



**BANK NEGARA MALAYSIA**  
CENTRAL BANK OF MALAYSIA

## ***Ijarah***

Applicable to:

1. Licensed Islamic banks
2. Licensed takaful operators and professional retakaful operators
3. Licensed banks and licensed investment banks carrying on Islamic banking business
4. Prescribed institutions carrying on Islamic financial business

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## PART A OVERVIEW

### 1. Introduction

- 1.1 Compliance with Shariah requirement is a prerequisite in ensuring the legitimacy of Islamic financial products and services. In meeting this expectation, it is essential for an Islamic financial institution (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 Shariah contract-based regulatory policy is intended to ensure end-to-end compliance with Shariah and therefore, enhance the integrity and sustainability of the IFI.
- 1.3 The policy document contains two distinctive parts, namely the Shariah requirements and operational requirements. The former highlights the salient features, essential conditions and optional practices of the *ijarah* contract including arrangement of the contract with other Shariah contracts or concepts. The latter outlines the operational requirements based on the core principles of good governance and oversight, proper product structuring, effective risk management, fair business and market conduct and sound financial disclosures. These operational requirements are aimed at complementing and promoting sound application of the Shariah principles.
- 1.4 An *ijarah* refers to a contract that transfers ownership of usufruct or service for a specified period in exchange for a specified consideration. There are two main structures of the *ijarah* in the context of Islamic financial transactions, namely the primary *ijarah* and *ijarah* financing.
- 1.5 Under the primary *ijarah* structure, the customer intends to obtain benefits from the leased asset, instead of committing to own the asset. As such, at the end of the lease period, the ownership of the asset may still remain with the IFI as the lessor. Meanwhile, the *ijarah* financing is structured to transfer the ownership of the asset to the customer at the end of the lease period. For this, the *ijarah* would be structured with supporting arrangements and/or other contracts to enable the transfer of the ownership of the leased asset from the IFI to the customer, for example, using the mechanism of *hibah* (gift) or *bai'* (sale).

- 1.6 It is pertinent for the IFI to make an assessment on the suitability of the types of the *ijarah* structure to be applied given that each *ijarah* structure have different risks and return profiles which corresponds to the degree of responsibilities and level of risk borne by the IFI and the customer.
- 1.7 The inherent risks in a primary *ijarah* structure includes the operational risk arising from the ownership of the asset, for example maintenance costs relating to the ownership, market risk associated with the potential loss in value of the asset owned by the IFI, and credit risk arising from the losses associated with the potential failure of the customer to pay the rental following the transfer of usufruct.
- 1.8 For an *ijarah* financing, the IFI is mainly exposed to the credit risk whereby the customer may potentially fail to pay the rental instalments. The operational and market risks can be mitigated given that there is a commitment from the customer to purchase the asset which enables the IFI to shift the other risks to the customer.
- 1.9 In order to ensure that the customer under an *ijarah* financing contract will be accorded with the same standard of protections as provided under the Hire-Purchase Act 1967 in the event of a repossession, this policy document also incorporates requirements to ensure that, among others, consumer protection elements in the Hire-Purchase Act 1967 relating to repossession, are reflected in the *ijarah* financing contract between IFI and its customers.
- 1.10 This policy document aims to:
- (a) set out the Shariah rulings associated with an *ijarah* contract;
  - (b) set out key operational requirements with regards to the implementation of an *ijarah* contract; and
  - (c) promote end-to-end compliance with Shariah requirements which include adherence to sound Islamic banking practices and safeguarding customers' interest.
- 1.11 This policy document sets out the following:
- (a) the mandatory Shariah requirements and permissible optional practices of *ijarah* under Part B; and
  - (b) the operational requirements on governance and oversight, structuring, risk management, business and market conduct and financial disclosure for both the *ijarah* financing and primary *ijarah* (in these parts refers as

*ijarah*) under Parts C and D respectively. The Parts describe five key principles for the sound management and operationalisation of *ijarah* and *ijarah* financing as follows:

- (i) **Principle 1:** The IFI shall establish a comprehensive governance and oversight framework to ensure that an *ijarah* transaction is conducted based on sound banking practices and complies with Shariah;
- (ii) **Principle 2:** The IFI shall ensure that the structuring and implementation of an *ijarah* is supported by robust policies, procedures, processes, adequate infrastructure and robust documentation;
- (iii) **Principle 3:** The IFI shall institute and implement sound and integrated risk management system to effectively manage risks in line with the IFI's risk appetite throughout the life cycle of an *ijarah*;
- (iv) **Principle 4:** The IFI shall undertake an *ijarah* transaction in a fair and transparent manner in line with the Shariah to protect customers' interest; and
- (v) **Principle 5:** The IFI shall provide adequate disclosure to facilitate stakeholders' understanding and assessment of the *ijarah* transactions.

## 2. Applicability

- 2.1 This policy document is applicable to all IFIs as defined in paragraph 5.2 that offer products and services structured using an *ijarah* contract, other than capital market instruments.
- 2.2 Notwithstanding paragraph 2.1, a licensed takaful operator is only required to comply with Part B of this policy document.

## 3. Legal provisions

- 3.1 The requirements in Part B of this policy document are specified pursuant to—
  - (a) section 29(1) of the Islamic Financial Services Act 2013 (IFSA); and
  - (b) section 33E(1) of the Development Financial Institutions Act 2002 (DFIA).
- 3.2 The requirements in Parts C and D of this policy document are specified pursuant to—

- (a) sections 29(2), 57, 135(1) and 155 of the IFSA; and
- (b) sections 33E(2), 41, 42C(1) and 116 of the DFIA.

3.3 The guidance in this policy document is issued pursuant to section 277 of the IFSA and section 126 of the DFIA.

#### 4. Effective date

4.1 This policy document comes into effect on 1 August 2018, except for paragraph 38 which shall come or take effect immediately upon issuance of this policy document.

#### 5. Interpretation

5.1 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.

5.2 For the purposes of this policy document–

“**S**” denotes a standard, an obligation, a requirement, specification, direction, condition and any interpretive, supplemental and transitional provisions that must be complied with. Non-compliance may result in enforcement actions;

“**G**” denotes guidance which may consist of statements or information intended to promote common understanding and advice or recommendation that are encouraged to be adopted;

“**Islamic financial institution**” or “**IFI**” means–

- (a) a licensed Islamic bank;
- (b) a licensed takaful operator and professional retakaful operator;
- (c) a licensed bank and licensed investment bank approved under section 15(1)(a) of the FSA to carry on Islamic banking business; and
- (d) a prescribed institution approved under section 33B(1) of the DFIA to carry on Islamic financial business.

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

## **6. Related Shariah rulings and policy documents**

6.1 This policy document must be read together with other relevant legal instruments and policy documents that have been issued by the Bank, in particular–

- (a) Shariah Advisory Council (SAC) rulings published by the Bank<sup>1</sup>;
- (b) Guidelines on Imposition of Fees and Charges on Financial Products and Services (BNM/RH/GL 016-2);
- (c) Guidelines on Outsourcing for Development Financial Institutions (BNM/RH/GL 005-10);
- (d) Guidelines on Outsourcing of Islamic Banking Operations (BNM/RH/GL 002-4);
- (e) Reference Rate Framework (BNM/RH/STD 028-6);
- (f) Responsible Financing (BNM/RH/GL 000-5); and
- (g) Risk-Informed Pricing (BNM/RH/STD 028-3).

