



BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Bai` al-Sarf
(Shariah Requirements and Optional Practices)
Exposure Draft

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As part of the objective to strengthen the Shariah-compliance practices 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 IFI comply with Shariah. In this regard, the Bank is issuing a series of policy documents on Shariah contracts to enhance end-to-end compliance with Shariah.

This Exposure Draft (ED) outlines the Shariah requirements and optional practices relating to *bai` al-sarf* to facilitate IFIs in developing Islamic financial services and products including the features of *bai` al-sarf* 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 a softcopy are preferable and may be submitted to shariahstandard@bnm.gov.my by 2nd November 2015. Hardcopy of the written feedback may also be submitted to:

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PART A OVERVIEW

1. Introduction

- 1.1 Compliance with Shariah requirement is a prerequisite in ensuring the legitimacy and integrity of Islamic financial products and services. In particular, the avoidance of prohibited elements such as *riba* and elimination of *gharar* (contractual ambiguity) are the cornerstones of a valid Islamic financial transaction from Shariah perspective. In meeting this expectation, it is essential for an IFI to establish the necessary operational framework and infrastructure to ensure that the conduct of Islamic financial transactions is consistent with Shariah.
- 1.2 The formulation of the Shariah contract-based regulatory policies aims to outline the essential regulatory requirements founded based on Shariah rulings to preserve the sanctity Shariah contract and promote consistent application in Islamic financial transactions. The fulfilment of these requirements support to attain validity of the Shariah contract, enhance the contracts' certainty and strengthen Shariah compliance by IFIs.
- 1.3 The Shariah contract-based regulatory policy consists of the Shariah requirements and optional practices of a specific Shariah contract. The policy documents highlight the salient features and essential conditions of the contract including arrangement of the contract with other Shariah contracts or concepts.
- 1.4 *Bai` al-sarf* is a contract where an exchange of money for money of the same or a different type takes place.

2. Policy objectives

- 2.1 This policy document aims to:
- (a) outline the Shariah requirements and optional practices relating to *bai` al-sarf* to be observed by the Islamic financial institutions (IFIs) in developing Islamic financial services and products;

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- (b) cover the arrangement of *bai` al-sarf* with other Shariah contracts or concepts; and
- (c) facilitate the understanding of the Shariah requirements relating to *bai` al-sarf* that must be adhered to by IFIs in order to ensure its validity.

3. Scope of policy document

- 3.1 Provides mandatory Shariah requirements to ensure the validity of *bai` al-sarf* and its optional practices.

4. Applicability

- 4.1 This policy document is applicable to all IFIs as defined in paragraph 7.2.

5. Legal provisions

- 5.1 The requirements in this policy document are:
 - (a) specified pursuant to section 29(1) of the Islamic Financial Services Act 2013 (IFSA) ; and
 - (b) issued pursuant to section 126 and constitute as a direction pursuant to section 129(3) of the Development Financial Institutions Act 2002 (DFIA).

6. Effective date

- 6.1 The consultation period for this Exposure Draft ends on 2nd November 2015

7. Interpretation

- 7.1 The terms and expressions used in this policy document shall have the same meanings as assigned under the Financial Services Act 2013 (FSA), IFSA and DFIA, as the case may be, unless otherwise defined in this policy document.

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7.2 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; and

“**G**” denotes guidance which consist information, advice or recommendation intended to promote common understanding and adoption of 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 bank and licensed investment bank under the FSA which are approved under section 15(1)(a) of the FSA to carry on Islamic banking business; and
- (c) prescribed institution under the DFIA which are approved under section 129(1) of the DFIA to carry on Islamic banking business or Islamic financial business.

7.3 A glossary of terms used in this policy document is set out in Appendix 2.

8. Related Shariah rulings and policy documents

8.1 This policy document must be read together with but not limited to such Shariah rulings and policy documents as specified in Appendix 3.

