



**Suruhanjaya Sekuriti**  
Securities Commission  
Malaysia

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

# Resolutions of the Shariah Advisory Council of the Securities Commission Malaysia



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Securities Commission  
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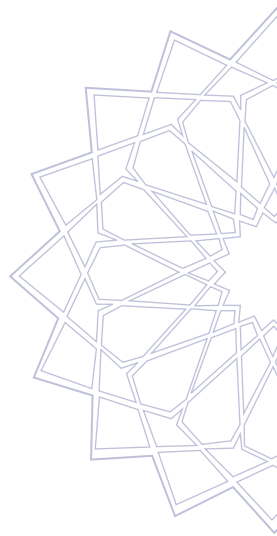
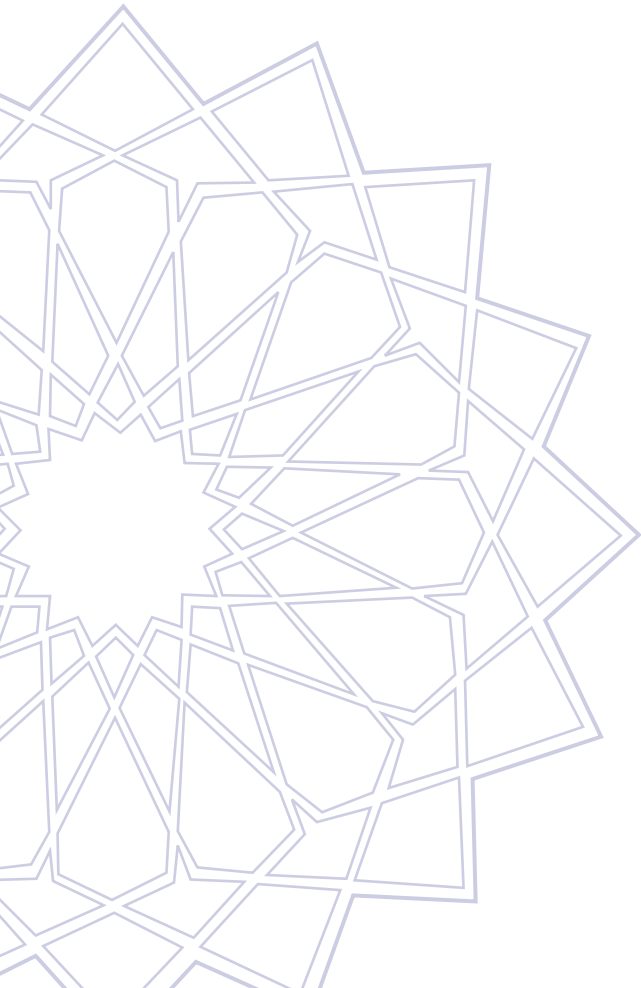
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## PART A

# INTRODUCTION AND OBJECTIVES



# INTRODUCTION

With the rapid growth of the Islamic capital market (ICM), various issues have been discussed and resolved by the Shariah Advisory Council (SAC) of the Securities Commission Malaysia (SC) through a 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

