Shariah Parameters on Islamic Exchange-Traded Fund Based on Gold and Silver

Issued: 7 October 2014
CONTENTS

PART A: GENERAL

1.0 INTRODUCTION 1

2.0 DEFINITIONS 1

PART B: SHARIAH REQUIREMENTS ON TRADING OF RIBAWI-BASED ITEMS

3.0 INTRODUCTION, CLASSIFICATION OF RIBAWI ITEMS AND REQUIREMENTS FOR TRADING OF RIBAWI ITEMS 2

PART C: SHARIAH REQUIREMENTS FOR ISLAMIC EXCHANGE-TRADED FUND (ETF) BASED ON GOLD AND SILVER

4.0 THE ESTABLISHMENT, STRUCTURING AND TRADING OF AN ISLAMIC ETF BASED ON GOLD AND SILVER AS AN UNDERLYING ASSET 4

5.0 ROLES OF THE SHARIAH ADVISER IN AN ISLAMIC ETF BASED ON GOLD AND SILVER AS AN UNDERLYING ASSET 5
PART A: GENERAL

1.0 INTRODUCTION

1.01 These *Shariah Parameters on Islamic Exchange-traded Fund based on Gold and Silver* (Shariah Parameters) are issued by the Securities Commission Malaysia (SC) as guidance and reference from Shariah perspective to facilitate the industry on matters relating to the Islamic exchange-traded fund (ETF) based on gold and silver.

1.02 These Shariah Parameters comprise the following parts:

(a) Shariah requirements on trading of gold and silver as set out in Part B of these Shariah Parameters; and

(b) Shariah requirements for the establishment, structuring and trading of an Islamic ETF based on gold and silver as an underlying asset as set out in Part C of these Shariah Parameters.

1.03 Notwithstanding the details as set out in these Shariah Parameters, the endorsement of the Shariah Advisory Council of the SC must be obtained prior to the issuance of any Islamic ETF based on gold and silver.

2.0 DEFINITIONS

2.01 In these Shariah Parameters, the following words and expressions have the following meanings, unless the context otherwise requires:

<table>
<thead>
<tr>
<th>exchange-traded fund (ETF)</th>
<th>has the meaning assigned to it under Chapter 2 of the <em>Exchange-traded Fund Guidelines</em> (as amended from time to time).</th>
</tr>
</thead>
<tbody>
<tr>
<td>Islamic ETF</td>
<td>means exchange-traded fund structured in compliance with Shariah principles.</td>
</tr>
</tbody>
</table>
PART B: SHARIAH REQUIREMENTS ON TRADING OF RIBAWI ITEMS

3.0 INTRODUCTION

3.01 The Shariah requirements for trading of *ribawi* items are stated in the well-known hadith of the Prophet Muhammad (Peace Be Upon Him) related by ‘Ubadah ibn al-Samit, narrated by Muslim as follows:

“(Exchange of) gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, salt for salt (shall be) in equal quantities and hand to hand (spot). If they differ in type, you may trade in them as you wish provided it is hand to hand (without deferment on either side).”

Classification of ribawi items

3.02 Following the above hadith, *ribawi* items can be classified into two main categories as follows:

(a) As a measure of value (*al-thaman*)

This refers to gold and silver which are used as currency to measure value of items valuable for sale and purchase. The modern currency (in the form of paper money) is classified as a *ribawi* item because it acts as a measure of value and medium of exchange.

(b) Staple and storable food

This is represented by wheat, barley, dates and salt which are used as staple and storable food. In the Malaysian context, rice would be included as a *ribawi* item as it is the main staple food in the country.

Requirements for trading of ribawi items

3.03 If the exchange transaction involves two *ribawi* items of the same type and effective cause (*i‘llah*) such as the exchange of gold for gold or wheat for wheat, the following requirements must be applied to avoid *riba*:

(a) The exchange must be for equal quantity of the counter-values; and
(b) It must be an “on-the-spot” transaction in which both of the counter-values must be handed over at the time of the contract.

3.04 If the exchange involves ribawi items with the same effective cause but of different type, such as the exchange of gold for silver or wheat for dates, it must fulfil only one requirement; that it is done on-the-spot where the exchange of counter values takes place at the time of the contract.

3.05 The requirements as specified in paragraph 3.03 of these Shariah Parameters namely, spot and equal exchange, do not apply if the exchange involves different ribawi items of different categories such as the exchange of a medium of exchange (for example gold or money) with staple food (for example wheat).
4.0 THE ESTABLISHMENT, STRUCTURING AND TRADING OF AN ISLAMIC ETF BASED ON GOLD AND SILVER AS AN UNDERLYING ASSET

Introduction

4.01 Gold and silver are ribawi items. Therefore, Shariah requirements as provided in the hadith and stated in paragraph 3.03 of these Shariah Parameters must be adhered to in establishing, structuring and trading of an Islamic ETF based on gold and silver as an underlying asset.

Creation of the Islamic ETF units

4.02 The Islamic ETF units represent an equivalent amount of physical gold and silver bullions/bars held by the custodian on behalf of the Islamic ETF. Hence, the Islamic ETF units represent the unit holders’ ownership of the gold and silver bullions/bars on a pro-rata basis.

4.03 The creation of the Islamic ETF units must be backed by physical gold and silver bullions/bars with specified quantity and quality.

4.04 At the inception and creation of the Islamic ETF units, the fund manager and the Shariah adviser of the Islamic ETF must verify that–

(a) the gold and silver bullions/bars, with the correct quantity and quality as per the specification, are in existence; and

(b) the gold and silver bullions/bars which form the underlying assets for the creation of the Islamic ETF units are allocated and segregated.

Trading of the Islamic ETF units

4.05 The trading of the Islamic ETF units between the buyer and the seller must be carried out in cash and on spot basis.

4.06 The Islamic ETF units can only be traded if the buyers have cash accounts or margin facility (via third-party financing).
Redemption of the Islamic ETF units

4.07 The Islamic ETF units to be redeemed must be backed by physical gold and silver bullions/bars.

4.08 The unit holders are entitled to redeem the Islamic ETF units in physical gold and silver bullions/bars or its equivalent in cash.

5.0 ROLES OF THE SHARIAH ADVISER IN AN ISLAMIC ETF BASED ON GOLD AND SILVER AS AN UNDERLYING ASSET

5.01 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.

5.02 The Shariah adviser of the Islamic ETF must conduct an annual audit including a site visit to the place where the gold and silver bullions/bars are kept to confirm its existence, quantity and other details such as record of its movement. This is to ensure that the Islamic ETF units created are backed by the actual gold and silver bullions/bars kept in the vault in a segregated and allocated manner.

5.03 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 unit holders.