9. Policy document superseded

9.1 Not applicable.

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PART B SHARIAH REQUIREMENTS AND OPTIONAL PRACTICES

10. Compliance with this part

- S** 10.1 An IFI which uses the *bai` al-sarf* as part of the underlying contract for its products and services shall ensure that such products and services are in compliance with this policy document.

DEFINITION AND NATURE OF *BAI` AL-SARF*

11. Definition

- S** 11.1 *Bai` al-sarf* is a contract where an exchange of money for money of the same or a different type takes place.

12. Nature

- S** 12.1 *Bai` al-sarf* is an exchange contract that is binding in nature. Therefore, the contract shall not be terminated unilaterally by either of the contracting parties.
- S** 12.2 The inherent nature of *bai` al-sarf* is transfer of ownership of money that is exchanged:
- (a) on the spot; and
 - (b) at par (by equal units of measurement) where the exchanged counter-values are of the same type.

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COMPONENTS OF *BAI` AL-SARF*

13. Contracting parties

- S** 13.1 The contracting parties in *bai` al-sarf* shall be a seller and a buyer.
- S** 13.2 The contracting parties shall have the legal capacity¹ to enter into a *bai` al-sarf* contract.
- S** 13.3 The contracting parties in the *bai` al-sarf* must be a natural person or a legal entity.
- G** 13.4 Any party to the *bai` al-sarf* may enter into the contract through an agent.

14. Offer (*ijab*) and acceptance (*qabul*)

- S** 14.1 *Bai` al-sarf* shall be entered into by an offer and acceptance between the contracting parties.
- G** 14.2 The offer and acceptance may be expressed orally, in writing or any other methods which could be evidenced by appropriate documentation or record.
- S** 14.3 Any term or condition mutually agreed upon, which does not contravene the Shariah principles, shall be binding on the contracting parties.

¹ *The legal capacity of a person, from the Shariah perspective, is defined as capacity to assume rights and responsibilities and capacity to give legal effect to his action. Among the important conditions are that the person must possess sound mind and the capacity to distinguish between what is harmful or beneficial to one's interests. Legal capacity of a legal entity is defined as eligibility of an entity to acquire rights and assume responsibilities. In Malaysia, legal capacity is governed under the Contracts Act 1950 and the Age of Majority Act 1971.*

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15. Subject matter

- S** 15.1 The subject matter in a *bai` al-sarf* shall be money which is known, in existence, deliverable and owned by the contracting parties.
- S** 15.2 Notwithstanding paragraph 15.1, in the case where the *bai` al-sarf* contract is executed by an agent, the money shall be owned by the principal.
- G** 15.3 The money in *bai` al-sarf* may be in the form of gold, silver², paper money, or other forms accepted by the Shariah.
- S** 15.4 Pursuant to paragraph 15.3, the type of money in *bai` al-sarf* shall be determined and mutually agreed by the contracting parties at the time of the execution of the contract.
- G** 15.5 The exchange rate in the *bai` al-sarf* contract may be determined based on the prevailing currency rate or any other rate mutually agreed by the contracting parties.

16. Requirements of *bai` al-sarf*

- S** 16.1 A *Bai` al-sarf* shall satisfy all essential elements, necessary conditions and requirements of a valid sale and purchase contract under Shariah.
- S** 16.2 The *Bai` al-sarf* shall satisfy the following specific requirements:
- (a) the transfer of ownership of money takes place before the contract session ends;
 - (b) the transaction is effected on a spot basis; and
 - (c) the transaction is done at par (by equal unit of measurement) where the exchanged counter-values are the same type of money.

² Gold and silver in this document includes, but is not limited to, wafer, bullion, bar and coin. Jewelry is, however, excluded.

