that KPIs are not met, the sukukholders shall be entitled to the nominal value of the sukuk in full subject to the terms and conditions of the sukuk issuance according to the Shariah principles.

The issue on waiver of rights by the sukukholders over certain percentage from the nominal value of the sukuk was deliberated in the SAC meeting to seek their decision.

RESOLUTION

The SAC had resolved that the sukuk structure based on the Shariah principle of *wakalah bi al-istithmar* which has the feature of waiver of rights by the sukukholders over certain percentage of the nominal value of the sukuk in the event that certain KPIs are met is permissible. The waiver of rights is based on the concept of *taradhi* as outlined in Shariah.

SHARIAH-COMPLIANT MECHANISM FOR DEFERMENT OF EXPECTED PROFIT DISTRIBUTION IN PERPETUAL SUKUK

INTRODUCTION

In the proposal of perpetual sukuk structured based on the Shariah principles of *musharakah*, *mudharabah* and *wakalah bi al-istithmar*, among the issue raised is whether the deferment of expected profit distribution requires a specific Shariah-compliant mechanism if the sukuk issuer opts to do so.

RESOLUTION

The SAC has resolved that the deferment of expected profit distribution [which is the payment of expected periodic distribution amount (EPDA)] in perpetual sukuk structured based on the Shariah principles of *musharakah*, *mudharabah* and *wakalah bi al-istithmar* are permissible.

If the sukuk issuer opts to defer the payment of EPDA either wholly or partly to the sukukholders, the said deferment may be done through a specific Shariah-compliant mechanism as follows and the deferment mechanism should be clearly explained to the sukukholders:

(i) Issuance of Deferral Notice

The sukuk issuer should issue deferral notice to the sukukholders (or via sukuk trustee) to inform the sukukholders with regard to such deferment. The deferral notice is issued based on the terms that have been agreed between the issuer and sukukholders; or

(ii) Execution of Commodity *Musawamah* Transaction

The sukukholders may provide *wa`d* for the execution of unilateral *musawamah* undertaking to the sukuk issuer whereby the sukukholders undertake to execute commodity *musawamah* transaction if the issuer opts to defer the payment of the EPDA to the sukukholders on the periodic distribution date. The said commodity *musawamah* transaction should be independent from the main contract of sukuk.

For perpetual sukuk structured based on the Shariah principles of *musharakah* and *mudharabah*, if the sukuk issuer opts to defer the payment of EPDA in the event of income generated from the *musharakah* or *mudharabah* ventures are equal to, in excess of the EPDA or less than the EPDA, the following Shariah-compliant mechanisms may be done:

(i) Reinvestment of EPDA as additional capital into an existing *musharakah* or *mudharabah* ventures if the income generated from the said ventures are equal to or in excess of the EPDA

If the sukuk issuer opts to defer the payment of the EPDA in the event as stated above, the issuer should inform the sukukholders on the said deferment.

The deferment of distribution of the EPDA may be achieved through reinvestment of an amount equal to the EPDA into the existing *musharakah* or *mudharabah* ventures. The said amount is considered as the sukukholders' additional capital in the venture. A notice should be issued to the sukukholders to evidence the additional capital contributed. In that situation, the contracting parties may opt any of the following:

- (a) Renegotiation with regard to the profit-sharing ratio or expected profit rate;
or
- (b) Agree to retain the same profit-sharing ratio or expected profit rate as agreed previously.

If the income generated from the *musharakah* or *mudharabah* ventures is in excess of the EPDA, any excess of profit above the EPDA may be retained in reserve account or given to the issuer as incentive.

(ii) Dissolution of existing *musharakah* or *mudharabah* ventures and investment into a new venture if the income generated from the venture is less than the EPDA

If the sukuk issuer opts to defer the payment of the EPDA in the event as stated above, the issuer should inform the sukukholders on the said deferment.

The deferment of the distribution of the EPDA may be achieved by way of dissolution of the existing venture through an exercise of purchase undertaking or sale undertaking. Sale and purchase contracts should be executed between the issuer and the sukukholders when the party's involved exercises the relevant undertakings. The issuer will pay the exercise price payable to the existing sukukholders. Then, the sukukholders may utilise the said payment to invest into a new venture subject to any of the following condition:

- (a) Investment into a different project (other than the existing venture under the dissolved *musharakah* or *mudharabah* ventures); or
- (b) Investment in the same project but with a different phase.

The SAC has also resolved that the flow of cash to the sukukholders upon dissolution of the existing *musharakah* or *mudharabah* ventures and the immediate investment into new venture may be evidenced by accounting entries. Then, the issuer and sukukholders will enter into a new *musharakah* or *mudharabah* agreements and form a new venture. However, the terms of the previous *musharakah* or *mudharabah* may be incorporated in the new agreement.

CONVERSION OF SUKUK AND REDEEMABLE CONVERTIBLE UNSECURED ISLAMIC DEBT SECURITIES (RCUIDS) INTO NEW ORDINARY SHARES OF THE ISSUER

INTRODUCTION

Several industry proposals relating to convertible sukuk structured based on the Shariah principles of *ijarah* and *wakalah bi al-istithmar* and redeemable convertible unsecured Islamic debt securities (RCUIDS) structured based on the Shariah principle of *murabahah* were presented to the SAC. The main Shariah issue discussed in those proposals was related to the conversion of sukuk and RCUIDS into new ordinary shares of the issuer (Conversion Shares).

Several issues in relation to the conversion of convertible sukuk and RCUIDS into the Conversion Shares were discussed as follows:

- (1) Convertible sukuk structured based on the Shariah principle of *ijarah* (Convertible Sukuk *Ijarah*)**
 - (a) Whether the conversion of the Convertible Sukuk *Ijarah* into the Conversion Shares is permissible and whether a leased asset could be considered as capital contribution in-kind by the sukukholders into the business of the issuer for the purpose of such conversion? and
 - (b) Is there any specific Shariah mechanism that should be applied to convert the Convertible Sukuk *Ijarah* into the Conversion Shares?
- (2) Convertible sukuk structured based on the Shariah principle of *wakalah bi al-istithmar* (Convertible Sukuk *Wakalah*)**
 - (a) Whether the conversion of the Convertible Sukuk *Wakalah* into the Conversion Shares is permissible if the ratio of non-debt investment assets is less than 33% of the aggregate value of the total *wakalah* investments portfolio ("*Wakalah* Portfolio"), which is applicable at the point of initial investment of the Convertible Sukuk *Wakalah*?

- (b) Whether the conversion of the Convertible Sukuk *Wakalah* into the Conversion Shares is considered as capital contribution in the form of debt by the sukukholders if the ratio of non-debt investment assets is less than 33% of the *Wakalah* Portfolio? and
- (c) Is there any specific Shariah mechanism that should be applied to convert the Convertible Sukuk *Wakalah* into the Conversion Shares?

(3) Redeemable convertible unsecured Islamic debt securities structured based on the Shariah principle of *murabahah* (RCUIDS *Murabahah*)

- (a) Whether the conversion of the RCUIDS *Murabahah* into the Conversion Shares is permissible since RCUIDS represent debt and whether debt could be used by the RCUIDS holders as capital contribution into the business of the issuer? and
- (b) Is there any specific Shariah mechanism that should be applied to convert the RCUIDS *Murabahah* into the Conversion Shares?

RESOLUTION

The SAC had resolved as follows:

1 Convertible Sukuk *Ijarah*

- (a) The conversion of the Convertible Sukuk *Ijarah* into the Conversion Shares is permissible. In this regard, a leased asset can be considered as capital contribution in-kind by the sukukholders into the business of the issuer.
- (b) The conversion of the Convertible Sukuk *Ijarah* into the Conversion Shares is effected by:
 - (i) giving notice of conversion; and
 - (ii) a conversion arrangement,as agreed by the contracting parties.

2**Convertible Sukuk *Wakalah***

- (a) The conversion of the Convertible Sukuk *Wakalah* into the Conversion Shares is permissible even though the ratio of non-debt investment assets is less than 33% of the *Wakalah* Portfolio.
- (b) The conversion of the Convertible Sukuk *Wakalah* would not be considered as capital contribution in the form of debt by the sukukholders into the business of the issuer since the Convertible Sukuk *Wakalah* represents ownership in the *Wakalah* Portfolio provided that the non-debt investment assets must at all time be a component of the *Wakalah* Portfolio.
- (c) The conversion of the Convertible Sukuk *Wakalah* into the Conversion Shares is effected by:
 - (i) giving notice of conversion; and
 - (ii) a conversion arrangement,as agreed by the contracting parties.

3**RCUIDS *Murabahah***

- (a) Direct conversion of RCUIDS *Murabahah* into the Conversion Shares is not permissible since RCUIDS *Murabahah* represents debt. However, the conversion of RCUIDS *Murabahah* into the Conversion Shares is permissible via specific Shariah mechanism in accordance with the requirements as set out in item 3(b) below.
- (b) The requirements for the conversion of the RCUIDS *Murabahah* into the Conversion Shares are as follows:
 - (i) The issuer should exchange the RCUIDS *Murabahah* held by the RCUIDS holders with non-debt assets (the value must be known);
 - (ii) The RCUIDS holders shall subsequently contribute the non-debt assets as their capital contribution in-kind into the business of the issuer; and
 - (iii) The issuer shall thereafter issue the Conversion Shares to the RCUIDS holders.

