



BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Kafalah
(Shariah Requirements And Optional Practices)
Exposure Draft

Issuance date: 6 December 2013

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As part of the objective to strengthen the Shariah-compliance culture among Islamic financial institutions (IFIs), Bank Negara Malaysia (the Bank) is embarking on an initiative to develop a Shariah-based regulatory framework. The purpose of the framework is to ensure that the IFIs comply with Shariah. In this regard, the Bank is issuing a series of policy documents on Shariah contracts to enhance the end-to-end compliance with Shariah.

This Exposure Draft (ED) outlines the Shariah requirements and optional practices relating to *kafalah* to facilitate IFIs in developing Islamic financial services and products including the features of *kafalah* and its arrangement with other Shariah contracts or concepts.

The Bank invites written comments from your institution on this ED, including suggestions for particular issues, areas to be further clarified/elaborated and any alternative proposal that the Bank should consider. To facilitate the Bank's assessment, please support each comment with clear rationale, accompanying evidence or illustrations, as appropriate.

Written comments in the form of softcopy are preferable and may be submitted to shariahstandard@bnm.gov.my by **10 January 2014**. Hardcopy of the written feedback may also be submitted to:

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

1. Objective

- 1.1 This policy document outlines the Shariah requirements and optional practices relating to *kafalah* to be observed by the IFIs in developing Islamic financial services and products.
- 1.2 This policy document also covers arrangement of *kafalah* with other Shariah contracts or concepts.
- 1.3 This policy document aims to facilitate the understanding of the Shariah requirements relating to *kafalah* which the IFIs must adhere to in order to ensure its validity.

2. Applicability

- 2.1 The policy document is applicable to all IFIs as defined in paragraph 5.2.

3. Legal provisions

- 3.1 The requirements in this policy document are specified pursuant to sections 29(1) of the Islamic Financial Services Act 2013 (IFSA).

4. Effective date

- 4.1 This Policy document comes into effect on XX XX XXXX.

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5. Interpretation

5.1 The terms and expressions used in this policy document shall have the same meanings assigned to them in the Financial Services Act 2013 (FSA), IFSA and the Development Financial Institutions Act 2002 (DFIA) unless otherwise defined in this policy document.

5.2 For the purpose of this policy document:

“**S**” denotes a standard, requirement or specification that must be complied with. Failure to comply may result in one or more enforcement actions;

“**G**” denotes guidance which may consist of such information, advice or recommendation intended to promote common understanding and sound industry practices which are encouraged to be adopted.

“**Islamic financial institutions**” or “**IFIs**” means –

- (a) licensed Islamic banks and licensed takaful operators under the IFSA;
- (b) licensed banks and licensed investment banks under the FSA which are approved under section 15(1)(a) FSA to carry on Islamic banking business; and
- (c) prescribed institutions which are approved under section 129(1) DFIA to carry on Islamic banking business or Islamic financial business.

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6. Related legal and policy documents

6.1 This policy document must be read together with the following legal and policy documents:

- (a) Any Shariah Advisory Council (SAC) rulings published by the Bank¹; and
- (b) Shariah Governance Framework for IFIs.

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

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PART B DEFINITION AND NATURE OF *KAFALAH*

7. Definition

- S** 7.1 *Kafalah* refers to conjoining the guarantor’s liability to the guaranteed party’s liability such that the obligation of the guaranteed party is established as a joint liability of the guarantor and the guaranteed party.

8. Nature

- S** 8.1 *Kafalah* is a type of assurance contract which is binding on the guarantor.
- S** 8.2 The specific inherent nature of *kafalah* is to provide assurance on the fulfilment of an obligation established as the guaranteed party’s liability.

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PART C COMPONENTS OF *KAFALAH*

9. Contracting parties

- S** 9.1 The contracting parties in a *kafalah* contract are the guarantor (*kafil*), the beneficiary² (*makful lahu*) and the guaranteed party³ (*makful `anhu*).
- S** 9.2 The contracting parties, except the guaranteed party, shall have the legal capacity⁴ to enter into the *kafalah* contract.
- G** 9.3 The contracting parties in a *kafalah* contract may be a natural person or a legal person.
- S** 9.4 The guarantor shall be accepted by the beneficiary.
- G** 9.5 A guaranteed party may be guaranteed by more than one guarantor.
- S** 9.6 A *kafalah* contract shall be entered by an offer and acceptance between the guarantor and the beneficiary.
- G** 9.7 The offer and acceptance may be expressed verbally or by appropriate documentation or by any other methods accepted by customary business practices (*`urf tijari*) which do not contravene the Shariah principles.