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- S** 16.3 Possession of the transacted money shall be either in the form of physical possession (*qabd haqiqi*) or constructive possession (*qabd hukmi*).
- S** 16.4 Possession of the money shall take effect by the seller delivering the money to the buyer through any mechanism permitted by Shariah, including customary business practice (*`urf tijar*), such that the buyer would have access to the money and would have assumed its ownership risk.
- S** 16.5 The rights and liabilities of the buyer as the owner of the transacted money are established upon his possession of the transacted money.
- S** 16.6 The seller shall bear the liability for loss or damage of the transacted money before it is delivered to the buyer.
- S** 16.7 The transacted money shall be delivered in full during the contract session and shall not be deferred. Therefore, conditional option (*khiyar al-shart*) and earnest, money (*`urbun*) shall not be applied in *bai` al-sarf*.
- G** 16.8 Notwithstanding paragraph 16.7, the delivery period of the money may be extended due to business processes and procedures acceptable by customary business practice.
- S** 16.9 In this regard, delivery of money shall not exceed two days from transaction date (T+2) and delivery within two days of transaction date is regarded as spot settlement.
- G** 16.10 The method of payment which fulfil the spot settlement of money may include the following:
- (a) payment by bankers cheque;
 - (b) payment by debit card, charge card, credit card or prepaid card; or
 - (c) cash payment including cash transfer from an account to another account.

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- S** 16.11 The *bai` al-sarf* involving the same type of currency denomination shall be exchanged at par (by equal unit of measurement).
- S** 16.12 The *bai` al-sarf* shall not be made conditional upon another contract such as a loan contract (*qard*) or other money exchanges.

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ARRANGEMENT OF *BAI` AL-SARF* WITH OTHER CONTRACTS OR CONCEPTS

17. Arrangement of *bai` al-sarf* with agency (*wakalah*)

- G** 17.1 In a *bai` al-sarf* contract, the contracting parties may appoint an agent to execute *bai` al-sarf* and to take possession or deliver the money.

18. Arrangement of *bai` al-sarf* with promise (*wa`d*)

- G** 18.1 A party may provide a unilateral promise to enter into *bai` al-sarf* with another party in the future.
- G** 18.2 The parties may provide two separate unilateral promises (*wa`dan*) to each other to enter into *bai` al-sarf* at a future date.
- S** 18.3 The parties may provide bilateral binding promise (*muwa`adah mulzimah*) to execute *bai` al-sarf*.
- G** 18.4 The contracting parties may agree on the currency exchange rate at the inception of the *wa`d*.
- S** 18.5 The promisor shall fulfill his *wa`d* in accordance with the conditions specified in the *wa`d* such as occurrence of a certain cause or event, etc.
- S** 18.6 In the event that a promisor has breached his binding promise, the promisee has a right against the promisor to claim for compensation on any actual loss incurred.
- G** 18.7 A promisor may provide the promisee a security deposit (*hamish jiddiyyah*) to secure the performance of the *wa`d*. The security deposit may be used to compensate the promisee against actual losses incurred in the event the promisor breaches his *wa`d*.

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S 18.8 Pursuant to 18.7, any excess of the security deposit after compensating the promisee against actual loss, shall be returned to the promisor.

S 18.9 Notwithstanding to paragraph 18.8, any shortage of the security deposit arising from the actual loss incurred shall be paid by the promisor upon claim by the promisee.

19. Arrangement of bai` al-sarf with ijarah al-ashkhas

G 19.1 *Bai` al-sarf* may be arranged with *ijarah al-ashkhas* (employment contract), which include but are not limited to:

- a) transfer of money (remittance) in a different currency; and
- b) cash withdrawal in a different currency.

S 19.2 Pursuant to paragraph 19.1, *bai` al-sarf* and *ijarah al-ashkhas* shall be entered into independently and separately where the effects of each contract are not interrelated with the other.

G 19.3 The service provider may charge a fee for the services rendered.

G 19.4 The exchange rate for the money, as the subject matter of the *bai` al-sarf* may be determined based on the prevailing currency rate or any mutually agreed rate.

20. Payment of debt in different currency

G 20.1 A debtor may pay the debt due upon him with a different currency from that of the original debt.

G 20.2 Parties who have debt obligation against each other may agree to set-off their obligations in different currencies.