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



## PART B SHARIAH REQUIREMENTS AND OPTIONAL PRACTICES

### 7. Compliance with this Part

- s 7.1 An IFI which uses the *ijarah* contract for its products and services shall ensure that such products and services are in compliance with Part B of this policy document.

### 8. Definition

- s 8.1 An *ijarah* refers to–
- (a) a lease contract that transfers the ownership of a usufruct of an asset to another person for a specified period in exchange for a specified consideration; or
  - (b) a contract for hiring of services of a person for a specified period in exchange for a specified consideration.

### 9. Nature

- s 9.1 An *ijarah* shall be categorised as follows:
- (a) a lease contract to transfer usufruct of a particular asset to another person in exchange for a rental; or
  - (b) a hire contract to employ a person with wages paid to him as a consideration for his services.
- s 9.2 This policy document shall only be applicable to the category mentioned in paragraph 9.1(a).
- G 9.3 The leased asset may be–
- (a) an asset in existence and has been identified at the time of entering into the *ijarah* contract; or
  - (b) an asset to be made available at an agreed future date based on agreed specifications, in which case the *ijarah* is known as *ijarah mawsufah fi zimmah*.

- S 9.4 The *ijarah* is a binding contract which shall not be terminated unilaterally by any of the contracting parties unless otherwise provided in this policy document.

## 10. Components of an *ijarah*

- S 10.1 An *ijarah* shall consist of the following components:
- (a) the contracting parties namely the lessor and lessee;
  - (b) *ijab* (offer) and *qabul* (acceptance);
  - (c) the asset and usufruct; and
  - (d) rental.

## 11. Contracting parties

- G 11.1 An *ijarah* contract may consist of more than one lessor or lessee.
- G 11.2 A party may enter into the *ijarah* contract through an agent (*wakil*).
- S 11.3 If the leased asset is jointly owned by more than one person, consent of all joint owners shall be obtained before the asset can be leased.
- S 11.4 The contracting parties shall be a natural person or a legal entity who has the legal capacity<sup>2</sup> to enter into the *ijarah* contract.

## 12. *Ijab* (offer) and *qabul* (acceptance)

- S 12.1 An *ijarah* contract shall be entered into through an offer and acceptance between the contracting parties.
- G 12.2 The offer and acceptance may be expressed orally, in writing or by any other method recognised by Shariah.
- S 12.3 Terms or conditions of the *ijarah* contract that have been mutually agreed by the contracting parties, which does not contravene the Shariah principles, shall be binding on the contracting parties.

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<sup>2</sup> From Shariah perspective, the legal capacity of a natural person is defined as the 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. The legal capacity of a legal entity is defined as eligibility of an entity to acquire rights and assume responsibilities. In Malaysia, the legal capacity of both natural person and legal entity is subject to the Contracts Act 1950 and the Age of Majority Act 1971.

**13. Asset and usufruct**

- s 13.1 The asset and usufruct in an *ijarah* contract shall be—
- (a) recognised by Shariah;
  - (b) valuable;
  - (c) in existence;
  - (d) identifiable;
  - (e) accessible;
  - (f) deliverable;
  - (g) not a debt-based asset; and
  - (h) non-perishable.
- s 13.2 The requirement in paragraph 13.1(c), shall not apply to an asset or usufruct at the time of entering into an *ijarah mawsufah fi zimmah*.
- s 13.3 The asset and its usufruct shall be owned by the lessor.
- G 13.4 The lessor may appoint the lessee or a third party as an agent to acquire the asset to be leased.

**Asset incapable of being used**

- s 13.5 The *ijarah* contract shall dissolve if a leased asset is permanently incapable of being used at any time during the lease period.
- s 13.6 Notwithstanding paragraph 13.5, the *ijarah* contract is not dissolved where the contracting parties have a prior agreement to replace or substitute the leased asset that is incapable of being used.

**Defective asset**

- s 13.7 Any defect in the leased asset discovered after entering into the *ijarah* contract shall entitle the lessee to either—
- (a) terminate the *ijarah* contract; or
  - (b) request for substitution or replacement of the leased asset.
- s 13.8 Notwithstanding paragraph 13.7, where the lessee is aware of any defects found on the asset at the point of entering into the *ijarah* contract and accepted the defects, the lessee shall not be entitled to terminate the *ijarah* contract or request for substitution or replacement of the leased asset.

**Permissible forms of leased assets**

- G 13.9 The asset in an *ijarah* contract may be–
- (a) tangible assets, which can either be movable or immovable physical assets such as land, buildings, vehicles and machines; or
  - (b) intangible assets, such as trademark, patent and other forms of intellectual property which are capable of being leased.
- S 13.10 An asset shall not be simultaneously leased in two or more *ijarah* contracts.
- G 13.11 Unless agreed otherwise by the contracting parties, the lessor may sell the leased asset to a third party at any time during the lease period without prior consent of the lessee subject to observance of paragraph 13.12.
- S 13.12 Where the leased asset is sold to a third party at any time during the lease period, all rights and liabilities of the lessor under the *ijarah* contract shall be transferred to and assumed by the third party. In the event that the third party was not informed of the existence of the *ijarah* contract prior to the execution of such sale, the third party shall have the right to rescind the sale contract.

**14. Rental**

- S 14.1 Rental shall be determined and agreed by the contracting parties at the inception of the *ijarah* contract.
- G 14.2 The contracting parties may mutually agree for the rental to be paid by the lessee in the following manner:
- (a) in cash or in kind;
  - (b) in advance or in arrears; and
  - (c) in a lump sum or by instalments at such intervals including daily, weekly, monthly, quarterly, semi-annually or annually.
- G 14.3 The contracting parties may agree for the rental amount–
- (a) to be paid in a fixed amount;
  - (b) to be determined *via* a reference to a specified benchmark or formula; or
  - (c) to be paid using a combination of paragraph 14.3(a) and 14.3(b) above.
- S 14.4 In respect of paragraph 14.3(b), the rental shall be subject to a minimum and maximum limit.

- S 14.5 The lessor shall not increase rental unilaterally.
- G 14.6 The contracting parties may, from time to time, mutually agree to revise the rental of the leased asset.
- G 14.7 The rental may be received in advance and such rental may be immediately utilised by the lessor.
- S 14.8 The lessee shall ensure that the payment of the rental is made timely, promptly and in accordance with the mutually agreed method. Any overdue rental shall be considered as a debt due from the lessee to the lessor.

**Non-delivery of leased asset**

- S 14.9 Where the rental is paid in advance and the lessor fails to deliver the leased asset to the lessee, the lessor shall refund the rental to the lessee.