INVESTMENT IN THE SHARIAH-COMPLIANT GENERAL BUSINESS BASED ON MUSHA` FOR SUKUK WAKALAH BI AL-ISTITHMAR

INTRODUCTION

In sukuk structuring which is based on the principle of *wakalah bi al-istithmar* (sukuk *wakalah*), there is situation where the sukuk is issued based on tranches¹ or series².

When the investment made by the *wakil* is in the Shariah-compliant general business and not in specific business, the question arises whether the investment in the former can be determined based on the concept of *musha`* via specific percentage for each issuance of tranche or series of the sukuk.

RESOLUTION

The SAC had resolved that the investment in the Shariah-compliant general business, which is based on tranches or series and that is determined based on the concept of *musha`* via specific percentage is permissible.

¹ Tranches refers to an issuance of sukuk program in several tranches. Each tranche of the sukuk is issued at different time with different tenure and maturity date for each tranche.

² Series refers to tranches, which are divided into several series. Every series issued in each tranche may have different maturity dates but were issued at the same time.

SUKUK WAKALAH BI AL-ISTITHMAR AND ITS TRADABILITY

INTRODUCTION

Sukuk *wakalah bi al-istithmar* (Sukuk *Wakalah*) refers to certificates of equal value evidencing the certificate holder's undivided ownership in the investment assets pursuant to their investment through the investment agent.¹

A Sukuk *Wakalah* may be structured whereby the Shariah-compliant *wakalah* investment portfolio (*Wakalah* Portfolio) comprises a combination of non-debt investment assets and debt investment assets.

For instance, under the structure of Sukuk *Wakalah*, the sukuk trustee (Sukuk Trustee) (acting on behalf of the sukukholders) enters into a *wakalah* contract with the sukuk issuer. The sukuk issuer is appointed by the Sukuk Trustee as its agent (*Wakil*) to perform certain services which include investing the Sukuk *Wakalah* proceeds received from the sukukholders into a *Wakalah* Portfolio and managing the *Wakalah* Portfolio in accordance with the agreed terms.

The *Wakalah* Portfolio may comprise of investment in Shariah-compliant business or tangible assets² and Shariah-compliant commodities which are traded under the Shariah principle of *murabahah* (via *tawarruq* arrangement) ("Commodity Murabahah Investment")³. The income generated from the *Wakalah* Portfolio will be distributed to the sukukholders based on the agreed terms and conditions.

Based on the above instance, the SAC had focused its deliberation to the investment of Sukuk *Wakalah* in a *Wakalah* Portfolio comprising a combination of non-debt investment assets and debt investment assets. In this regard, several questions have been raised as follows:

¹ Guidelines on Islamic Capital Market Products and Services, Chapter 3, Definition.

² Among the examples of non-debt investment assets.

³ Among the examples of debt investment assets.

- (i) **Minimum Percentage for Non-Debt Investment Assets in a *Wakalah* Portfolio**
What is the minimum percentage for non-debt investment assets to ensure that such sukuk complies with the features of Sukuk *Wakalah* that invest in a *Wakalah* Portfolio comprising a combination of non-debt investment assets and debt investment assets?; and
- (ii) **Tradability of Sukuk *Wakalah***
Is Sukuk *Wakalah* that comprises of non-debt investment assets (the percentage of which is less than the percentage of debt investment assets) considered as debt and is the tradability of such Sukuk *Wakalah* on the secondary market subjected to the principle of *bai` al-dayn* (sale of debt)?

RESOLUTION

The SAC had deliberated several issues in relation to sukuk *wakalah bi al-istithmar* (Sukuk *Wakalah*) where the *Wakalah* Portfolio comprises a combination of non-debt investment assets and debt investment assets. The SAC resolved as follows:

A **Minimum Percentage for Non-Debt Investment Assets in *Wakalah* Portfolio**

- (i) At least 33% of the Sukuk *Wakalah* proceeds shall be invested into non-debt investment assets. This minimum percentage must be complied with at the time of each issuance of Sukuk *Wakalah*.
- (ii) It is not required to maintain such percentage throughout the tenure of the Sukuk *Wakalah*. However, the non-debt investment assets shall at all times be a component of the *Wakalah* Portfolio.

B **Tradability of Sukuk *Wakalah***

- (i) Sukuk *Wakalah* that has a component of non-debt investment assets (even when its percentage is less than the percentage of debt investment assets) is considered as a portfolio of assets. Therefore, such Sukuk *Wakalah* is not categorised as debt.

- (ii) Such Sukuk *Wakalah* can be traded on the secondary market at any negotiated price between the contracting parties without being subjected to the principle of *bai` al-dayn* as long as the non-debt investment assets shall at all times be a component of the *Wakalah* Portfolio.

SUBSCRIPTION OF SUKUK BY WAY OF MUQASAH

INTRODUCTION

Muqasah (offset) is a concept that has been accepted by Shariah. In the structuring of sukuk based on Asset-Backed Securitisation (ABS), there is an issue related to *muqasah*, which is the *muqasah* between the sukuk subscription price by the originator and the purchase price of the asset that is payable by the issuer to the originator.

In the issuance of sukuk involving the abovementioned issue, the originator has sold its asset to the issuer at a certain price. To pay the purchase price of the asset, the issuer will issue sukuk to the investors.

If the originator subscribed the sukuk as an investor, the originator is not required to make any cash payment to the sukuk issuer for the sukuk subscription price. This is because the sukuk subscription price that should be paid by the originator will be offset by way of *muqasah* against the purchase price of the asset payable by the sukuk issuer to the originator.

Hence, question arises whether Shariah permits the subscription of sukuk by the originator by way of *muqasah* against the payment of the purchase price of the asset payable by the sukuk issuer to the originator.

RESOLUTION

The SAC had resolved that the subscription of sukuk by the originator by way of *muqasah* against the payment of the purchase price of the asset payable by the sukuk issuer to the originator is permissible.

SETTLEMENT OF PURCHASE CONSIDERATION OF RECEIVABLES BY WAY OF MUQASAH

INTRODUCTION

A proposal from the industry in relation to the Sukuk *Murabahah* Asset-Backed Securitisation (ABS) Programme (Sukuk *Murabahah*) has been presented to the SAC. Among the issues raised was the settlement of the purchase consideration of receivables by way of *muqasah*.

In the Sukuk *Murabahah* proposal, the originator and the sukuk issuer have executed the contract of sale and purchase of receivables where the originator sells the receivables to the sukuk issuer. At the same time, the originator also subscribes to the Sukuk *Murabahah* issued by the sukuk issuer as the junior class sukukholder of the Sukuk *Murabahah* (Junior Sukuk *Murabahah*).

In the above situation, the sukuk issuer needs to pay the purchase consideration of the receivables to the originator, and the originator as the sukukholder of the Junior Sukuk *Murabahah* needs to pay to the sukuk issuer the subscription price of the Junior Sukuk *Murabahah*.

In this industry proposal, part of the payment of the purchase consideration of the receivables will be settled by the sukuk issuer to the originator by way of *muqasah* against the payment of the subscription price of the Junior Sukuk *Murabahah* that need to be paid by the originator to the sukuk issuer. Meanwhile, the balance of the purchase consideration of the receivables will be settled by the sukuk issuer to the originator in cash.

A question arises on whether the settlement of the purchase consideration of the receivables by the sukuk issuer to the originator can be done by way of *muqasah* in situation where the originator also needs to pay the subscription price of the Junior Sukuk *Murabahah* to the sukuk issuer.

RESOLUTION

The SAC resolved that the settlement of the purchase consideration of the receivables by the sukuk issuer to the originator by way of *muqasah* against the payment of the subscription price of the Junior Sukuk *Murabahah* that needs to be paid by the originator to the sukuk issuer is permissible.

In the event that there is a difference of value between the amount of the two debts (i.e debt owed by the sukuk issuer to the originator and debt owed by the originator to the sukuk issuer), the difference needs to be settled on the spot basis either by way of cash, in-kind or combination of both.

SHARIAH-COMPLIANT SECURITIES WHICH ARE SUBSEQUENTLY RECLASSIFIED AS SHARIAH NON-COMPLIANT SECURITIES

INTRODUCTION

The change of status of Shariah-compliant securities to Shariah non-compliant securities is normally due to certain factors such as changes in the companies' business operations, financial positions and companies' investment. In this situation, a question arose on what are the appropriate guidance and solutions that should be given to investors on the timing to dispose securities that have been reclassified as Shariah non-compliant.