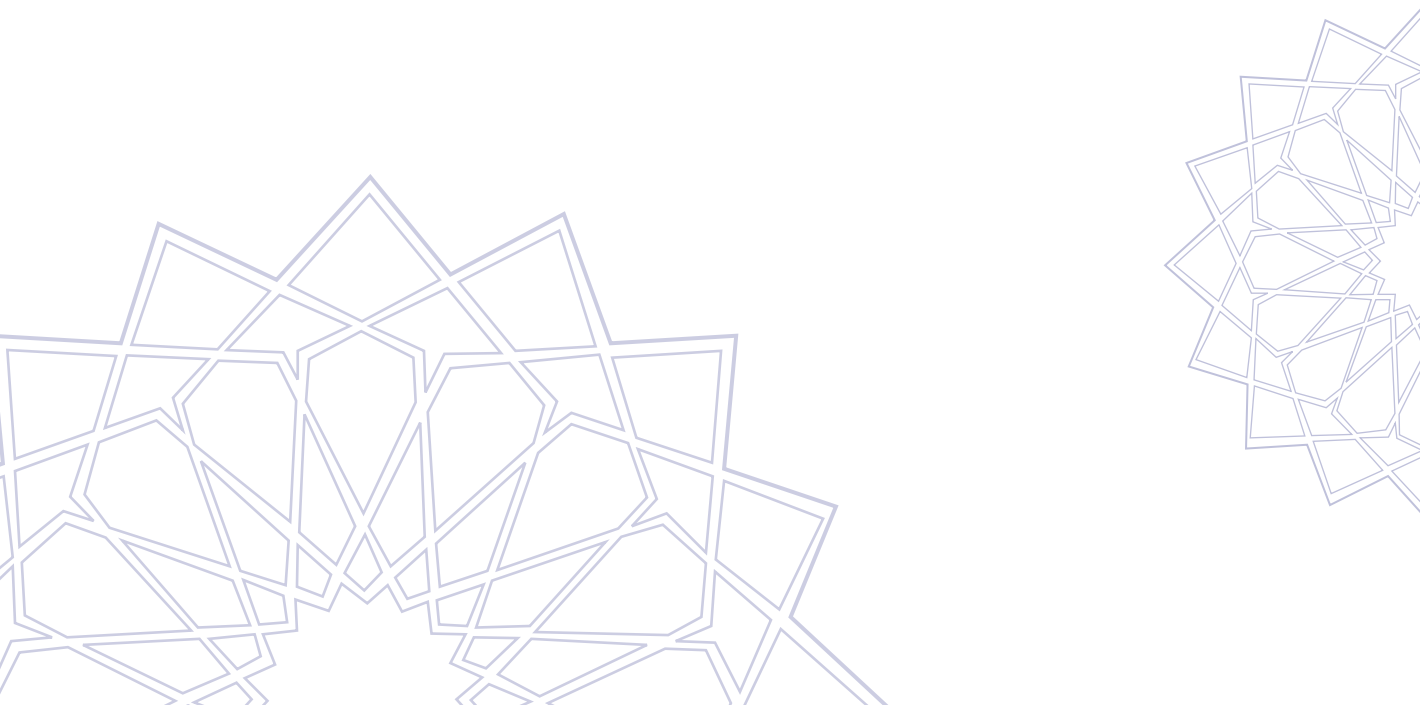
The objectives of this publication is to–

- (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* (compensation) 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* (compensation) 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* (contracts of exchange) 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:

### A

#### 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* (compensation) and *gharamah* (penalty);
- (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;

- (iv) The late payment charge will be determined by the court rules. 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 creditor,<sup>1</sup> 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*.

## B

### **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

---

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

*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

## 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 *Syara`*.

## 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 *Syara`*;
- (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, Trust Deed, Information Memorandum, Master Agreement and other related documents.

The SAC also resolved that the practice of pre-signing<sup>1</sup> 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.

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.

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<sup>1</sup> 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).

**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 *Syara`* 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.



# 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* (contracts of exchange) including:

#### (i) *Murabahah* and *Musawamah*

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

#### (ii) *Ijarah*

*Ibra'* refers to release of rights on accrued rental.

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

**(i) Early redemption**

- (a) 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.
- (b) The formula for the computation of early settlement may be stated as a guide to the issuer.
- (c) 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.

**(ii) Other event(s)**

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

# WA`D AND MUWA`ADAH

## INTRODUCTION

The principles of *wa`d* (unilateral promise) and *muwa`adah* (bilateral promise) 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* (compensation) based on actual loss suffered (if any) by the aggrieved promisee due to the breach of the *wa`d*.