**Late delivery of leased asset**

- S 14.10 In the event the lessor fails to deliver the usufruct of the leased asset to the lessee on the agreed date, any rental paid by the lessee prior to the delivery of the asset shall not be earned by the lessor until the asset is delivered.
- G 14.11 In the case of failure to deliver the usufruct of the leased asset on the agreed timeline, the contracting parties may opt for other arrangements, including—  
(a) to reduce the rental on a pro-rated basis; or  
(b) to extend the lease period by the equivalent period of the late delivery.
- G 14.12 In the event that the lessee decides to return the leased asset to the lessor before the maturity of the *ijarah* contract, the *ijarah* contract may be dissolved.
- S 14.13 In the event that the contracting parties opt to dissolve the *ijarah* contract under paragraph 14.12, the lessee shall compensate the lessor in accordance with the mutually agreed terms under the *ijarah* contract.

## MANAGEMENT OF IJARAH

### 15. Use of the leased asset

#### Specified purpose

- s 15.1 The lessee shall use the leased asset solely for the purpose that has been mutually agreed between the contracting parties which does not in contravention with Shariah principles.

#### Use consistent with customary practice (*`urf*) when purpose is not specified

- s 15.2 If the *ijarah* contract does not specify the purpose for which the leased asset may be used, the lessee shall use the leased asset for any purpose in accordance with the *`urf* so long it does not contravene Shariah principles.

#### Use other than for specified purpose or *`urf*

- s 15.3 If the lessee intends to use the leased asset for purposes other than the purposes set out in paragraphs 15.1 and 15.2, the lessee shall obtain a prior permission from the lessor.
- s 15.4 In relation to paragraph 15.3, the lessor shall only permit the lessee to use the leased asset for purposes that is in line with Shariah.

### 16. Rights and liabilities

#### Rights and liabilities of the lessor and lessee in an *ijarah*

- s 16.1 The rights and liabilities arising from the ownership of the leased asset shall be assumed by the lessor while the rights and liabilities arising from the usage of the leased assets shall be assumed by the lessee.
- s 16.2 Risks associated with the ownership of the leased asset shall be assumed by the lessor including any loss or impairment relating to the leased asset. Any expenses incurred in maintaining the availability and accessibility of the usufruct of the leased asset shall therefore be borne by the lessor.

**Contracting parties liability for loss, damage or impairment of leased asset**

- S 16.3 The lessee shall be held liable for any loss, damage or impairment of the leased asset unless he proves that there is no *ta`addi* (misconduct), *taqsir* (negligence) or *mukhalafah al-shurut* (breach of specified terms) on his part that resulted to such loss or impairment.
- S 16.4 Where it has been proven that loss, damage or impairment of the leased asset is due to the lessee's misconduct, negligence or breach of specified terms, the lessee shall be responsible for restoring the asset. All costs and expenses related to such restoration shall be borne by the lessee. During the restoration, the lessee shall remain liable to pay rental for such period.
- S 16.5 Where the usufruct of the leased asset is impaired and it has been proven that there is no misconduct, negligence or breach of specified terms by the lessee, the lessor or any person who caused such impairment shall be responsible for restoring the usufruct of the leased asset.
- S 16.6 Where the loss, damage or impairment is due to *force majeure*, the lessor shall be responsible for restoring the usufruct and bearing such cost.
- G 16.7 The lessor may mitigate specific risks relating to loss, damage or impairment of the leased asset through a takaful coverage.

**Maintenance of the leased asset and related costs and expenses**

- G 16.8 Notwithstanding paragraphs 16.1 and 16.2, the lessor may alternatively appoint the lessee to maintain the leased asset and/or to obtain a takaful coverage for the leased asset.
- S 16.9 In respect of paragraph 16.8, where the lessor appoints the lessee to maintain the leased asset and/or to obtain the takaful coverage on its behalf, the lessee shall be entitled to recover all costs incurred for such maintenance from the lessor in the absence of any mutual agreement to the contrary. As such, the lessee shall accordingly be reimbursed by the lessor pursuant to any claim made by the lessee.
- G 16.10 Notwithstanding paragraphs 16.8 and 16.9, and subject to the terms of *ijarah* contract, the contracting parties may mutually agree on who will bear the cost of maintenance and takaful coverage of the leased asset.

**17. Lease period**

- S 17.1 The period of an *ijarah* contract shall be determined and agreed between the contracting parties at the inception of the *ijarah* contract.
- G 17.2 The period of the *ijarah* contract may be varied after the inception of the *ijarah* contract.
- S 17.3 In relation to paragraph 17.2, variation to the period of the *ijarah* contract is subject to mutual agreement of the contracting parties.
- S 17.4 The lease period of the *ijarah* contract shall commence from the point where the lessee has the access to the usufruct of the leased asset, regardless of whether the lessee has actually used the asset.

**ARRANGEMENT OF SUB-LEASE AND LEASE BACK****18. Sub-lease**

- G 18.1 Unless expressly prohibited in the main *ijarah* contract, a lessee may sub-lease the leased asset to a third party.

**Period of sub-lease**

- S 18.2 The period of a sub-lease shall not exceed the period of the main *ijarah* contract.

**Rental rate**

- G 18.3 The rental under the sub-lease may be similar, higher or lower than the rental agreed under the main *ijarah* contract.
- S 18.4 The rental in the sub-lease shall be mutually agreed between the contracting parties in the sub-lease contract in accordance with paragraphs 14.1 to 14.8 above.

**Obligation of the lessee to the lessor**

- S 18.5 Notwithstanding the sub-lease, the lessee shall remain fully liable to the lessor under the main *ijarah* contract.



**19. Lease and lease back**

- G 19.1 After entering into an *ijarah* contract, a lessee may subsequently lease back the leased asset to the lessor at a rental equal to, higher or lower than the rental agreed in the initial *ijarah* contract.
- S 19.2 The rental in the lease back shall be mutually agreed between the contracting parties in accordance with paragraphs 14.1 to 14.8 above.
- S 19.3 The lease and lease back shall fulfil the following requirements:
- (a) both the initial *ijarah* and lease back contracts shall be entered into separately and shall be independent of each other. In this regard—
    - (i) the offer and acceptance of the initial *ijarah* and the offer and acceptance of lease back contracts shall be initiated separate and independently of one another;
    - (ii) the contracting parties shall not make any promise or undertaking (*wa`d*) to lease back the asset;
    - (iii) the contracting parties shall not pre-sign either the initial *ijarah* or the lease back contracts; and
    - (iv) any document or oral record involved in the negotiation between the contracting parties shall not describe or make any reference of the arrangement and the sequence that creates an obligation for any of the contracting parties to lease back the asset in any manner; and
  - (b) the lease back contract shall be for a duration not exceeding the initial *ijarah* contract.

**ARRANGEMENT OF A FORWARD IJARAH****20. Forward *ijarah***

- G 20.1 A forward *ijarah* may be effected either as—
  - (a) *ijarah mawsufah fi zimmah*; or
  - (b) *ijarah mudafah ila mustaqbal*.
- S 20.2 In respect of paragraph 20.1(a), the *ijarah mawsufah fi zimmah* shall be effected as follows:
  - (a) the lessor transfers usufruct of an asset for a specified duration in the future; and
  - (b) the asset is to be made available at an agreed future date based on

agreed specifications between the contracting parties at the inception of the contract.