RESOLUTION

The SAC had resolved, in respect of Shariah-compliant securities which have been reclassified as Shariah non-compliant securities on the date of the announcement of the List of Shariah-compliant Securities takes effect, the timing for the disposal of such securities are as follows:

- (i) If the market price of the said securities exceeds or is equal to the investment cost, investors who hold such Shariah non-compliant securities must dispose them off. Any dividends received up to date of the announcement and capital gains arising from the disposal of Shariah non-compliant securities on the date of the announcement can be kept by the investors. However, any dividends received and excess capital gain from the disposal of Shariah non-compliant securities after the date of the announcement should be channelled to *baitulmal* and/or charitable bodies; and

- (ii) If the market price of the said securities is below the investment cost, the investors are allowed to hold their investment in the Shariah non-compliant securities until the investors receive the investment cost. It is also permissible for the investors to keep the dividends received during the holding period until such time when the total amount of dividends received and the market value of the Shariah non-compliant securities held equal the investment cost. At this stage, the investors are advised to dispose of their holding.

In addition, during the holding period of the Shariah non-compliant securities, the investors are also allowed to subscribe to:

- (a) any issue of new securities by a company whose Shariah non-compliant securities are held by the investors, for example the investors subscribe to rights issues, bonus issues, special issues and warrants (excluding securities whose nature is Shariah non-compliant e.g. loan stocks); and
- (b) Shariah-compliant securities of other companies offered by the company whose Shariah non-compliant securities are held by the investors.

If by taking the actions as specified in items (a) and (b) above the investors manage to get back the investment cost, they must expedite the disposal of the Shariah non-compliant securities held.

UNINTENTIONAL MISTAKE OF INVESTING IN SHARIAH NON-COMPLIANT SECURITIES

INTRODUCTION

The SAC through the SC constantly reviews listed securities on Bursa Malaysia to determine and classify the Shariah status of the listed securities based on the specified criterias. This is to facilitate the investors to fulfill the objective of investment in Shariah-compliant securities.

For investors who have the objective of investing in the Shariah-compliant securities but due to unintentional mistake invest in Shariah non-compliant securities, a question arose whether they should dispose such securities as soon as possible or whether there is flexibility given by Shariah to dispose such securities within certain period.

RESOLUTION

The SAC had resolved that for investors who invest based on Shariah principles but due to unintentional mistake invest in Shariah non-compliant securities, the following steps must be taken:

- (i) To dispose the Shariah non-compliant securities held within a period of not more than one month after knowing the status of the securities; and
- (ii) In the event that there is any gain made in the form of capital gain or dividend received before or after the disposal of the securities, it has to be channelled to *baitulmal* and/or charitable bodies. The investors have the right to retain only the investment cost.

The above SAC resolutions are also applicable to Islamic funds such as Islamic unit trust funds, Islamic wholesale funds and others. If the disposal of the Shariah non-compliant securities causes losses to the Islamic funds, the fund management company must bear the losses by ensuring the loss portion be restored and returned to the funds.

SHARIAH COMPLIANCE FOR COMPANIES THAT CARRY OUT ACTIVITIES INVOLVING MANUFACTURING, PROCESSING AND MARKETING OF FOOD AND COSMETIC PRODUCTS OR PERSONAL CARE AND HEALTH PRODUCTS

INTRODUCTION

In general, the Shariah status of securities listed on Bursa Malaysia are subject to the Shariah screening methodology set up by the SAC which adopts a two-tier quantitative approach which applies business activities benchmarks and the financial ratios benchmarks. In addition, qualitative aspects involving the general perception or image of the company's activities from the Islamic perspective are also taken into account in the screening methodology.

For companies which are involved with business activities related to manufacturing, processing and marketing of food and cosmetic products or personal care and health products, there are specific Shariah compliance issues that should be addressed. This is because it involves the issue of halal products and the ingredients in food, the ingredients in cosmetic products or personal care and health products that are feared to be harmful to consumers.

Thus, a question arose on what are the Shariah compliance guidelines relating to the above issues that need to be complied by the listed companies which involve with such activities.

RESOLUTION

The SAC had resolved that the listed companies whose activities involve in the manufacturing, processing and marketing of food and cosmetic products or personal care and health products shall comply with the Shariah guidelines as follows:

- (i) For listed companies whose activities involve in the manufacturing, processing and marketing of food product, they shall obtain halal certification from Jabatan Kemajuan Islam Malaysia (JAKIM). Meanwhile, for food products from outside Malaysia for local market, the listed companies shall ensure that the products are recognised by halal certification bodies; and

- (ii) For listed companies whose activities involve in the manufacturing, processing and marketing of cosmetic products or personal care and health products, they shall make declaration that the ingredients or mixture of ingredients of their products do not contain any non-halal substances such as liquor, animals' organs and any other substances which may cause harm to the consumers.

GIVING SHARIAH NON-COMPLIANT SECURITIES BY WAY OF HIBAH

INTRODUCTION

Giving Shariah non-compliant securities by way of *hibah* to investors is a gift of securities which does not involve any purchase cost incurred by the investors. For instance, giving securities ABC by way of *hibah* to the investors whereby such securities will be deposited into the investors' Central Depository System (CDS)¹ account without incurring any purchase cost. Hence, a question arose whether such securities can be held by the investors or not. Several scenarios in relation to the above have been presented to the SAC for their decision.

SCENARIO 1:

The issuer issues the securities where its Shariah compliance status are unknown and give the securities to the investors as a gift without imposing any purchase cost. When the List of Shariah-Compliant Securities was announced by the SC, the relevant securities were classified as Shariah non-compliant securities.

RESOLUTION

The SAC had resolved that the investors are allowed to hold such securities until it is classified as Shariah non-compliant securities on the date of the announcement of the List of Shariah-Compliant Securities by the SC. At this stage, the investors must dispose the securities and any capital gains arising from the disposal of such securities on the announcement date can be kept by the investors.

¹ CDS acts as a way of representing the ownership and movement of securities. CDS account holders obtain benefit in doing the transfer of securities and settlement transactions electronically.

SCENARIO 2:

The issuer issues securities where its Shariah compliance status is unknown and give the securities to the investors as a gift without imposing any purchase cost. When the List of Shariah-Compliant Securities was announced by the SC, such securities were classified as Shariah non-compliant securities. However, the investors do not dispose the securities on the announcement date but instead the disposal of the securities was made after the announcement date.

RESOLUTION

The SAC had resolved that in such circumstances, the investors are allowed to keep the capital gain up to the closing price on the announcement date only. Thus, any excess capital gain, i.e. the difference between the market price (sale price) of the securities and the closing price on the announcement date should be channelled to *baitulmal* and/or charitable bodies. This is because the price increase takes place when the securities were classified as Shariah non-compliant securities.

The above SAC resolution is also applicable in respect of any dividends received (after the announcement date) whereby the investors should channel such dividends to *baitulmal* and/or charitable bodies given that the dividends were received when the securities were classified as Shariah non-compliant securities.

SCENARIO 3:

The issuer issues securities where its Shariah compliance status is unknown and give the securities to the investors as a gift without imposing any purchase cost. The investors perform their own review on the Shariah status of such securities and, by applying their own *ijtihad*, decided that such securities are classified as Shariah non-compliant securities.

RESOLUTION

The SAC had resolved that if the investors know that the securities given to them as a gift are Shariah non-compliant, the investors' ownership over such securities are considered as invalid. Hence, such securities must immediately be disposed of at any price on or after the date of announcement and any capital gain should be channelled to *baitulmal* and/or charitable bodies.

PURIFICATION OF INCOME BY INVESTORS

INTRODUCTION

A proposal was received from the industry pertaining to the purification of dividends received and excess capital gained from the disposal of Shariah non-compliant securities after the date of announcement, as well as capital gained and dividends received from the disposal of Shariah non-compliant securities which were mistakenly invested (Tainted Income) to be undertaken by the investors.

Therefore, the issue was presented to the SAC for deliberation on whether investors of Islamic funds are allowed to undertake the purification of the Tainted Income themselves instead of the fund manager of the Islamic funds.

RESOLUTION

The SAC resolved that it had no objection to the proposal for the purification of the Tainted Income to be undertaken by the investors subject to the following conditions:

- (i) Upon receipt of the Tainted Income, the fund manager shall deposit the Tainted Income into a separate account which is segregated from the account of the Islamic fund;
- (ii) The fund manager shall distribute the Tainted Income to the investors as soon as practically possible which shall be advised by the Shariah adviser of the Islamic fund;
- (i) The fund manager shall inform or notify the investors of their obligations to purify the Tainted Income in accordance with the Shariah principles upon distribution of the Tainted Income to the investors; and

- (ii) The processes and procedures for the purification of the Tainted Income by the investors shall be clearly disclosed in the prospectus/offering document.

The SAC also resolved that it had no objection for the fund manager to utilise a portion of the Tainted Income to pay all cost associated with the distribution of the Tainted Income.

CHANGE OF SHARIAH STATUS FOR SECURITIES USED AS COLLATERAL FOR ISLAMIC SHARE MARGIN FINANCING

INTRODUCTION

An enquiry was received from the industry pertaining to the collateral for Islamic share margin financing (Islamic SMF) for Islamic stockbroking services.

The current practice by Islamic Participating Organisations (POs) is to accept only Shariah-compliant securities as collateral for Islamic SMF. However, when such securities are subsequently reclassified to Shariah non-compliant securities (SNCS) by the SAC in its bi-annual review, the Islamic POs would automatically exclude such securities as collaterals resulting in margin call and/or forced selling of such securities.