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

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

⁴ The legal capacity of a person is defined as the capacity to assume rights and responsibilities, and the capacity to give legal effect to his action. Among the important conditions of it are possession of sound mind and the capacity to distinguish between what is harmful or beneficial to one's interests. The legal capacity of a legal entity is defined as eligibility of an entity to acquire rights and assume responsibilities.

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10. Subject matter of *kafalah*⁵

- S** 10.1 The subject matter of *kafalah* is categorized into:
- (a) *Kafalah al-dayn* (Guarantee of a debt liability);
 - (b) *Kafalah al-`ayn* (Guarantee to deliver a physical asset).
- G** 10.2 The subject matter of *kafalah* of debt liability may be a debt that is currently obliged (*dayn lazim*) or that will be obliged (*ma ya'ul ila luzum*) in the future.
- G** 10.3 The subject matter of *kafalah* may also be in the form of a guarantee of performance of a certain act by the guaranteed party or a guarantee of fulfilment of an undertaking by the guaranteed party.
- G** 10.4 Notwithstanding paragraph 10.3, subject to the beneficiary's consent, the guarantor may fulfil the guarantee obligation by compensating the beneficiary an agreed amount.
- S** 10.5 The subject matter of *kafalah* shall not be any obligation arising from any non-Shariah-compliant contract.

⁵ For the purpose of the standard, the subject matter of *kafalah* shall be confined to commercial or financial guarantees (*kafalah bi al-mal*).

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PART D MANAGEMENT OF *KAFALAH*

11. Rights and responsibilities

- G** 11.1 The guarantor may give an unrestricted *kafalah* whereby the *kafalah* is of the original debt without any additional condition or description to the terms of the original debt.
- S** 11.2 Pursuant to paragraph 11.1, the guarantor shall be held liable to the obligation according to the terms of the original debt.
- G** 11.3 The guarantor may give a restricted *kafalah* whereby the details of the guarantee are specified. The specified details may include time, effective date/trigger event of the guarantee, the amount, or any additional condition acceptable in the Shariah.
- S** 11.4 Pursuant to paragraph 11.3, the guarantor shall be held liable to the *kafalah* obligation according to the specified details.
- S** 11.5 If the obligation becomes claimable before maturity due to the demise or dissolution of the guaranteed party, the *kafalah* remains enforceable upon the maturity date of the original obligation unless otherwise specified.
- S** 11.6 If the guarantee period is not specified and the beneficiary grants the guaranteed party an extension period to settle the obligation, such extension shall also apply to the guarantee.
- S** 11.7 In the event that the guaranteed party is guaranteed by multiple guarantors, the sequence and obligation for each of the guarantors shall be determined before entering into the *kafalah*.

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- G** 11.8 The beneficiary may claim his debt from the guaranteed party and/or the guarantor, either the full amount of the debt from either of them, or a part of the debt from the guaranteed party and the other part from the guarantor.
- G** 11.9 The guarantor and the beneficiary may agree on the sequence of claims by stipulating that the beneficiary shall first claim the debt from the guaranteed party and will only claim from the guarantor if the guaranteed party is unable to settle his debt or fulfill his obligation.

12. Imposition of fee or charges on *kafalah*

- G** 12.1 The guarantor may impose a fee for providing the *kafalah* service to the guaranteed party.
- G** 12.2 Pursuant to paragraph 12.1, the fee may include any agreed amount in the course of providing the *kafalah* service.

13. Recourse and recovery

- S** 13.1 The guarantor shall have no recourse against the guaranteed party in either of the following circumstances:
- (a) the *kafalah* is given on a voluntary basis, without request or consent from the guaranteed party;
 - (b) the guaranteed party has no legal capacity to acknowledge indebtedness.
- G** 13.2 A guarantor may seek recourse against the guaranteed party for any amount paid to settle the obligation if the *kafalah* is created upon the

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request or by the consent of the guaranteed party at any time during the guarantee period.

- S** 13.3 In the event that the guarantor secures a discount and thus settles the debt with an amount less than the original debt, the guarantor is only entitled to the actual amount he has paid to the beneficiary.
- S** 13.4 The guarantor is only entitled to recourse for an amount up to the original debt.
- S** 13.5 In the event that the guarantor has equivalent liability to that of the guaranteed party and both parties agree to set off their respective liabilities, the guarantor is not entitled to recourse from the guaranteed party.

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PART E ARRANGEMENT OF *KAFALAH* WITH ANOTHER CONTRACT

14. Arrangement of *kafalah* with assurance

- G** 14.1 A *kafalah* contract may be arranged with an assurance.
- G** 14.2 The guaranteed party may place a full or partial amount of collateral in the custody of the guarantor to fulfil the amount of the guarantee.
- G** 14.3 The guarantor may set off the recourse amount on any collateral placed in the custody of the guarantor by the guaranteed party.
- G** 14.4 The guarantor may appoint another party as guarantor to guarantee the obligation due to beneficiary.