- s 20.3 In respect of paragraph 20.1(b), the *ijarah mudafah ila mustaqbal* shall be effected in a manner where the contracting parties agree at inception of the contract that the lessor will transfer usufruct of an identified asset for a specified duration at an agreed date in the future.

#### **Rental rate**

- s 20.4 The rental in the forward *ijarah* shall be mutually agreed between the contracting parties in accordance with paragraphs 14.1 to 14.8 above.

#### **Delivery of a leased asset which is under construction**

- s 20.5 Where a leased asset is still under construction at the inception of the *ijarah* contract, the lessor shall deliver the leased asset to the lessee on a specified date and for a specified duration as mutually agreed between the contracting parties.

- s 20.6 In respect of paragraph 20.5, in the event that the leased asset is not delivered within the agreed timeline, the lessee shall–
- (a) terminate the *ijarah* contract; or
  - (b) continue the *ijarah* contract with or without revising the terms.

#### **Failure to meet agreed specification**

- s 20.7 Where the delivered leased asset does not meet the agreed specification, the lessee shall–
- (a) terminate the *ijarah* contract; or
  - (b) continue the *ijarah* contract with or without revising terms.

#### **Right to renegotiate terms of the *ijarah* contract**

- G 20.8 In respect of paragraphs 20.6(b) and 20.7(b), where the lessee opts to continue with the *ijarah* with the revised terms, the lessee may either request for replacement of the leased asset, rectification of the leased asset to meet the agreed specification or renegotiate any other terms of the *ijarah* contract.
- s 20.9 In respect of paragraph 20.8, any new terms and conditions shall be mutually agreed by the contracting parties.

**Termination due to non-delivery or failure to meet agreed specification**

- s 20.10 In the event that the lessee opts to terminate the *ijarah* contract either due to the failure of the lessor to deliver the asset or failure of the lessor to meet agreed specifications of the asset, the lessor shall return all rentals which have already been paid up to the date of termination to the lessee.

**ARRANGEMENT OF AN IJARAH WITH OTHER CONTRACTS OR CONCEPTS****21. Bai` (sale) and *ijarah* (lease)**

- G 21.1 A person may sell his asset and subsequently lease the asset from the buyer under an *ijarah* contract.
- s 21.2 In respect of paragraph 21.1, the following shall be complied with:
- (a) the sale must be concluded first prior to entering into the *ijarah* contract;
  - (b) the two transactions shall be documented in two separate and distinct contracts, in which each contract needs to be executed individually and in accordance with paragraph 21.2(a); and
  - (c) the *ijarah* contract shall not be stipulated as a condition or pre-condition of the sale of the asset.

**22. *Ijarah muntahiyah bi tamlik***

- s 22.1 The *ijarah muntahiyah bi tamlik* is an *ijarah* contract which shall have the ultimate purpose of the lessee to own the leased asset and shall contain a mechanism for the transfer of ownership of the leased asset to the lessee from the lessor during or at the end of the lease period.

**Modes of ownership transfer at the end of the lease period**

- G 22.2 The transfer of ownership of the leased asset from the lessor to the lessee at the end of the lease period may be effected by way of sale, conditional *hibah* or promise to *hibah*.
- s 22.3 The transfer of ownership of the leased asset from the lessor to the lessee shall be effected as follows:
- (a) by way of sale, where a sale contract shall be executed separately after the expiry or termination of the *ijarah* contract;

- (b) by a conditional *hibah*, where the transfer shall be effective once the relevant condition is fulfilled; or
- (c) by way of a promise to *hibah*, where the *hibah* shall be executed separately from the *ijarah* contract.

**Wa`d (promise) to purchase upon default or breach of terms and conditions by the lessee**

- G 22.4 At the inception of the *ijarah* contract, the lessor may request the lessee to provide a binding promise to purchase the leased asset.
- S 22.5 In respect of paragraph 22.4, the binding promise shall only be triggered on the occurrence of the following:
  - (a) an event of default by the lessee; or
  - (b) breach of the terms and conditions specified in the *wa`d* documentation by the lessee.

**Purchase price**

- G 22.6 The purchase price of the leased asset may be determined as follows:
  - (a) where the leased asset is purchased upon expiry of the *ijarah* contract, the purchase price may be—
    - (i) at a nominal value agreed between the contracting parties;
    - (ii) at the prevailing market price at the time of the sale; or
    - (iii) determined in accordance with such other methods of calculation as may be agreed between the parties on a willing-buyer and willing-seller basis; and
  - (b) where the *ijarah* is terminated during the contract, the contracting parties may mutually agree to a specific method of calculating the purchase price that is different from the purchase price of the leased asset at the expiry of the *ijarah*.

**Transfer of right and liability to another party**

- G 22.7 Where the lessee decides to discontinue the *ijarah*, the lessee may transfer all his rights and liabilities to another party who will assume the lessee's role to continue with the *ijarah* and ultimately own the asset.
- S 22.8 The lessee is allowed to discontinue the *ijarah* and transfer all his rights and liabilities to another party subject to the mutual agreement of the contracting parties.

**Application of the binding promise to purchase the leased asset**

- G 22.9 The application of the binding promise to purchase the leased asset pursuant to paragraph 22.4 may be conducted in any of the following approaches:
- (a) where the lessee fails to perform his promise after the invocation of the promise by the lessor–
    - (i) the lessor may sell the asset to a third party as agreed by the contracting parties;
    - (ii) the proceeds of the sale under paragraph (i) may be used to settle the promised purchase price of the leased asset, rental due (if any) and costs related to liquidation; and
    - (iii) if the proceeds of the sale are inadequate to meet the claim under paragraph (ii), the lessor may claim the shortfall from the lessee; or
  - (b) where the lessee defaults or breaches the terms of the *ijarah* contract which trigger the promise to purchase–
    - (i) the lessor may sell the leased asset to the lessee on credit basis at a mutually agreed price;
    - (ii) the lessor may hold the asset as a collateral to secure due and punctual payments of the purchase price;
    - (iii) where the lessee defaults on the obligation to pay the purchase price, the lessor may exercise its right to liquidate the collateral and the following may be applied:
      - (1) the lessor may claim the remaining purchase price under the credit sale, net off *ibra'* (rebate), if applicable, any overdue rental and costs related to liquidation of the collateral; or
      - (2) in the event where the proceeds from the liquidation of the collateral is inadequate to meet the claim under paragraph (1), the lessor as a creditor may claim the shortfall from the lessee.

- S 22.10 In respect of paragraph 22.9(b)(iii), any excess amount from the proceeds of the collateral liquidation after the deduction of claims, shall belong to the lessee.

**Completion**

- S 22.11 The contracting parties shall be free from any contractual obligations when–
  - (a) the contracting parties fulfil all of their respective obligations under the

*ijarah* contract and the ownership of the leased asset is transferred to the lessee at the end of the lease period; or

- (b) all consequential obligations arising from the default or breach of the *ijarah* contract have been fulfilled.