Therefore, this issue was presented to the SAC to seek their decision on the permissibility for the Islamic POs to maintain Shariah-compliant securities, which were reclassified to SNCS, as collaterals for Islamic SMF.

RESOLUTION

The SAC resolved that it is permissible for the Islamic POs to maintain Shariah-compliant securities, which were reclassified to SNCS, as collaterals until the end of the Islamic SMF tenure.

APPLICATION OF BAI` SALAM PRINCIPLE IN SHARES TRADING

INTRODUCTION

Bai` salam is a sale and purchase contract whereby at the time when the contract is executed, the purchaser has made full payment of the purchase price prior to the delivery of goods by the seller where both contracting parties have agreed on the following:

- (i) Specification of characteristics, types and quantity of *muslam fih* (*salam* goods);
and
- (ii) The delivery of goods is made at the time and place which has been determined.

When the principle of *bai` salam* is applied in the context of trading of ordinary shares of Shariah-compliant listed companies on Bursa Malaysia (Shariah-Compliant Listed Shares), the purchase price for the Shariah-Compliant Listed Shares must be paid in full upon the execution of the contract. The types of the Shariah-Compliant Listed Shares (i.e. the name of the company of the Shariah-Compliant Listed Shares) and the quantity of the Shariah-Compliant Listed Shares must also be determined upon the execution of the contract. Meanwhile, the delivery of the Shariah-Compliant Listed Shares will take place at a time which has been determined in the future as agreed by both parties.

RESOLUTION

The SAC had resolved as follows:

- (1) The application of *bai` salam* principle in the trading of the Shariah-Compliant Listed Shares is permissible.

- (2) The Shariah-Compliant Listed Shares can be used as *muslam fih* (*salam* goods) since the Shariah-Compliant Listed Shares can be categorised as *mal mithli* (asset that is homogenous in nature).
- (3) The trading of the Shariah-Compliant Listed Shares using the principle of *bai` salam* is subject to the following conditions:
- (i) The Shariah-Compliant Listed Shares cannot be determined specifically and limited (*ta`yin*) which cause difficulty in receiving and delivering the *muslam fih*. Therefore, it is not permitted to determine specific serial numbers, specific owner or the like on the required Shariah-Compliant Listed Shares;
 - (ii) The company's name and the quantity of the Shariah-Compliant Listed Shares must be determined; and
 - (iii) The date for the delivery of the Shariah-Compliant Listed Shares must be determined.
- (4) *Bai` salam* does not occur in the sale and purchase transaction of the Shariah-Compliant Listed Shares which is executed through the trading and settlement system in Bursa Malaysia where the settlement of payment and the delivery are made on T+2 day. This transaction is a normal sale and purchase transaction because the settlement of payment and the delivery on the T+2 day has been recognised as a spot transaction based on *`urf tijari*.

HOLDING OR KEEPING DIVIDEND IN THE FORM OF SHARES TO RECOVER ACTUAL LOSSES SUFFERED DUE TO DISPOSAL OF SHARIAH NON-COMPLIANT SHARES BELOW THE INVESTMENT COST

INTRODUCTION

In general, dividend payout from companies may be paid in the form of shares, cash or in-kind.

A question arises from the industry whereby Islamic fund manager, on behalf of the investors, had disposed Shariah-compliant shares which were reclassified as Shariah non-compliant shares on announcement date of the List of Shariah-compliant Securities by the SAC below the investment cost. Prior to the announcement date, the company had declared dividends of the particular year in the form of shares to the shareholders which will be paid on a specific date in the future. In the situation involving the Islamic fund manager as described above, the dividend in the form of shares were received by the Islamic fund manager after the disposal of the mother shares which has been reclassified as Shariah non-compliant shares.

Hence, a question arises whether it is permissible by Shariah or not if the Islamic fund manager keeps the dividend in the form of Shariah non-compliant shares (Dividend Shares) until value of the Dividend Shares can cover the cost of losses borne by the Islamic fund manager due to the disposal of the mother shares below the investment cost.

RESOLUTION

The SAC had resolved that the Islamic fund manager, on behalf of Muslim investors, is allowed to hold or keep the Dividend Shares received after disposal of mother shares that has been reclassified as Shariah non-compliant shares (which were disposed at a loss position) subject to the following conditions:

- (i) Dividend Shares received can be held or kept until the price of the Dividend Shares plus the price from the disposal of the mother shares (which were disposed earlier at a loss) are equal to the investment cost. At this stage, the Islamic fund manager should dispose of their holding; and
- (ii) Excess profit gained from the disposal of the Dividend Shares (if any) must be channelled to *baitulmal* and/or approved charitable bodies.

PROCEEDS FROM THE SALE OF SUBSCRIPTION RIGHTS OF LOAN STOCKS TO COVER TECHNICAL LOSSES OF THE COMPANY SHARES

INTRODUCTION

Subscription rights are the rights of existing shareholders to retain their holding or ownership percentage in a company by subscription of new shares issuance at or below market prices. These rights include subscription rights of loan stocks.

In relation to the subscription rights of loan stocks, there is an enquiry from the industry on the Islamic fund manager who holds company shares (mother shares) which were classified as Shariah-compliant shares which are subsequently reclassified as Shariah non-compliant. During the period of holding of mother shares, the company proposed to issue loan stocks to raise funds for the company. Prior to the issuance of the loan stocks, the company will issue the subscription rights of loan stocks to the existing shareholders to subscribe the loan stocks that are going to be issued or sell the said subscription rights to other party.

Generally, when the loan stocks are issued, a dilution would occur whereby there will be an increase of the number of the company shares and this will cause the price of the company shares held by the fund manager or investors to fall.¹ In this situation, since such subscription of loan stocks is not permitted by the Shariah, the Islamic fund manager or Muslim investor who did not subscribe to the loan stocks would incur losses or “technical losses”.

As such, the above issue was presented to the SAC to seek decision whether Shariah permits or not the Islamic fund manager or Muslim investor to sell the subscription rights

¹ The fall in shares price refers to the decline in the shares price of a parent company (mother shares) after the issuance of the loan stock as compared to the mother shares price before issuing such loan stocks.

of loan stocks to cover the “technical losses” incurred on the shares held by them due to the fall in such shares price.

RESOLUTION

The SAC has resolved that the Islamic fund manager or Muslim investor is not allowed to subscribe the loan stocks. Nevertheless, if a company has issued the subscription rights of loan stocks to the existing shareholders to subscribe the loan stocks, the SAC has resolved that the Islamic fund manager or Muslim investor is allowed to sell the subscription rights of loan stocks to cover the technical losses due to the fall in the mother shares price that have been held by them.

There are two scenarios which might occur in relation to the holding of the subscription rights of loan stocks as follows:

1 The existing shareholders who hold the Shariah-compliant shares

(i) In the event of a fall in the price of the company shares

The proceeds from the sale of subscription rights of the loan stocks may be used by the Islamic fund manager or Muslim investor to compensate the losses. Even though it might not cover the entire losses, at least the investors would be able to minimise their losses.

However, if the proceeds from the sale of the subscription rights are more than the losses, then the surplus should be channelled to *baitulmal* and/or approved charitable bodies.

(ii) In the event of increase or no change in the price of the company shares

The proceeds from the sale of such subscription rights should be channelled to *baitulmal* and/or approved charitable bodies.

The calculation of the above situations will take into account the difference between the closing price of the shares on the day before the loan stocks are issued and the closing price of the shares on the day the loan stocks are issued.

2 The existing shareholders who hold the Shariah-compliant shares which are subsequently reclassified as Shariah non-compliant

The Islamic fund manager or Muslim investor is allowed to use the proceeds from the sale of the subscription rights of loan stocks to cover the investment cost of the Shariah-compliant mother shares which are subsequently reclassified as Shariah non-compliant that would be disposed below the investment cost price in order to expedite the disposal of the Shariah non-compliant shares.

If the proceeds from the sale of such subscription rights exceed the amount to cover the investment cost (if any), the surplus should be channelled to *baitulmal* and/or approved charitable bodies.

ISLAMIC FOREIGN CURRENCY OPTION BASED ON WA`D

INTRODUCTION

An industry proposal was presented to the SAC relating to the Islamic Dual Currency Investment (DCI-i) which was an Islamic structured investment product. The proposed DCI-i product was linked to the performance of a pair of currencies (between Ringgit Malaysia and foreign currency) under the principle of *wakalah bi al-istithmar*.

Among the issues discussed in the presentation was the application of Islamic foreign currency option-i (FX option-i) using the principle of *wa`d*. In the proposed DCI-i product, the bank gives *wa`d* to the counterparty to enter into currency exchange transaction in the future based on the strike price under the FX option-i structure. Hence, this issue was presented to the SAC to seek their decision.