S 20.3 Pursuant to paragraph 20.1 and 20.2, the payment of debt in different currency shall be effected at the prevailing exchange rate or a mutually agreed rate on the day of payment (not pre-agreed rate).

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DISSOLUTION (*FASAKH*) AND COMPLETION (*INTIHA`*) OF *BAI` AL-SARF*

21. Dissolution of *bai` al-sarf*

- S** 21.1 A *bai` al-sarf* contract is dissolved under the following circumstances:
- (a) the contracting parties mutually agree to cancel the contract; and
 - (b) one of the contracting parties exercises the defect option (*khiyar al-`ayb*) to terminate the contract.

22. Completion of *bai` al-sarf*

- S** 22.1 A *bai` al-sarf* contract is completed by any of the following circumstances:
- (a) Possession of the exchanged money by contracting parties;
 - (b) set-off (*muqassah*) of debt obligation between the contracting parties in different currencies; or
 - (c) transfer of debt obligation (*hiwalah al-dayn*) to pay the counter-value to a third party provided that it is effected on the spot.
- S** 22.2 Upon completion of the *bai` al-sarf* contract, the contracting parties are free from any contractual obligations.

APPENDICES

Appendix 1: Legitimacy of *bai` al-sarf*

The Quran

1. The following verse of the Quran implies the general permissibility of sales contract including *bai` al-sarf*:

وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرِّبَا

“...whereas Allah SWT has permitted trading and forbidden usury...”³

The *Sunnah* of the Prophet Muhammad (peace be upon him)

2. The legality of *bai` al-sarf* is indicated in the following hadith:

"الذهب بالذهب والفضة بالفضة والبر بالبر والشعير بالشعير والتمر بالتمر والملح بالملح مثلاً بمثل سواء بسواء يداً بيد، فإذا اختلفت هذه الأصناف فبيعوا كيف شئتم إذا كان يداً بيد"

“[Exchange of] gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, or salt for salt [shall be] in equal quantities and hand to hand (spot). If they differ in type, you may trade them as you wish provided it is hand to hand (without deferment on either side)”⁴

³ Surah al-Baqarah, verse 275

⁴ Sahih Muslim, hadith no. 1587

Appendix 2: Glossary

Terms	Definition
<i>Hamish jiddiyah</i>	A security deposit placed to secure the undertaking to purchase an asset before entering into the sale and purchase agreement.
<i>Hiwalah al-dayn</i>	Assignment/transfer of debt from the liability of the original debtor to the liability of a third person so that the original debtor becomes free of liability
<i>Ibra'</i>	Rebate
<i>Ijab</i>	Offer
<i>Khiyar al-`ayb</i>	Option arising from a defect; the option of dissolving or continuing the contract upon discovery of a defect in the asset purchased
<i>Khiyar al-shart</i>	Conditional option
<i>Muqassah</i>	Offsetting
<i>Muwa`adah mulzimah</i>	Bilateral binding promise
<i>Qabd haqiqi</i>	Physical possession. It refers to a state where a person has actual possession and the rights to control an asset
<i>Qabd hukmi</i>	Constructive possession. It does not refer to an actual possession, but it is a presumptive possession based on the right of the owner towards an asset.
<i>Qabul</i>	Acceptance
<i>`Urbun</i>	Earnest money paid to secure purchase of an asset in an exchange contract which is considered part of the price if the purchaser decides to continue the contract and is not refundable.
<i>`Urf tijari</i>	Customary business practice which is acceptable by

	the community and does not contradict the Shariah principles.
<i>Wa`d</i>	A promise or undertaking which refers to an expression of commitment given by one party to another to perform certain action(s) in the future.
<i>Wakalah</i>	Agency

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Appendix 3: Related Shariah Rulings and policy documents

1. Shariah Advisory Council of Bank Negara Malaysia (SAC) published by the Bank;¹and
2. Shariah Governance Framework for Islamic Financial Institutions.

¹ *Including Shariah resolutions in Islamic finance, standards, circulars or any directive pertaining to Shariah matters issued by the Bank.*