### **23. Arrangement of an *ijarah* with a *wa`d***

- G 23.1 The contracting parties of an *ijarah* contract may provide a *wa`d* for the following circumstances:
- (a) a *wa`d* to rent an asset from the lessor after the latter's acquisition of the asset;
  - (b) a *wa`d* by the lessor to transfer the leased asset to the lessee as *hibah* contingent upon the occurrence of an agreed event;
  - (c) a *wa`d* by the lessor to sell the leased asset to the lessee at a mutually agreed price upon early termination of the *ijarah* contract or at the expiry of the lease period; or
  - (d) a *wa`d* by the lessee to purchase the asset upon the occurrence of an event of default either through non-payment of rental or breach of the terms in the *ijarah* contract leading to the termination of the *ijarah* contract.
- G 23.2 Pursuant to paragraphs 23.1(c) and (d), the purchase price may be determined based on market value, fair value, face value, nominal value or such other value as may be mutually agreed between the contracting parties.
- S 23.3 The *ijarah* contract shall be executed separately from the *wa`d*.
- S 23.4 Where the lessee has given a *wa`d* to rent and take delivery of the asset but subsequently refuses to enter into the *ijarah* contract after the asset has been acquired by the lessor, the lessee shall be liable for breach of the *wa`d* and the lessee shall compensate the lessor for actual loss incurred in acquiring the asset and its disposal to a third party.

### **24. Arrangement of an *ijarah* contract with an *istisna`* contract**

- G 24.1 The contracting parties under an *ijarah mawsufah fi zimmah* contract may enter into an *istisna`* contract where the lessor may request the lessee to construct an asset that will be leased out in the future.

- S 24.2 The *ijarah mawsufah fi zimmah* contract shall be executed separately from the *istisna`* contract.

## 25. Arrangement of an *ijarah* contract with assurances

- G 25.1 An *ijarah* contract may be arranged with assurances such as a *kafalah*, a *rahn*, a *hamish jiddiyah* or an *`urbun*.

a) **Assurance of an *ijarah* through a *kafalah***

- G 25.2 A *kafalah* may be arranged with *ijarah* to secure a rental payment due.

b) **Assurance of an *ijarah* through a *rahn***

- G 25.3 The lessor may require the lessee to pledge collateral (*marhun*) to secure obligation under the *ijarah* contract.

- G 25.4 The contracting parties may include the following claims under the *rahn*:

- (a) overdue rental;
- (b) actual costs incurred for the recovery of the overdue rental; and/or
- (c) any other amount due arising from the lessee's misconduct, negligence or breach of specified terms.

c) **Assurance of an *ijarah* through a *hamish jiddiyah***

- G 25.5 The lessor may require the lessee to place a security deposit (*hamish jiddiyah*) to secure the *wa`d* for the renting of the asset.

- G 25.6 The *hamish jiddiyah* may be used to compensate against any actual loss incurred by the lessor in the event the lessee breaches the *wa`d*.

- G 25.7 After the inception of the *ijarah* contract, the *hamish jiddiyah* may be treated as part of the payment of the agreed rental for the *ijarah* contract.

- S 25.8 Where the contracting parties agree that the *hamish jiddiyah* will not be treated as part of the payment of the *ijarah* rental, it shall be returned to the lessee.

- S 25.9 The lessor shall only claim up to his actual loss and the lessor shall return any excess between the *hamish jiddiyah* and actual losses to the lessee.

d) **Assurance of an *ijarah* through an *`urbun***

- G 25.10 Upon entering into an *ijarah* contract, the lessee may place an earnest money (*`urbun*) with the lessor which entitles the lessee to the following:
- (a) to continue with the *ijarah* contract within the specified timeframe; or
  - (b) to terminate the *ijarah* contract within an agreed specified time.
- S 25.11 In respect of paragraph 25.10(b), where the lessee opts to terminate the *ijarah* contract, the *`urbun* shall be forfeited.

**26. Arrangement of an *ijarah* with a *ta`widh* and/or a *gharamah***

- G 26.1 The contracting parties may agree to include a clause in the *ijarah* contract which stipulates imposition of late payment charges as determined by the relevant authorities.
- S 26.2 In respect of paragraph 26.1, the late payment charges shall consist of—:
- (a) compensation (*ta`widh*) for actual loss borne by the lessor; and/or
  - (b) penalty (*gharamah*).
- G 26.3 In relation to paragraph 26.2(a), the *ta`widh* may be recognised as an income to the lessor.
- S 26.4 In relation to paragraph 26.2(b), the *gharamah* shall not be recognised as an income to the lessor and shall be channelled to the Baitulmal and/or other charitable bodies.



## DISSOLUTION (*FASAKH*) AND COMPLETION (*INTIHA'*) OF *IJARAH* CONTRACTS

### 27. Dissolution of an *ijarah*

- S 27.1 An *ijarah* contract shall dissolve upon the occurrence of any of the following circumstances:
- (a) mutual agreement between the contracting parties to terminate the contract;
  - (b) any contracting party exercises its option to terminate the *ijarah* contract within an agreed time period;
  - (c) the lessee who has paid the *`urbun* in the *ijarah* contract does not exercise the option to continue the contract within the specified time; or
  - (d) total destruction of the leased asset, except for *ijarah mawsufah fi zimmah* or where there is a prior arrangement between the contracting parties to replace or substitute the leased asset.
- S 27.2 Except for paragraph 27.1(c), upon the dissolution of the *ijarah* contract, the lessor shall return any rental paid in advance to the lessee.
- G 27.3 Loss of capacity to contract due to demise of either contracting party does not automatically dissolve the *ijarah* contract. The legal heirs may exercise the right to continue the *ijarah* contract or otherwise.

### 28. Completion of an *ijarah*

- S 28.1 An *ijarah* contract shall complete upon expiry of the lease period and receipt of all rental payments and any other obligations by the lessor.
- S 28.2 Upon completion of the *ijarah* contract, the contracting parties shall be free from any contractual obligation related to the *ijarah* contract.

## PART C OPERATIONAL REQUIREMENTS FOR AN *IJARAH* FINANCING

### 29. Governance and oversight

- s 29.1 While the existing governance and oversight arrangements can be applied on *ijarah* financing, IFIs must observe specific requirements on the roles and responsibilities of the Board of Directors (the Board), Shariah Committee (SC) and senior management as specified in paragraphs 29.2 to 29.4 relating to the application of *ijarah* financing.

#### Board of Directors

- s 29.2 The roles and responsibilities of the Board shall include the following:
- (a) approve and oversee policies and procedures governing the operations of the *ijarah* financing including policies on–
    - (i) recognition of advance rental and its return in the case of non-delivery of the asset or termination by the customer arising from failure to meet the agreed specification on the asset;
    - (ii) permissibility of sub-lease and usage of the leased asset by a third party; and
    - (iii) repossession of the leased asset for *ijarah* financing involving consumer goods<sup>3</sup> and motor vehicles<sup>4</sup>; and
  - (b) ensure policies and procedures pertaining to Shariah matters are endorsed by the SC.