RESOLUTION

The SAC resolved that the Islamic Foreign Currency Option (FX Option-i) based on *wa`d* is permissible. This is essentially based on the *wa`d* which binds one of the parties (i.e. the promisor) to enter into a currency exchange (*bai` al-sarf*) transaction on a future date with the counterparty (i.e. the promisee) to receive the pay-off of the investment under *wakalah bi al-istithmar* based on a pre-determined conversion rate (Strike Rate) under the structure of the FX Option-i which have been agreed initially.

In the event that the *wa`d* is exercised by the counterparty (as the promisee), the promisor is bound to exchange the original investment currency (Base Currency) into the selected alternative currency (Alternate Currency) thus resulting the promisor to receive

the Alternate Currency from the counterparty in exchange of the Base Currency based on the terms and conditions which have been agreed under the *wa`d* arrangement.

The Shariah requirement of *bai` al-sarf* under the structure of the FX Option-i has been met. This is because the exchange rate (i.e. the Strike Rate) of these currencies (i.e. the Base Currency and the Alternate Currency) has been agreed upfront under the *wa`d* arrangement.

PAYMENT OF DEBT IN THE INVESTMENT CURRENCY BY USING THE ALTERNATE CURRENCY BASED ON THE CURRENCY EXCHANGE RATE THAT IS DETERMINED IN THE WA`D ARRANGEMENT

INTRODUCTION

In the Islamic Dual Currency Investment (IDCI) which is based on the principle of *murabahah* (via *tawarruq* arrangement), there is a main issue that arises in relation to the payment of debt in the investment currency (Investment Currency) by using the selected alternate currency (Alternate Currency) based on the currency exchange rate that is determined in the *wa`d* arrangement.

In the IDCI structure, the investor gives *wa`d* to the bank where the investor agrees to receive the *murabahah* sale price in the Alternate Currency on the maturity date of the IDCI based on the exchange rate which was agreed in the *wa`d* arrangement. In the event that the Investment Currency is stronger than the Alternate Currency, the bank shall exercise the *wa`d* and consequently, *bai` al-sarf* (currency exchange) will be executed. The investor will receive the *murabahah* sale price from the bank in the Alternate Currency based on the exchange rate which was agreed in the *wa`d* arrangement.

The Shariah issue which was discussed by the SAC is related to the payment of the *murabahah* sale price in the Alternate Currency through the execution of *bai` al-sarf* on the maturity date of the IDCI, based on the exchange rate which was agreed in the *wa`d* arrangement.

The SAC had resolved as follows:

A WA`D FOR THE EXECUTION OF BAI` AL-SARF THAT IS NOT ASSOCIATED WITH INDEBTEDNESS

If *wa`d* for the execution of *bai` al sarf* is not associated with indebtedness, the determination of the currency exchange rate may be agreed in the *wa`d* arrangement by the parties involved based on:

- (i) any exchange rate which was agreed in the *wa`d* arrangement; or
- (ii) the prevailing currency exchange rate.

The agreed currency exchange rate may be applied when *bai` al-sarf* is executed.

B WA`D FOR THE EXECUTION OF BAI` AL-SARF THAT IS ASSOCIATED WITH INDEBTEDNESS

(1) Determination of the Currency Exchange Rate on the Debt Payment Date

Payment of debt in the Alternate Currency through the execution of *bai` al-sarf* on the debt payment date is permissible, subject to the following conditions:

- (i) The currency exchange rate shall be based on the prevailing currency exchange rate or any rate agreed upon by the parties involved, on the debt payment date; and
- (ii) The debt that has been identified for payment in the Alternate Currency shall be fully paid on spot basis on the debt payment date.

(2) Determination of the Currency Exchange Rate at a Pre-Agreed Exchange Rate in the *Wa`d* Arrangement

Payment of debt in the Alternate Currency through the execution of *bai` al-sarf* on the debt payment date based on the exchange rate which was agreed in the *wa`d* arrangement is not permissible unless the following requirements are fulfilled:

- (i) The debt in the Investment Currency must be fully paid in the same currency on the specified date; and
- (ii) The conversion of the Investment Currency into the Alternate Currency shall only occur on the day of the execution of *bai` al-sarf* based on the exchange rate which was agreed in the *wa`d* arrangement, upon the full payment of the debt in the Investment Currency.

Wa`d for the currency exchange that is provided by the promisor shall only be for the purpose of the execution of *bai` al-sarf*.

THE APPLICATION OF BAI` AL-DAYN BI AL-SILA` IN THE ISLAMIC CAPITAL MARKET

INTRODUCTION

An industry proposal of Redeemable Convertible Unsecured Islamic Debt Securities (RCUIDS) was presented in the SAC meeting. This proposal involved the issue of *bai` al-dayn bi al-sila`* where the obligation of the issuer to pay debt which arose pursuant to the issuance of RCUIDS was undertaken by exchanging the RCUIDS (*al-dayn*) with commodity (*al-sila`*). In this context, the commodity was considered as payment 'in-kind' by the issuer to the RCUIDS holders based on the obligation of the issuer under the RCUIDS. This issue was presented to the SAC to seek their decision.

RESOLUTION

The SAC resolved that *bai` al-dayn bi al-sila`* is permissible.

BAI` WA SALAF

INTRODUCTION

The issue on the combination of sale and loan (*qardh*) contracts arose when discussing the proposal from the industry on the structuring of sukuk based on *musharakah* contract. Therefore, this issue was discussed to seek the SAC's opinion whether the combination of the said contracts can be categorised as *bai` wa salaf* which is prohibited by Prophet Muhammad (PBUH).

RESOLUTION

The SAC discussed on the issue of the combination of sale and loan (*qardh*) contracts in several meetings. The SAC resolved that, for any ICM proposal which includes the structure of sale contract and loan contract, there should not be any conditions in such proposal which indicates any link or connection between the sale contract and loan contract. It is because the conditional feature in the combination of sale contract and loan contract would fall under the prohibition in a hadith by Prophet Muhammad (PBUH) on *bai` wa salaf*.

The SAC also resolved that the main criteria of combination between sale and loan contracts that can be classified under *bai` wa salaf* are as follows:

- (i) There is interconnectivity between sale and loan contracts; and/or
- (ii) There is an opportunity by the contracting parties to take advantage or manipulate the agreed pricing in the sale and purchase contract for the benefit of the creditor via the loan contract that has connection with *`uqud mu`awadhat*.

UJRAH ON GUARANTEE

INTRODUCTION

Ujrah refers to a financial payment for the use of services or usufruct. In the current economic context, it refers to a payment of fee as consideration for services such as salary, commission or the like.

Question arises on whether the imposition of *ujrah* on guarantee provided by third party which involves *`uqud mu`awadhat*, *`uqud ishtirak* and *`aqd wakalah bi al-istithmar* is permissible by Shariah or not.

RESOLUTION

The SAC had resolved that the imposition of *ujrah* on guarantee provided by third party which involves *`uqud mu`awadhat*, *`uqud ishtirak* and *`aqd wakalah bi al-istithmar* is permissible.

COLLATERAL ASSETS IN ISLAMIC CAPITAL MARKET PRODUCTS

INTRODUCTION

In certain issuances of Islamic capital market (ICM) products in Malaysia, there are products which are secured with a particular collateral that is suitable and sufficient in terms of its value as a security for the investors if the issuer of ICM product fails to fulfill its obligation towards them. From the Shariah perspective, this issue is viewed in the context of *rahn*. *Rahn* in the context of current Islamic finance refers to a collateral or security.

Assets that can be used as collateral in the ICM products, among others, are physical assets and financial assets. However, several questions arise as follows:

- (i) Whether an asset that can be used as collateral is limited to Shariah-compliant asset or it can also involve a Shariah non-compliant asset?; and
- (ii) Whether the whole value of the Shariah non-compliant asset can be accepted as collateral or the collateral value is limited to the Shariah-compliant portion only?

RESOLUTION

The SAC had resolved the following:

- 1 Asset which is valuable and recognised by Shariah may be used as collateral in ICM products. These assets include:
 - (i) A physical asset that is used to carry out activities which are Shariah-compliant and/or Shariah non-compliant; and

(ii) A financial asset that is Shariah-compliant and/or Shariah non-compliant.

2 In the case where Shariah non-compliant financial asset is used as collateral, the SAC resolved as follows:

(i) Ordinary Shares and Preference Shares

- (a) Shariah non-compliant ordinary shares and preference shares of companies listed on Bursa Malaysia; and
- (b) Shariah non-compliant ordinary shares and preference shares of unlisted companies,

may be accepted as collateral provided that the core business of the companies is Shariah-compliant based on the confirmation by the Shariah advisers registered with the Securities Commission Malaysia. The total value of the Shariah non-compliant ordinary shares and preference shares may be accepted as the collateral value.

(ii) Conventional Insurance

An asset must be covered through *takaful* scheme. However, if the asset is already covered under an existing conventional insurance policy, the entire value of the conventional insurance policy coverage may be accepted as collateral. Such conventional insurance policy may be maintained until its expiry.

Once the conventional insurance policy expires, such asset must be covered by *takaful* scheme. If the *takaful* scheme is not available or is not commercially viable as determined by the Shariah adviser, such asset may be covered under a conventional insurance policy and the entire value of such conventional insurance policy coverage may be accepted as collateral.