2

**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.

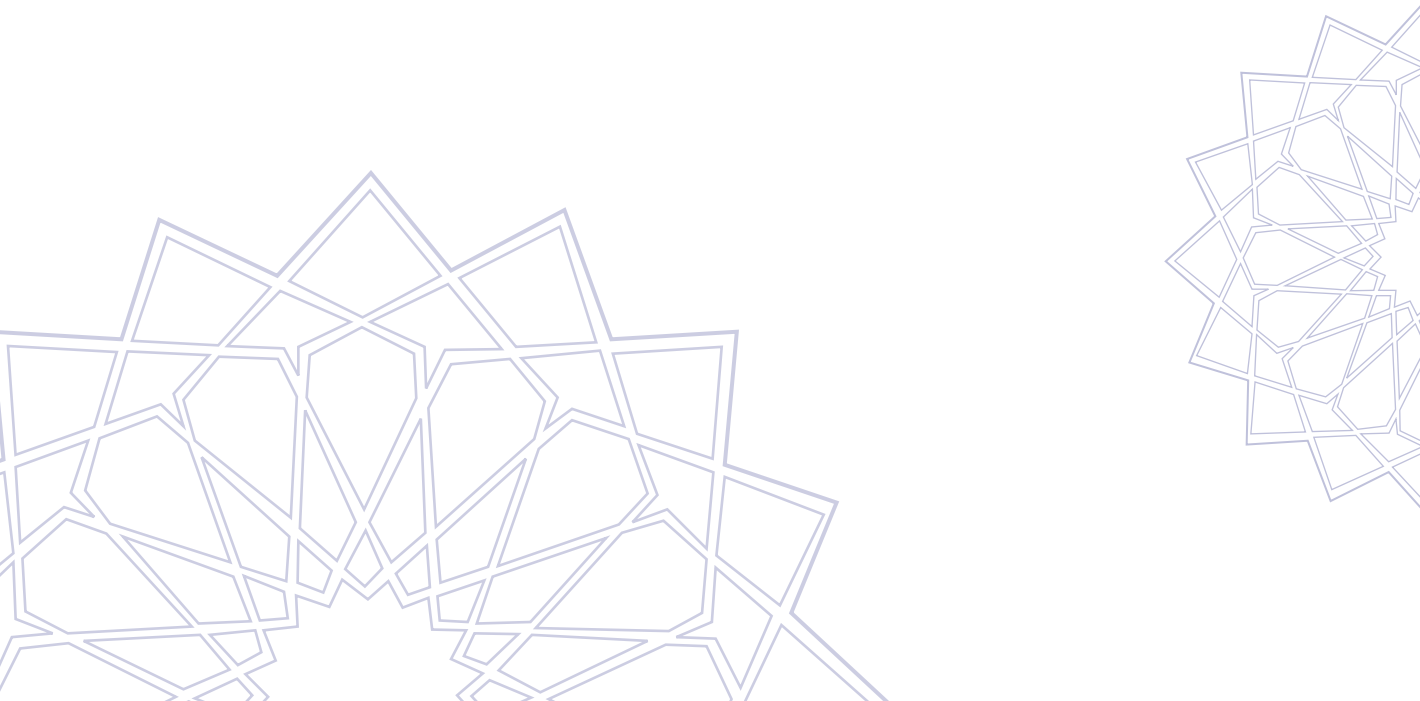
(iv) Implication of breach of *Muwa`adah*

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

PART B

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

## ISLAMIC CAPITAL MARKET PRODUCTS FROM THE SHARIAH PERSPECTIVE



# ISLAMIC BUSINESS TRUSTS

## 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

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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 (ISLAMIC ETF 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 basis.<sup>1</sup>
- (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 the Islamic ETF units created are backed by the actual gold and silver kept in the vault in a segregated and allocated manner.

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<sup>1</sup> The current trading and settlement system of the stock exchange supports the spot transaction, even though settlement is only made on T+3 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.

- (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

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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) Model.<sup>1</sup> 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`* (sale) transactions that includes the feature of *wa`dan* (two unilateral promises/undertakings), *khiyar al-shart* (conditional option)<sup>2</sup> and the provision of collateral as security for the indebtedness.

## RESOLUTION

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

<sup>1</sup> 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.

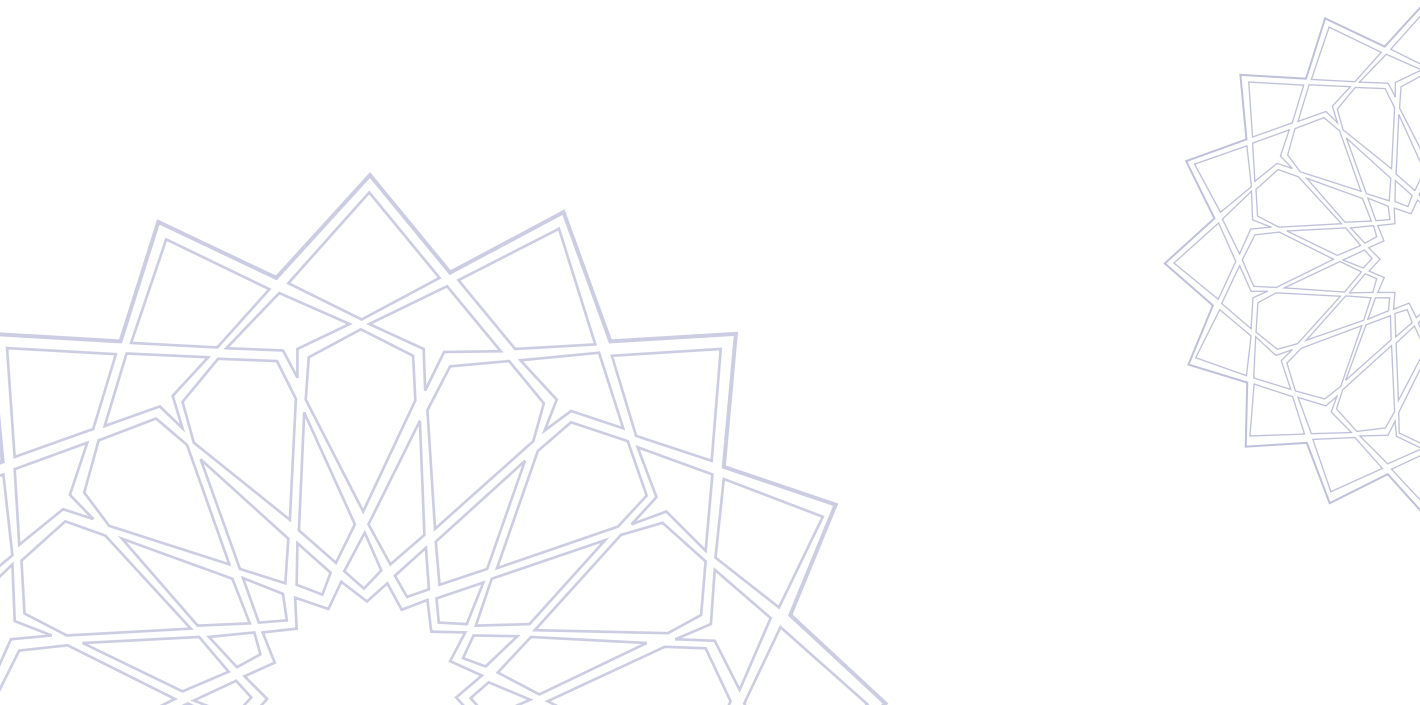
<sup>2</sup> *Khiyar al-syart* (conditional option) is an option to cancel a previous agreed sale within a specific number of days.