#### Shariah Committee

- s 29.3 The roles and responsibilities of the SC shall include the following:
- (a) ensure the rights and obligations between the IFI and customer are specified in the relevant documentation; and
  - (b) endorse the application of Shariah contracts or concepts in the relevant policies and procedures governing the application of the *ijarah* financing including–
    - (i) the eligible assets for the *ijarah* financing and the purposes of usage of such assets;
    - (ii) the list of costs and expenses borne by the respective contracting parties;

<sup>3</sup> Consumer goods means asset purchased for personal, family or household purposes.

<sup>4</sup> Motor vehicles include motor cycles, motor cars including taxi cabs and hire cars and buses.

- (iii) the mechanism for sale of the *ijarah* financing to a third party during the term of the *ijarah*;
- (iv) the mechanism on transfer of the ownership of the leased asset from the IFI to the customer for the *ijarah* financing;
- (v) a non-exhaustive list of *force majeure* events of which the customer cannot be held liable for any losses, damages and impairment of the leased asset; and
- (vi) the mechanism of settlement or termination of the *ijarah* financing prior to maturity and the settlement formula<sup>5</sup>, including those arising from—
  - (a) refinancing practices;
  - (b) default;
  - (c) loss of legal capacity of either contracting party;
  - (d) total loss of the leased asset due to *force majeure* events; and
  - (e) total loss of the leased asset due to incidents other than *force majeure*.

### Senior Management

- s 29.4 The roles and responsibilities of the senior management shall include the following:
- (a) establish policies and procedures governing operations of the *ijarah* financing, and ensure its proper communication and delegation of responsibilities to all relevant functions within the IFI;
  - (b) undertake regular reviews and monitor compliance with the approved policies; and
  - (c) ensure timely disclosure of relevant information to the Board and the SC.

## 30. Structuring

### Structure

- G 30.1 An IFI may structure the *ijarah* financing by combining the *ijarah* contract with other Shariah contracts or concepts such as *bai'* (sale), *hibah* (gift), *istisna'* (order to manufacture) and *wa`d* (promise or undertaking). A common example of *ijarah* financing is *ijarah muntahiyah bi tamlik*.

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<sup>5</sup> Including any early termination fee imposed.

- s 30.2 The IFI shall determine the appropriate structure of an *ijarah* financing from its inception until resolution pursuant to paragraph 22.2, including the following arrangements:
- (a) any *wa`d* either to reflect the customer's intention to own asset or the IFI's intention to transfer ownership; or
  - (b) a contract or an arrangement for the transfer of ownership of the leased asset.
- G 30.3 The IFI may use any of the following mechanisms to reflect the customer's intention to own the asset or the IFI's intention to transfer the ownership of the asset to the customer upon maturity–
- (a) a *wa`d* to purchase by the customer or a third party<sup>6</sup>;
  - (b) a *wa`d* to give a *hibah* by the IFI;
  - (c) a *wa`d* to sell by the IFI; or
  - (d) a conditional *hibah* by the IFI.
- s 30.4 Notwithstanding paragraph 30.3, the IFI shall employ the *wa`d* to purchase by the customer as the mechanism to transfer ownership in the case of early settlement or event of default.
- s 30.5 Where the structure of the *ijarah* financing involves a *wa`d*–
- (a) in the case of paragraphs 30.3(b) and (c) and the IFI acts as the lessor who provides the *wa`d*, the IFI shall fulfil the *wa`d* by executing the contract as promised upon the occurrence of the trigger events; and
  - (b) in the case of paragraphs 30.3(a) and 30.4 and the customer provides the *wa`d*, the IFI shall execute the relevant documentation if the customer intends to fulfil the *wa`d*.
- s 30.6 If an *ijarah* contract is arranged with other Shariah contract, the IFI shall adopt an appropriate sequence of the contracts and concepts that is required by Shariah in the *ijarah* financing to ensure its effectiveness<sup>7</sup>.
- s 30.7 Where the structure of the *ijarah* financing involves a *wa`d* to purchase or sell as specified in paragraphs 30.3(a) and 30.3(c) respectively, the IFI shall

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<sup>6</sup> Refer to a person other than the customer.

<sup>7</sup> For example, IFI must ensure it has obtained the ownership of the leased asset before executing the *ijarah* contract with customer; and the sale contract to transfer the asset to customer must be effective only after the *ijarah* financing period has ended or terminated, although the sale contract is signed by one party at the inception.

determine and notify the customer on the sale price of the asset or its formula at the inception of the contract.

- s 30.8 Where the *wa`d* under paragraphs 30.3(a) and (c) are adopted and the *ijarah* financing is used to finance the acquisition or refinancing of consumer goods or motor vehicles<sup>8</sup>, the IFI shall determine and notify the customer that the final instalment amount shall be considered as the selling price of the asset.
- s 30.9 The IFI shall clearly determine the appropriate treatment of any deposits payable by the customer to the dealer/supplier<sup>9</sup>.
- s 30.10 The IFI shall accord appropriate treatment of the deposits paid by the customer in the event the *ijarah* financing is terminated.

### **Costs and expenses**

- s 30.11 Fair dealing practices shall be observed by the IFI in ascertaining cost of maintenance and takaful coverage (protection) of the leased asset pursuant to paragraph 16.7.
- G 30.12 In negotiating cost of maintenance and takaful coverage of the leased asset, the IFI may take into consideration the following:
- (a) **Adjusted rental**
- Where the customer agrees to bear the cost of maintenance and takaful contribution for the asset, the customer may enjoy a lower or a more competitive rental; or
- (b) **Total enjoyment rights**
- The IFI may negotiate for the cost of maintenance and takaful contribution for the leased asset to be borne by the customer where the customer has the right to total enjoyment of the asset during the *ijarah* period as specified in the *ijarah* financing contract<sup>10</sup>.

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<sup>8</sup> Consumer goods and motor vehicles as defined in paragraph 29.2.

<sup>9</sup> For example, instead of providing refund to the customer who acted as an agent to the IFI to purchase the asset, may treat the deposits paid as a security deposit or earnest money.

<sup>10</sup> For example, in the case of an *ijarah* financing for residential house, customer may make modification on the house so long it does not impair the usufruct of the house and rental instalments are paid within the stipulated period.

- G 30.13 The IFI may impose other charges<sup>11</sup> that are mutually agreed by both the customer and the IFI<sup>12</sup>.

### **Rental**

- G 30.14 The rental amount or rate may be reviewed periodically during the *ijarah* financing tenure.
- S 30.15 In relation to paragraph 30.14, the IFI and its customer must mutually agree on the periodical review of the rental amount or rate at the inception of the *ijarah* financing.
- S 30.16 The IFI shall establish policies and procedures in reviewing the rental amount or rate including the trigger events that warrant the revision of the rental<sup>13</sup>.
- S 30.17 The IFI shall clearly ascertain the purpose of advance payment<sup>14</sup> received from the customer prior to the delivery of the usufruct or during the construction of the asset to be leased and accordingly record the transaction in the IFI's financial accounts.
- S 30.18 In relation to paragraphs 14.7 and 14.9, where the rental is received in advance before the delivery of the leased asset, the IFI shall determine and reflect in its policies and procedures the following:
- (a) the appropriate treatment to recognise the advance rental; and
  - (b) procedures to return the advance rental in the case of non-delivery of the leased asset or termination by the customer arising from the failure to meet the agreed specification on the asset.