However, in the event that the policyholder still renews the existing conventional insurance policy of its asset without taking into consideration the *takaful* scheme coverage, the value of the conventional insurance policy acceptable as collateral is only limited to the Shariah-compliant portion which constitutes the total amount of premium paid by the policyholder.

(iii) Shariah Non-Compliant Financial Asset other than Ordinary Shares, Preference Shares and Conventional Insurance

Shariah non-compliant financial asset other than the ordinary shares and preference shares as stated in item (2)(i)(a), (2)(i)(b) and (2)(ii) above may be accepted as collateral provided that the value of the collateral is limited to the Shariah-compliant portion only. In this regard:

- (a) the collateral value of the Shariah non-compliant financial asset which is based on interest such as conventional fixed deposit certificate and conventional bond is limited to the principal amount of such instruments; and
- (b) the collateral value of the Shariah non-compliant unit trust fund is limited to the initial investment and any additional investment by the investors.

FORMS OF CAPITAL CONTRIBUTION IN MUSHARAKAH AND MUDHARABAH

INTRODUCTION

In the context of *musharakah* and *mudharabah*, the capital contribution comes from the contracting parties, either from the *musharik* (contracting partner) or *rabb al-mal* (capital provider), for the purpose of the *musharakah* and *mudharabah* venture. Nevertheless, a question arises on the form of capital contribution that is permitted and prohibited according to Shariah.

RESOLUTION

The SAC had resolved that the capital contribution provided by each *musharik* in a *musharakah* venture or *rabb al-mal* in a *mudharabah* venture must be in the form of something that is readily available, identifiable and accessible at the time of execution of contract. The forms of capital contribution permitted by Shariah are cash, in-kind or combination of both. Nevertheless, a debt cannot be accepted as a capital contribution in *musharakah* and *mudharabah*.

VALUATION OF CAPITAL CONTRIBUTION IN-KIND IN MUSHARAKAH AND MUDHARABAH

INTRODUCTION

Capital contribution in *musharakah* and *mudharabah* can be in various forms such as cash and in-kind. If the capital contribution is in-kind, a question arises whether the said capital contribution needs to be valued initially in monetary value or not. The said valuation is made to ensure that the value of capital contribution from the contracting parties is clearly determined.

RESOLUTION

The SAC resolved that capital contribution in-kind by *musharik* or *rabb al-mal* must be valued in monetary value at the time of the execution of *musharakah* and *mudharabah* contracts. The said valuation needs to be conducted to ensure that the value of capital contribution from the contracting parties is clearly determined at the time of the execution of such contracts.

DETERMINATION OF JOINT-OWNERSHIP RATE OVER AN ASSET WHICH IS PHYSICALLY UNDIVIDED

INTRODUCTION

A joint-ownership over an asset, which is physically undivided is referred to as *mal musha`*. If the jointly-owned asset is physically divided among the partners, the feature of joint-ownership cease to exist, and it becomes a specific ownership of each partners over such asset.

Apart from a joint-ownership over an asset, there is also a situation whereby the joint-ownership is on a Shariah-compliant business of a company which is physically undivided.

Therefore, in the context of *mal musha`*, a question arises whether Shariah permits or not, joint-ownership which is physically undivided via specific percentage.

RESOLUTION

The SAC had resolved that the ownership over *mal musha`* which is determined via specific percentage is permissible.

DIGITAL ASSETS FROM SHARIAH PERSPECTIVE

INTRODUCTION

Digital assets as regulated under the jurisdiction of SC consist of digital currency¹ and digital token (Digital Assets). The definition and scope of digital currency and digital token which were defined as securities are as prescribed under the Capital Markets and Services (Prescription of Securities) (Digital Currency and Digital Token) Order 2019.² Several issues from Shariah perspective in relation to Digital Assets were presented to the SAC.

Since there are Digital Assets which are categorised as capital market instruments, the SAC had discussed the following issues from Shariah perspective:

- (i) Whether Digital Assets can be recognised as *mal* (asset)³ from Shariah perspective?;
- (ii) Whether Digital Assets can be classified as currency or *`urudh* (goods)⁴?; and
- (iii) How to determine the Shariah status of a digital token?

¹ Refers to a digital currency that is approved by the SC for trading on *Digital Asset Exchange (DAX)*.

² The definition and scope of digital currency and digital token are as prescribed under the Capital Markets and Services (Prescription of Securities) (Digital Currency and Digital Token) Order 2019 which can be retrieved at the following SC's website: <https://www.sc.com.my/api/documentms/download.ashx?id=8c8bc467-c750-466e-9a86-98c12fec4a77>

³ According to the majority of Islamic scholars, *mal* refers to something that has value, can be traded and shall be subject to compensation for anyone who damage it. al-Suyuti, *al-Asybah wa al-Naza'ir*, 1983, p. 409.

⁴ Ibn Qudamah defines *`urudh* as *mal* other than currency such as plants, animals, lands and others. Meanwhile, for al-Bujairimi, anything that is exchanged with currency, it is considered as *`urudh*. Ibn Qudamah, *al-Mughni*, v. 4, p. 249, al-Bujairimi, *al-Bujairimi `ala al-Khatib*, v. 3, p. 55.

SAC in a series of its meetings had discussed issues in relation to Digital Assets from Shariah perspective. The discussions on Digital Assets in the SAC meetings are limited to Digital Assets that are regulated by the SC. In the said SAC meetings, the SAC had resolved the following:

A Digital Currency

Digital currency is recognised as *mal* from Shariah perspective. The SAC had viewed digital currency from two scopes, as follows:

(1) Digital currency that is based on technology without any underlying

Digital currency in this form is categorised as *`urudh* and it is not a currency from Shariah perspective. Such digital currency is not categorised as *ribawi* items. Therefore, the trading of such digital currency is not subject to the principle of *bai` al-sarf* (currency exchange).

(2) Digital currency that is backed by *ribawi* items

(i) Digital currency that is backed by gold, silver and currency

If a digital currency is backed by *ribawi* items comprising gold, silver and currency, it is categorised as a currency from Shariah perspective. Hence, the trading of such digital currency is subject to the principle of *bai` al-sarf*.

(ii) Digital currency that is backed by *ribawi* items other than gold, silver and currency

If a digital currency is backed by *ribawi* items other than gold, silver and currency, it is categorised as *amwal ribawiyyah* (*ribawi* items).

Therefore, the trading of such digital currency is subject to the Shariah requirements of *ribawi* items.

B

Digital Token

Digital token is recognised as *mal* under the category of *`urudh* from Shariah perspective.

In determining the Shariah status of a digital token, the following matters must be fulfilled:

- (i) The proceeds raised from the issuance of the digital token must be utilised for Shariah-compliant purposes;
- (ii) The rights and benefits attached to the digital token must be Shariah-compliant; and
- (iii) In the event that the utilisation of proceeds under item (i) and the entitlement of rights and benefits under item (ii) above are for mixed activities of Shariah-compliant and Shariah non-compliant purposes, the existing SAC resolution on utilisation of sukuk proceeds and the business activities benchmark under the Shariah screening methodology for listed companies on Bursa Malaysia are applicable.

If a digital token is backed by *ribawi* items, the trading of such digital token is subject to the Shariah requirements for trading of *ribawi* items.

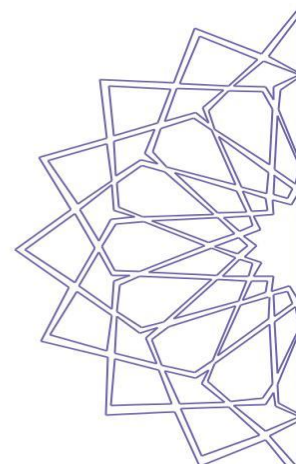
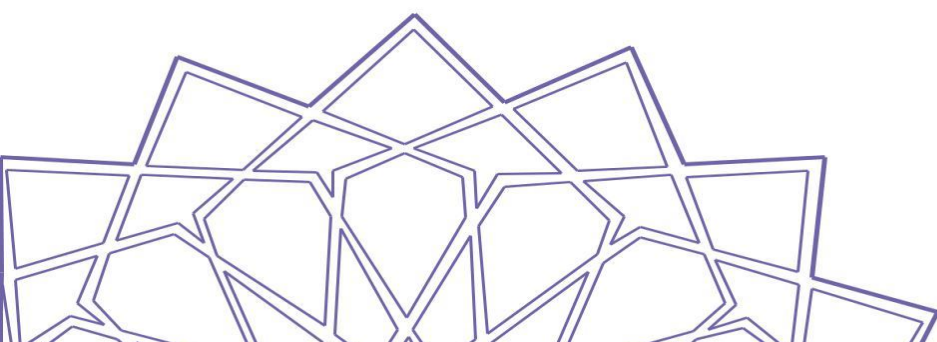
This resolution is not applicable to any Digital Assets which are outside the jurisdiction of SC.

The SAC has also resolved that investment and trading of Digital Assets that fulfil the above requirements and which are traded on Digital Asset Exchange (DAX) registered with SC are permissible.

