

Response to feedback received

Kafalah

Introduction

The finalised policy document on *kafalah*, incorporates the policy requirements in the Concept Paper (CP) that was issued in September 2015 and taking into account the feedback received during the consultation period.

The Bank received written responses from 30 Islamic financial institutions during the consultation period. While the respondents were broadly supportive of the proposals set out in the CP, this document also incorporated the alternative views provided by the respondents.

The Bank appreciates the feedback and suggestions received during the consultation process. Other comments and suggestions for clarification have been incorporated in the final policy where appropriate.

Bank Negara Malaysia

13 April 2017

1. Scope of policy documents

- 1.1 The CP proposed that the policy document is applicable only to financial products and services structured using the *kafalah* contracts. Some respondents enquired whether the policy document is applicable to undertakings or covenants which are embedded in products under various Shariah contracts.
- 1.2 The Bank is of the view that undertakings or covenants which are embedded in financial contracts do not fall under the scope of the policy document as they do not fulfil the requirements of salient features under *kafalah*. Therefore, an Islamic financial institution (IFI) is advised to assess the applicability of the policy document by differentiating between financial products structured based on *kafalah* contract and that adopt contract terms with guarantee element.

2. Documentation of *kafalah*

- 2.1 The CP proposed for the IFI to stipulate in the *kafalah* legal documentation that the beneficiary has the right to claim the guaranteed liability from the guaranteed party in priority of the guarantor.
- 2.2 While the Bank acknowledges that the proposed requirement may be adopted for financial guarantee facility, it is not strictly applicable to financial on-demand guarantee facility. In addition, the existing legal framework accords flexibility for contracting parties to specify the terms on priority of claims in the legal documentation.
- 2.3 As to ensure certainty in the claim process under the *kafalah* contract, the final policy document sets out the requirement for IFI to specify the terms on priority of claims (against guaranteed party and guarantor) in the terms and conditions of the *kafalah* contract.
- 2.4 With regard to the use of Shariah non-compliant terminologies in trade documentation, for example “interest charges” as stipulated in Uniform Customs and Practice for Documentary Credit (UCP 600), the Shariah Advisory Council (SAC) resolved that IFI should avoid the use of such Shariah non-compliant terminologies. However, if the application of such Shariah non-compliant terminologies in the international trade documentation is not avoidable, the IFI must cleanse all income received from transactions where such Shariah non-compliant terminologies are applied.

3. Status of *kafalah* following the demise of guarantor

- 3.1 Some respondents enquired on the effect of the *kafalah* contract following the demise of the guarantor. The Bank has sought the SAC's view on this matter and the rulings of the SAC have been incorporated accordingly in paragraphs 14.14 and 14.15 of the policy document.
- 3.2 For avoidance of doubt, the treatment on the dissolution of a corporate guarantor (including in the instance where IFI undertake the role of a guarantor), is subjected to the winding up procedures as provided in the Companies Act 1965.