### **Termination**

- S 30.19 The IFI shall specify the events or conditions that trigger the termination of the *ijarah* contract prior to the maturity date.

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<sup>11</sup> For example, arising from late payment and early settlement of financing, *i.e.* determination of the reasonable estimate of the cost incurred for the purpose of settlement prior to the maturity of an *ijarah* financing.

<sup>12</sup> For retail customers, the imposition of fees and charges must be in line with the *Guidelines on Imposition of Fees and Charges on Financial Products and Services*.

<sup>13</sup> For example changes in the economic conditions, increase in the cost of maintaining the asset such as cost of takaful (if IFI bears the cost), new regulations by the authority, or changes in the market rate *i.e.* Base Rate (as specified in the *Reference Rate Framework*) for financing.

<sup>14</sup> Rental received in advance for an *ijarah mawsufah fi zimmah* structure.

- G 30.20 Events or conditions that trigger the early termination of the *ijarah* contract may include early settlement of the *ijarah* financing or breach of any terms of the *ijarah* contract.
- s 30.21 The IFI shall not invoke the *wa`d* to purchase the leased asset by the customer in the following events:
- (a) a total loss of the asset arising from the *force majeure* event; and
  - (b) for an asset under construction, an incompleteness or non-delivery of the asset.
- s 30.22 The IFI shall establish an appropriate resolution mechanism according to different trigger events that include the following:
- (a) events of default;
  - (b) demise of the customer; and
  - (c) partial and total loss of the leased asset.
- G 30.23 The IFI may refer to Appendix 4 which provides an example of the resolution mechanism in the event of default.
- G 30.24 In establishing the appropriate resolution mechanism in the case of demise of the customer, the IFI may consider the following:
- (a) to claim an amount from the *takaful*<sup>15</sup> (if any), to cover outstanding obligations of the deceased customer;
  - (b) to provide in the financing legal document of the *ijarah* financing a specific provision on the heir's ability to continue with the financing; or
  - (c) in the case where the legal heir opts to discontinue with the *ijarah* financing, the IFI may repossess the leased asset and terminate the *ijarah* contract.
- G 30.25 In establishing the resolution mechanism for the total loss of asset arising from *force majeure*, the IFI may consider the following:
- (a) to identify *force majeure* events and assess the level of risk of each event;
  - (b) to ensure *takaful* coverage on the *force majeure* events that are assessed to have a material level of risk; and
  - (c) to outline procedures and conditions for the customer to notify the IFI on the occurrence of the total loss due to a *force majeure* event including documentary evidence and duration to notify.

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<sup>15</sup> For example, *takaful* credit protection scheme, reducing *takaful* or mortgage reducing term *takaful*.

**Documentation**

- s 30.26 The IFI shall develop comprehensive and legally enforceable documentation<sup>16</sup> for the *ijarah* financing that complies with Shariah requirements. The documentation shall clearly specify the ownership of the leased asset, mechanism to transfer the ownership of the leased asset, terms of the rental payment and *ijarah* financing period.
- s 30.27 The IFI shall ensure the *ijarah* financing is supported with documentary evidence, which includes the following:
- (a) ownership of the leased asset;
  - (b) terms and conditions of *ijarah* financing;
  - (c) mechanism to transfer the ownership of the leased asset;
  - (d) transfer of ownership of the leased asset to the customer<sup>17</sup>; and
  - (e) where applicable, the appointment of a *wakil* (agent) to undertake the acquisition of the asset.
- s 30.28 The IFI shall ensure that any usage of Arabic terminology in the documents is sufficiently clarified or translated to facilitate understanding of the contracting parties.

**Documentation of the asset ownership**

- s 30.29 As a lessor, the IFI shall ensure that it has relevant documentations<sup>18</sup> evidencing its ownership on the asset prior to executing the *ijarah* financing contract.
- G 30.30 The IFI may acquire the ownership of the asset through–
- (a) direct purchase from the vendor, supplier, the customer (in the case of sale and lease-back structure) or other party;
  - (b) construction of the asset (in the case of the *ijarah mawsufah fi zimmah*);  
or
  - (c) other sale-based contracts.

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<sup>16</sup> This will cover contracts, master agreements and commercial documents such as invoices, transport document, delivery notes, document of title and other generally acceptable documents in trade and financial transactions.

<sup>17</sup> For example, the Release Letter, Notice of Ownership Transfer, Letter of Termination of Trust.

<sup>18</sup> For example, purchase invoice, novation agreement, purchase agreement or agency agreement.



**Documentation of ijarah financing**

- s 30.31 The IFI shall clearly stipulate the terms, conditions, rights, duties and obligations of the contracting parties in the *ijarah* financing contract. At a minimum, the contract shall clearly specify–
- (a) the role of the contracting parties;
  - (b) terms and conditions of the *ijarah* financing which shall include–
    - (i) a description and specifications of the leased asset<sup>19</sup>;
    - (ii) the agreed *ijarah* financing period;
    - (iii) the description, applicable treatment and terms on the recovery process associated with the events of default and total loss of the leased asset;
    - (iv) provision on the compensation mechanism in the case of a total loss of the leased asset due to negligence, misconduct or breach of specified terms by the customer;
    - (v) provision on total loss of the leased asset due to *force majeure*;
    - (vi) mechanism or formula to determine the purchase price of the leased asset in the event of default;
    - (vii) provisions on the procedures in the case of repossession by the IFI, in which the terms on repossession for *ijarah* financing involving consumer goods and motor vehicles shall observe the requirements in paragraphs 32.11 to 32.14;
    - (viii) provisions on demise or loss of legal capacity of the contracting parties; and
    - (ix) provisions on early settlement of financing and late payment of rentals; and
  - (c) rights, duties and obligations of the contracting parties in the *ijarah* financing contract which shall include–
    - (i) the payable amount of periodic rental and the total rental (if the *ijarah* financing adopts fixed profit rate);
    - (ii) the first rental amount, a benchmark or formula, and any applicable minimum and maximum limits (if the *ijarah* financing adopts variable profit rate);
    - (iii) the responsibility of the contracting parties to bear costs, expenses in the event of loss, damage or impairment of the leased asset;
    - (iv) the responsibility of the customer to ensure the asset is in good condition throughout the *ijarah* financing period and utilise the

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<sup>19</sup> The description of the asset may include where applicable, whether the asset is new, used or reconditioned, model or year of manufacturing.

asset for the purpose permissible by the Shariah and any applicable laws;

- (v) the status of, permission for the customer to sub-lease of the leased asset or a third party to utilise the leased asset; and
- (vi) the responsibility of customer to notify the IFI where there is a change in the location of a movable leased asset.

#### ***Documentation for mechanism to transfer ownership of asset***

- s 30.32 The IFI shall ensure that the customer's intention to own the asset and the IFI's intention to transfer the ownership of the asset to the customer is separately documented and executed from the *ijarah* financing contract<sup>20</sup>.
- s 30.33 The IFI must clearly provide the agreed terms and mechanism for the transfer of the ownership of the leased asset from the IFI to the customer at the inception of the *ijarah* financing contract<sup>21</sup>.