PART B

**RESOLUTIONS
OF THE SHARIAH ADVISORY COUNCIL
OF THE SECURITIES COMMISSION MALAYSIA**

**SHARIAH CRITERIA
FOR LISTED AND UNLISTED SECURITIES**



SHARIAH SCREENING METHODOLOGY FOR LISTED SECURITIES

INTRODUCTION

In classifying the Shariah status for securities listed on Bursa Malaysia on an annual basis, the SAC received input and support from the SC in gathering information on the companies through annual reports and the latest available annual audited financial statements of the companies as well as additional information obtained from the companies. The SAC adopts two screening approaches i.e. quantitative and qualitative. For quantitative approach, the SAC adopts a two-tier quantitative approach, which applies:

- (i) The business activity benchmarks; and
- (ii) The financial ratio benchmarks.

Hence, the securities will be classified as Shariah-compliant if they are within the business activity and the financial ratio benchmarks. As for the qualitative approach, the SAC takes into account the qualitative aspect which involves public perception or image of the company's activities from the Islamic perspective.

RESOLUTION

The SAC adopts two main approaches i.e. quantitative and qualitative, in determining the Shariah status of the listed securities. The quantitative approach is as follows:

A Business Activity Benchmarks

The SAC updated its decision relating to the business activity benchmarks from four benchmarks i.e. 5%, 10%, 20% and 25% to two benchmarks only i.e. 5% and 20%.

In determining the Shariah status of the listed securities on Bursa Malaysia, the contribution of Shariah non-compliant activities to the Group revenue and Group profit before taxation of the company will be computed and compared against the relevant business activity benchmarks as follows:

(i) The 5% benchmark

The 5% benchmark is applicable to the following businesses/activities:

- conventional banking and lending;
- conventional insurance;
- gambling;
- liquor and liquor-related activities;
- pork and pork-related activities;
- non-halal food and beverages;
- Shariah non-compliant entertainment;
- tobacco and tobacco-related activities;
- interest income¹ from conventional accounts and instruments (including interest income awarded arising from a court judgement or arbitrator);
- dividends² from Shariah non-compliant investments; and
- other activities deemed non-compliant according to Shariah principles as determined by the SAC.

For the above-mentioned businesses/activities, the contribution of the Shariah non-compliant businesses/activities to the Group revenue or Group profit before taxation of the company must be less than 5%.

(ii) The 20% benchmark

The 20% benchmark is applicable to the following businesses/activities:

^{1,2} Interest income and dividends from Shariah non-compliant investments will be compared against the Group revenue. However, if the main activity of the company is holding of investments, the dividends from Shariah non-compliant investments will be compared against the Group revenue and Group profit before taxation.

- share trading;
- stockbroking business;
- rental received from Shariah non-compliant activities; and
- other activities deemed non-compliant according to Shariah principles as determined by the SAC.

For the above-mentioned businesses/activities, the contribution of Shariah non-compliant businesses/activities to the Group revenue or Group profit before taxation of the company must be less than 20%.

B

Financial Ratio Benchmarks

The SAC in its series of meetings discussed issues relating to the determination of financial ratio benchmark and resolved the following:

- (i) The applicable financial ratio benchmarks are as follows:
 - (a) Cash over total assets

Cash only includes cash placed in conventional accounts and instruments, whereas cash placed in Islamic accounts and instruments is excluded from the calculation.
 - (b) Debt over total assets

Debt only includes interest-bearing debt whereas Islamic financing or sukuk is excluded from the calculation.
- (ii) The above-mentioned financial ratio is intended to measure *riba* and *riba*-based elements within a company's statements of financial position. Hence, in classifying a company as Shariah-compliant, cash over total assets and debt over total assets ratios must be less than 33%.

In addition to the above two-tier quantitative criteria, the SAC also takes into account the qualitative aspect which involves public perception or image of the company's activities from the Islamic perspective.

SHARIAH SCREENING METHODOLOGY FOR LISTED SECURITIES OF A STOCK EXCHANGE HOLDING COMPANY (SEHC)

INTRODUCTION

The SAC had, in series of its meetings, deliberated on the Shariah screening methodology for a Stock Exchange Holding Company (SEHC). Under the law, the SEHC has the obligation to facilitate capital raising and trading activities which include services for the listing, trading, clearing, settlement and depository of both Shariah-compliant and Shariah non-compliant listed securities (Activities Beyond Control). The SEHC also offers its own products comprising Shariah-compliant and Shariah non-compliant products to be listed and traded on the stock exchange as well as other services and activities (Activities Within Control).

Hence, this issue was presented to seek the SAC decision with regards to the appropriate Shariah screening methodology to be applied, in determining the Shariah status of the SEHC securities.

RESOLUTION

The SAC had resolved that due to the nature of the SEHC as a national exchange that undertakes Activities Beyond Control and Activities Within Control, a specific two-tier business activities benchmark would be applicable in determining its Shariah status as follows:

1 5% Benchmark

For Activities Within Control, the contribution from the Shariah non-compliant activities to the group revenue or group profit before taxation (PBT) must be less than 5%; and

2

33% Benchmark

For Activities Beyond Control, the contribution from the Shariah non-compliant activities to the group revenue or group PBT must be less than 33%.

The financial ratio benchmark will continue to be applicable to the SEHC.

SHARIAH SCREENING METHODOLOGY: SPECIAL PURPOSE ACQUISITION COMPANIES (SPAC)

INTRODUCTION

Special Purpose Acquisition Companies (SPAC) is a special investment vehicles formed to acquire businesses through acquisition or merger with other entities. SPAC is a publicly traded shell company that raises funds through Initial Public Offering (IPO). The proceeds are placed in a trustee pending a qualified business acquisition.

The investment fund raised through SPAC enables the public to invest in private equity which was normally dominated by private equity participants and hedge fund. In essence, SPAC does not only promote investment activities in private equity but it also intensifies corporate transformation by fostering merger and takeover of identified companies.

The issue on whether securities of SPAC can be classified as Shariah-compliant or not was presented to the SAC for their decision.

RESOLUTION

The SAC had resolved that in order for securities of SPAC to be classified as Shariah-compliant, the company should fulfill the following criteria:

- (i) The proposed business activity should be Shariah-compliant;
- (ii) The proceeds raised from the Initial Public Offering (IPO) should be placed in an Islamic account; and
- (iii) In the event that the proceeds are invested, the investment should be Shariah-compliant.

BENCHMARK FOR CINEMA BUSINESS

INTRODUCTION

The SAC has set out certain benchmarks to classify securities of a company listed on Bursa Malaysia as Shariah-compliant. Cinema business is among the activities which are analysed by the SAC.

For cinema business, the benchmark which has been determined by the SAC previously to measure the contribution of mixed activities is 5% based on *sadd zari`ah* (i.e. to prevent the access that can lead to bad practice since there is negative image associated with cinema). However, the issue of benchmark was discussed again in the SAC meeting to ensure whether the cinema business can be equated with other activities which are clearly prohibited by *Syara`* such as *riba* (interest-based companies such as conventional banks), gambling, liquor and pork which are classified under the 5% benchmark.

RESOLUTION

The SAC updated the resolution on the benchmark for cinema business from 5% to 20% benchmark. The SAC resolved that it is not suitable to equate cinema business with other activities which are clearly prohibited by Shariah such as *riba* (interest-based companies such as conventional banks), gambling, liquor and pork which are classified under the 5% benchmark.

REMOVAL OF 20% BENCHMARK FOR HOTEL AND RESORT OPERATIONS

INTRODUCTION

In the previous Shariah screening methodology for securities listed on Bursa Malaysia, the SAC had set 20% as a benchmark which is applicable for hotel and resort operations. However, the benchmark has been discussed again in the SAC meeting since the main purpose of hotel and resort operations nowadays is to provide accommodation.

RESOLUTION

The SAC has resolved that the 20% benchmark for hotel and resort operations under the business activity benchmarks in the Shariah screening methodology is no longer applicable. This is because the main purpose of hotel and resort operations nowadays is to provide accommodation.

However, other benchmarks in relation to Shariah non-compliant activities under the business activity benchmarks in the Shariah screening methodology remain applicable for companies which involve in hotel and resort operations.

SHARIAH SCREENING METHODOLOGY FOR UNLISTED MICRO, SMALL AND MEDIUM ENTERPRISES (MSMEs)

INTRODUCTION

SC acknowledges the importance of MSMEs to the development of Malaysian economy as it contributes more than a third to the local Gross Domestic Product (GDP). Hence, as part of the efforts to develop this segment, the SAC has introduced a new Shariah screening methodology for unlisted MSMEs. It will be adopted in the Shariah Screening Assessment Toolkit for unlisted MSMEs issued by SC.

In determining the Shariah status of the MSMEs, the SAC has taken into account the current situation and limitation that the MSMEs are facing.