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 zimma* refers to an *ijarah* contract in respect of an asset which will exist in the future provided that the lease rate, specification of the asset to be leased, lease period and lease payment method are specified clearly in the *ijarah* contract. This *ijarah* principle and its related issues were presented to the SAC for their decision.

## RESOLUTION

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

1

### Lease payment method

The lease payment method for *ijarah mawsufah fi zimma* shall be based on the agreement made between the contracting parties.

2

### Failure to fulfill the required specification

The SAC had resolved that 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 MUNTAHİYAH 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* (gift). 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* (undertaking) to sell or to give the *ijarah* asset as *hibah* (gift) 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.

## RESOLUTION

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

1

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

The *wa`d* (undertaking) to sell or give the *ijarah* asset as *hibah* (gift) 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 effected 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* (gift) 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 effected automatically upon fulfillment of the stipulated conditions in *hibah* contract.

# SUBLEASE

## INTRODUCTION

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

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

### **Lease of the *ijarah* asset by the lessee to a third party**

The lessee may lease the *ijarah* asset to a third party as long as there is no restriction from the owner of the asset and the lessee has the right over the usufruct of the asset.

2

### **Lease 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 period of the sublease does not exceed the period of the principal lease.

# ASSET AND USUFRUCT AS MAHAL AL-`AQD IN IJARAH CONTRACT

## INTRODUCTION

*Ijarah* is one of the contracts recognised by *Syara'*. It is a contract between a lessor and a lessee to own usufruct of an asset which is permissible by *Syara'* 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, asset and usufruct that forms the subject matter of lease (*mahal al-`aqd*) 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 *Syara'*;
- (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* (market practice).

# 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 have 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

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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* (contracts of exchange) 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. Therefore, this issue was presented to the SAC for their decision.

### 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) In 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

## INTRODUCTION

Normally the rental rate of an asset is determined based on a fixed rate. However, in the context of issuance of sukuk *ijarah* that involves long-term lease, rental rate based on 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). In this context, an issue was raised on whether the rental rate based on fixed and/or floating rate is permitted by *Syara'* or not. The issue was presented to the SAC for their decision.

## 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.



## 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 jiddiyyah* in its custody and shall not utilise it for any other purposes; or
- (ii) **Trust for investment**  
The payment of *hamisy jiddiyyah* 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* (gift).

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.

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

### INTRODUCTION

Issues relating to *ijarah* agreement and *mal musha`* (undivided asset)<sup>1</sup> 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 that:

- 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:
  - (i) the proportionate interest in the leased assets;
  - (ii) the maturity period; and

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<sup>1</sup> *Musha`* from the perspective of *fuqaha`* refers to joint ownership over an asset in proportion and physically undivided. However, if the asset which is jointly owned is divided among the partners, hence the feature of joint ownership (الشأن) cease to exist and it becomes specific ownership of the partners over the asset. 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.



- (iii) 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 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 issue if the proportionate interest in the asset is only specified via percentage in the case of *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* (gift), etc., to give effect to the ownership transfer of the asset to the issuer/owner. This mechanism is required to facilitate retirement/redemption of the sukuk at each maturity.