PART F DISSOLUTION (*FSAKH*) AND COMPLETION (*INTIHA'*) OF *KAFALAH* CONTRACT

15. Dissolution of *kafalah*

- 15.1 A *kafalah* contract is dissolved under any of the following circumstances:
 - (a) the beneficiary and the guarantor mutually agree to terminate the *kafalah* contract; or
 - (b) the beneficiary exercises the option to terminate the *kafalah* contract.
- S** 15.2 Notwithstanding paragraph 15.1 (a), in the event that the *kafalah* contract involves imposition of a fee, the contract shall not be terminated without the consent of the guaranteed party.

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- S** 15.3 Upon dissolution of *kafalah*, in case any obligation remains upon the guaranteed party, the obligation remains upon the guaranteed party and not upon the guarantor. Any amount paid to the guarantor shall be returned to the payer.

16. Completion of *kafalah*

- 16.1 The *kafalah* contract ends under the following circumstances:
- (a) payment of the guaranteed debt by the guaranteed party, his agent (*wakil*), or the guarantor;
 - (b) the beneficiary waiving its right to claim the guaranteed debt from the guaranteed party and/or the guarantor through a rebate (*ibra'*);
 - (c) set-off (*muqassah*) of debt obligations between the beneficiary and the guaranteed party/guarantor; or
 - (d) expiry of the period of guarantee and period of claim.
- S** 16.2 Upon completion of the *kafalah*, the guarantor shall be free from the obligation.
- S** 16.3 In the event the beneficiary discharges the guaranteed party from the debt, the guarantor is automatically discharged from his liability.
- S** 16.4 In the event the beneficiary discharges the guarantor from the liability, the guaranteed party remains indebted.

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APPENDICES

17. Appendix 1 Legitimacy of *kafalah*

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

The Quran

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

قَالُوا نَفَقْدُ صُوعَ الْمَلِكِ وَلِمَنْ جَاءَ بِهِ حِمْلُ بَعِيرٍ وَأَنَا بِهِ زَعِيمٌ

[The officials] said, "We are missing the king's goblet." [And their chief added], "He who brings it shall have a camel-load of provisions; I personally guarantee it." (*Surah Yusuf, verse 72*).

The Sunnah of Prophet Muhammad (peace be upon him)

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

عَنْ جَابِرٍ، قَالَ: كَانَ رَسُولُ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ لَا يُصَلِّي عَلَى رَجُلٍ مَاتَ وَعَلَيْهِ دَيْنٌ، فَأُتِيَ بِمَيِّتٍ، فَقَالَ: أَعَلَيْهِ دَيْنٌ؟ قَالُوا: نَعَمْ، دِينَارَانِ، قَالَ: صَلُّوا عَلَى صَاحِبِكُمْ. فَقَالَ أَبُو قَتَادَةَ الْأَنْصَارِيُّ: هُمَا عَلَيَّ يَا رَسُولَ اللَّهِ. قَالَ: فَصَلَّى عَلَيْهِ رَسُولُ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ.

Jabir narrated: The Messenger of Allah (peace be upon him) would not say funeral prayer over a person who died while a debt was due from him. The body of a Muslim was brought to him, and he asked: "Is there any debt due from him?" [The companions] said: "Yes, two dinars." He said: "Pray over your companion [as he has unpaid debt]." Then Abu Qatadah al-Ansari said: "I shall pay them, Messenger of Allah." The Messenger of Allah (pbuh) then prayed over him." (*Narrated by Abu Dawud, Sunan Abi Dawud, Hadith no. 3343*)

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Consensus of the Muslim jurists (*Ijma'*)

17.4 The Muslim jurists have reached *ijma'* on the permissibility of *kafalah* in general, as cited by Ibn Qudamah (*Al-Mughni*, 4:400).

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18. Appendix 2 Glossary

Terms	Explanation
<i>Dayn lazim</i>	A legally binding debt.
<i>Ibra'</i>	Rebate.
<i>Kafalah al-`ayn</i>	Guarantee of a physical asset.
<i>Kafalah al-dayn</i>	Guarantee of a debt liability.
<i>Kafalah bi al-mal</i>	Commercial or financial guarantee.
<i>Kafil</i>	Guarantor.
<i>Makful `anhu</i>	The guaranteed party is a debtor or a party guaranteed by the guarantor.
<i>Makful lahu</i>	The beneficiary is a creditor or a party who has the right to claim the liability (debt) from the guaranteed party (<i>makful `anhu</i>) or the guarantor (<i>kafil</i>).
<i>Ma ya'ul ila luzum</i>	A debt that will become legally binding in the future.