RESOLUTION

The SAC had resolved that the Shariah screening methodology for unlisted MSMEs should adopt a two-tier quantitative approach in determining the Shariah status of unlisted MSMEs. The quantitative approach is as follows:

A Business Activity Benchmarks

In determining the Shariah status of unlisted MSME, the contribution of Shariah non-compliant activities to the revenue and profit before taxation of the MSME should be computed and compared against the relevant business activity benchmarks as follows:

(i) The 5% benchmark

The 5% benchmark is applicable to the following businesses/activities:

- conventional banking and lending;
- conventional insurance;
- gambling;
- liquor and liquor-related activities;
- pork and pork-related activities;
- non-halal food and beverages;
- Shariah non-compliant entertainment;
- tobacco and tobacco-related activities;
- interest income¹ from conventional accounts and instruments (including interest income awarded arising from a court judgement or arbitrator);
- dividends² from Shariah non-compliant investments; and
- other activities deemed non-compliant according to Shariah principles as determined by the SAC.

For the above-mentioned businesses/activities, the contribution of the Shariah non-compliant businesses/activities to the revenue or profit before taxation of the MSME must be less than 5%.

(ii) The 20% benchmark

The 20% benchmark is applicable to the following businesses/activities:

- rental received from Shariah non-compliant activities; and
- other activities deemed non-compliant according to Shariah principles as determined by the SAC.

For the above-mentioned businesses/activities, the contribution of Shariah non-compliant businesses/activities to the revenue or profit before taxation of the MSME must be less than 20%.

^{1,2} Interest income and dividends from Shariah non-compliant investments should be compared against the revenue.

B Financial Ratio Benchmarks

In determining the financial ratio benchmarks for unlisted MSME, the SAC has resolved the following:

(i) Total cash over total assets

Cash only includes cash placed in conventional accounts and instruments.

The ratio, which is intended to measure *riba* and *riba*-based elements within a company's statements of financial position, must be less than 33%.

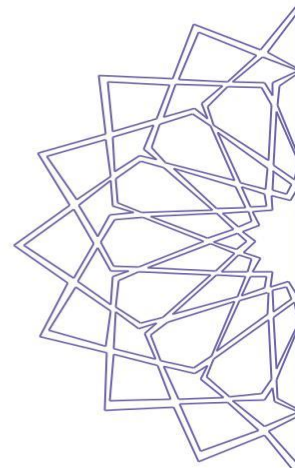
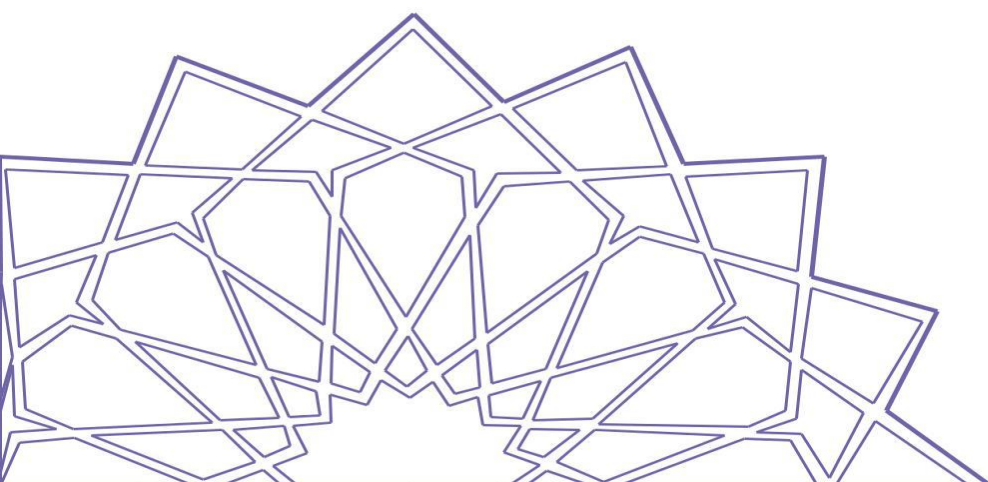
(ii) Total debt over total assets

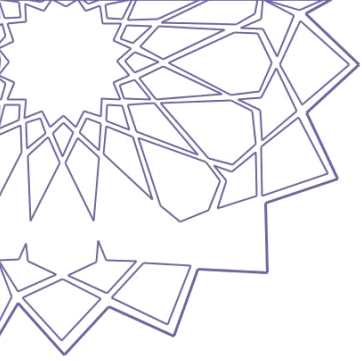
Debt only includes interest-bearing debt.

The ratio, which is intended to measure *riba* and *riba*-based elements within a company's statements of financial position, must be less than 49%.

The SAC had also resolved that the benchmark for the total debt over total assets ratio will be reduced from less than 49% to less than 33% after three (3) years from 6 August 2023.

GLOSSARY





GLOSSARY

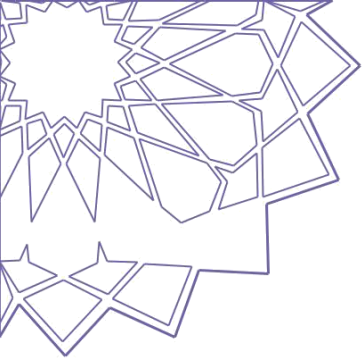
This Glossary clarified the meaning of Arabic terms that were used throughout the book.

TERM	MEANING
<i>Al-qabdh al-haqiqi</i>	The possession or holding of asset physically
<i>Al-qabdh al-hukmi</i>	The possession or holding of asset constructively
<i>`Aqd al-tawrid</i>	A contract between customer/purchaser and supplier/seller for supply of goods or services where its features have been specified to be delivered to the customer/purchaser on a certain period of time and at a certain payment price as agreed by the contracting parties
<i>`Aqd wakalah</i>	Agency contract
<i>`Aqd wakalah bi al-istithmar</i>	Agency contract for investment purposes
<i>Bai`</i>	Sale contract
<i>Bai` bithaman ajil</i>	A sale and purchase contract of assets on a deferred and instalment basis with pre-agreed payment period
<i>Bai` `inah</i>	A contract which involves the sale and buy back transaction of an asset by a seller
<i>Bai` al-sarf</i>	Currency exchange contract
<i>Fuqaha`</i>	Islamic jurists
<i>Gharamah</i>	Penalty
<i>Hajah</i>	Necessity
<i>Haq maliy</i>	Rights on assets with financial values and can be traded
<i>Hibah</i>	Gift

TERM	MEANING
<i>Ibra'</i>	An act of releasing absolutely or conditionally one's rights and claims - either partially or in full - absolutely or conditional on any obligation against another party
<i>Ijarah</i>	A contract whereby a lessor (owner) leases out an asset to a lessee at an agreed lease payment for a pre-determined lease period. The ownership of the leased asset shall always remain with the lessor
<i>Istisna'</i>	A purchase order contract where a buyer requires a seller or a contractor to deliver or construct the asset to be completed in the future according to the specifications given in the sale and purchase contract. The payment term can be as agreed by both parties in the contract
<i>Kafalah</i>	Guarantee
<i>Khiyar al-shart</i>	Conditional option
<i>Mudharabah</i>	Profit sharing contract
<i>Mudharib</i>	Entrepreneur
<i>Murabahah</i>	A sale and purchase contract of assets whereby the cost and profit margin (mark-up) are made known
<i>Muqasah</i>	Offset
<i>Mustaqir</i>	Established and certain
<i>Musharakah</i>	Profit and loss sharing contract
<i>Musharik</i>	Partner
<i>Muwa`adah mulzimah</i>	Bilaterally binding promise
<i>Qabdh</i>	The possession or holding of asset which is valid according to Shariah
<i>Qalb al-dayn</i>	Conversion of an existing debt into a new debt
<i>Qardh</i>	Loan
<i>Rabb al-mal</i>	Capital provider

TERM	MEANING
<i>Rukhsah</i>	Leniency compared to the original law
<i>Ta'jil al-badalain</i>	Delivery of goods or preparation of services and the payment of the price are deferred to a future time
<i>Takhliyah</i>	Denying the right of the seller completely in respect of the sold asset
<i>Tamkin</i>	Creating complete right of the purchaser in respect of the purchased asset
<i>Tanazul</i>	Waive of rights
<i>Taradhi</i>	Mutual consent
<i>Ta`widh</i>	Compensation
<i>Tawarruq</i>	Purchasing a commodity/asset on a deferred price and then selling it to a third party for cash
<i>Ujrah</i>	Financial payment for consumption of services or usufruct/ fee
<i>Ulama'</i>	Islamic scholars
<i>`Urf</i>	Customary practice which are acceptable by the community, whether in the form of words or practices that is not prohibited by Shariah
<i>`Urf tijari</i>	Customary business practice which is acceptable by the community and does not contradict with Shariah
<i>`Uqud ishtirak</i>	Partnership contracts such as <i>musharakah</i> and <i>mudharabah</i>
<i>`Uqud mu`awadhat</i>	Exchange contracts such as <i>bai` bi thaman ajil</i> , <i>murabahah</i> , <i>istisna`</i> and <i>ijarah</i>
<i>Wa`d</i>	Promise
<i>Wa`dan</i>	Two unilateral promises
<i>Wa`d mulzim</i>	Unilaterally binding promise

TERM	MEANING
<i>Wa`d mu`allaq</i>	Promise in a way of <i>ta`liq</i>
<i>Zimmah</i>	Liability



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