# MIXED ASSET AS AN UNDERLYING ASSET IN SUKUK IJARAH

## INTRODUCTION

An industry proposal was presented to the SAC relating to the proposed structure of asset-backed sukuk *Ijarah* which involves the use of Mixed Asset<sup>1</sup> as the underlying asset. The issue in deliberation was on the permissibility of using Mixed Asset as an underlying asset for the proposed sukuk *Ijarah*.

## RESOLUTION

The SAC had resolved that it is permissible to use Mixed Asset as an underlying asset for sukuk *Ijarah* provided that:

- 1 The rentals received from the Shariah non-compliant businesses/activities in the Mixed Asset must be below 20% of the total rentals received, if such rentals could be determined; or
- 2 The lettable area used for Shariah non-compliant businesses/activities in the Mixed Asset must be below 20% of the total lettable area, if the rentals could not be determined.

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<sup>1</sup> Mixed Asset refers to asset which consists of Shariah compliant and Shariah non-compliant businesses or activities.

# 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.



## 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.

# DEFERMENT OF PROFIT DISTRIBUTION TO JUNIOR SUKUKHOLDERS OF SUKUK STRUCTURED BASED ON `UQUD MU`AWADHAT (CONTRACTS OF EXCHANGE)

## 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* (contracts of exchange) is permissible by *Syara`*. It is permissible based on the concept of *tanazul* (waive of rights) and *taradhi* (mutual consent) 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.

# UTILISATION OF SUKUK PROCEEDS

## INTRODUCTION

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

This issue was discussed in a series of SAC meeting on whether the utilisation of the sukuk proceeds raised from any issuance of sukuk based on various Shariah principles for various specified purposes is considered as Shariah compliant or otherwise. Therefore, this issue was presented to the SAC to seek their decision.

## 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 has further resolved that the utilisation of the sukuk proceeds for the following purposes are Shariah compliant:

1

### Refinancing of Conventional Borrowings

The sukuk proceeds may be utilised to refinance (wholly or partly) conventional borrowings.

2

### General Business

The sukuk proceeds may be utilised for general business of the issuer including for general corporate purposes, working capital requirements and capital expenditures provided that the principal activities of the issuer are Shariah compliant based on the following business activity benchmarks (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.

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 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 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 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 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, computed against the total revenue from the Building with Mixed Activities must be less than the following 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 above are only applicable at the point of issuance of the sukuk.

### **Appendix 1**

- (i) Conventional banking;
- (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 as determined by the SAC of SC.

### **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 as determined by the SAC of SC.

# 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

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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* (mutual consent) as outlined in Shariah.

## 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 RCUIDSholders 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`* (exchange of debt with commodity) 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 pricing for the benefit of the creditor from the loan contract that has connection with *`uqud mu`awadhat* (contracts of exchange).

# GUARANTEE ON TA`WIDH, FEES AND EXPENSES

## INTRODUCTION

An industry proposal was presented to the SAC relating to sukuk *wakalah bi al-istithmar* (contract of agency for investment) which involved guarantee on *ta`widh*, fees and expenses. The guarantor in the proposed sukuk structure was the parent company of the issuer. This issue was presented to the SAC to seek their opinion and decision.

## RESOLUTION

The SAC resolved that *ta`widh* which was imposed on sukuk issued under *`uqud ishtirak* (contracts of partnership), *`uqud mu`awadhat* (contracts of exchange) or *`aqd wakalah* (contract of agency) may be included as part of the guaranteed amount under the *kafalah* contract or conventional guarantee for the said sukuk. This is because the amount payable arising from *ta`widh* is regarded as debt owed by the relevant party in a sukuk transaction.

The SAC also resolved that guarantee on fees and expenses are permissible. Fees and expenses due under the sukuk *wakalah bi al-istithmar* could be guaranteed by the parent company of the issuer (as guarantor) as they are debts.

# 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* (contract of agency for investment). 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* (unilateral promise). 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.



## 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 *Syara'* such as *riba* (interest-based companies such as conventional banks), gambling, liquor and pork which are classified under the 5% benchmark.

# 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;
- (iii) The fund manager shall inform/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
- (iv) 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.

# 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.

PART B

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

## SHARIAH CRITERIA FOR LISTED 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 perspective of Islam.

## 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;
- 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 income from conventional accounts and instruments (including interest income awarded arising from a court judgement or arbitrator and dividends from Shariah non-compliant investment); and
- other activities deemed non-compliant according to Shariah.

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:

- share trading;
- stockbroking business;
- rental received from Shariah non-compliant activities; and
- other activities deemed non-compliant according to Shariah.

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 perspective of Islam.



# 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.

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