#### ***Documentation for transfer of asset ownership***

- s 30.34 The IFI must ensure the document evidencing the transfer of the ownership of the leased asset upon the maturity or at early termination of the *ijarah* contract is separately documented and executed from the *ijarah* financing contract.
- s 30.35 If, at the inception of the contract, the customer executes a sale contract to transfer the asset ownership upon maturity or at early termination, the IFI must ensure that the document shall take effect only after the *ijarah* contract has ended.

#### ***Supplementary documentations***

- G 30.36 The IFI may enter into a master agreement with its customer to specify the overall structure and the terms and conditions of the *ijarah* financing.
- G 30.37 The IFI may execute additional supplementary documentation on the following:
  - (a) *wa`d* by the customer to enter into an *ijarah* financing contract after the IFI has acquired the asset to be leased;

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<sup>20</sup> For example, if *wa`d* to purchase by the customer is employed, the *wa`d* document must be separated from *ijarah* financing contract.

<sup>21</sup> For example, upon an early settlement the customer who has provided a *wa`d* to purchase the asset must execute the sale and purchase contract to evidence the transfer of ownership.

- (b) appointment of agent for the customer to undertake purchase of the asset which also outlines treatment of deposits payable by the customer to the dealer or supplier either as a *hamish jiddiyyah* (security deposit), rental deposit or share of ownership;
- (c) the IFI's right to recourse the asset prior to the settlement of the *ijarah* financing;
- (d) acknowledgement of the customer's acceptance and satisfaction on the conditions of the leased asset;
- (e) guarantee by a third party on the payment of rentals or any amounts owing to the IFI;
- (f) the documentation to indemnify the IFI against a loss or damage arising from the negligence or misuse of the asset by the customer; and
- (g) any other relevant legal documents.

### 31. Risk management

- s 31.1 The IFI shall effectively manage risks throughout the period of the *ijarah* financing, which includes–
- (a) the assessment and implementation of suitable risk management techniques such as setting prudent limit on financing-to-value ratio, and prudent maximum tenure of financing based on useful life of the leased asset;
  - (b) imposition of security deposit or *`urbun* (earnest money) as mitigation measure prior to purchasing an asset, if the IFI acquires the asset directly from the supplier; and
  - (c) provision of takaful coverage for the leased asset with clear conditions on the amount and types of risks<sup>22</sup> to be covered.
- s 31.2 Pursuant to paragraph 30.37(c), the IFI shall ensure that it has legally enforceable right to recourse the leased asset or other collateral through creating a binding and irrevocable documentation taking into account any legal constraints and differences among jurisdictions, and where applicable, registering its interest on the asset.
- s 31.3 The IFI shall outline in its policies and procedures, the status of permission and conditions<sup>23</sup> on the following:

<sup>22</sup> Such as fire, theft, accident and flood.

<sup>23</sup> For example, restriction on Shariah-compliant purposes on use of the asset and conditions to mitigate risk associated with a sub-lease and usage by a third party, such as the customer is not

- (a) sub-leasing; and
- (b) usage of the leased asset by a third party.

s 31.4 In the case of *ijarah mawsufah fi zimmah*, the IFI shall undertake necessary due diligence process to assess the capacity of the vendor, manufacturer or contractor to fulfil their contractual obligations and timely deliver the asset to be leased to the IFI.

## 32. Business and market conduct

s 32.1 The IFI shall give due regard to the interests of the customer in the policies and procedures to ensure the *ijarah* financing is conducted in a fair, transparent and responsible manner.

### Information disclosure

s 32.2 At the pre-contractual stage, the IFI shall provide adequate and relevant information with regard to the *ijarah* financing.

s 32.3 The IFI shall provide additional disclosures in the Product Disclosure Sheet<sup>24</sup> on the followings:

- (a) the roles, responsibilities, rights and liabilities of the contracting parties;
- (b) in the case of the *ijarah mawsufah fi zimmah*, specific disclosure is required on–
  - (i) the applicable profit rate prior to the delivery of asset; and
  - (ii) the obligation to refund the advance rental to customers in case of non-delivery of the asset and termination arising from the failure to meet the agreed specifications on the asset;
- (c) mechanism for the transfer of asset ownership<sup>25</sup>. If *wa`d* is employed, the IFI shall disclose the implications arising from any breach of the *wa`d* terms to ensure that the customers are aware of their obligations and liabilities arising from the provision of the *wa`d*;
- (d) clarification on the purpose of deposits payable by customers, either as a security deposit, rental deposit or earnest money and the implication from any breach of terms or discontinuation of the *ijarah* financing contract;

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automatically discharged from being liable in the case of loss due to negligence, misconduct or breach of specified terms by the sub-lessee or the third party.

<sup>24</sup> Or alternative document such as General Terms and Conditions for non-retail customers.

<sup>25</sup> Such as a *wa`d* to purchase by customer and a *wa`d* to sell by the IFI.

- (e) clarification on the applicable formula and profit rate, an illustration on the calculation and the minimum and maximum rental limits for the *ijarah* financing with variable profit rate; and
- (f) clarification on the applicable formula and conditions associated with the settlement prior to the maturity of the *ijarah* financing.

s 32.4 The IFI must ensure that the appropriate terminologies that are reflective of the nature of the *ijarah*<sup>26</sup> and other relevant contracts or arrangements are used in all information disclosures including promotional materials and Product Disclosure Sheet.

s 32.5 The IFI must provide relevant and timely information to the customer during the period of the *ijarah* contract such as notice of changes to terms and conditions, features, rights, obligations, fees or charges.

#### **Fair dealings**

s 32.6 The IFI shall implement and enforce clear policies and procedures to ensure fair dealing practices particularly on the following matters:

- (a) suitability and affordability assessment of potential customers;
- (b) disclosure of clear and accurate information to be provided in a timely manner to customers to facilitate informed decision making; and
- (c) imposition of charges and responsibilities of customers.

s 32.7 Under the *ijarah mawsufah fi zimmah*, the IFI shall not invoke the *wa`d* to purchase by the customer in the event of any failure of the contractor to deliver the asset within the agreed duration.

s 32.8 The IFI shall observe the following in the event that the *ijarah* financing is terminated or settled prior to its maturity:

- (a) the maximum amount payable by the customer shall be the settlement amount (*i.e.* the rentals due that are yet settled plus balance of the principal amount); and
- (b) any early termination fee imposed shall represent reasonable estimation of costs to be incurred by the IFI arising from the termination or settlement prior to the financing maturity as per the policy document on *Responsible Financing*;
- (c) other relevant fees and charges imposed on the customer, shall be

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<sup>26</sup> For example, rental schedule as opposed to instalment schedule.

based on the *Guidelines on Imposition of Fees and Charges on Financial Products and Services*; and

- (d) the SC of the IFI shall perform an effective oversight over the implementation and in the determination of the early termination fee to reflect reasonable cost incurred by the IFI.

G 32.9 To ensure that the IFI can immediately engage the legal heirs on the continuation of the *ijarah* financing in the event of customer's demise or loss of legal capacity<sup>27</sup>, the IFI is encouraged to request for information<sup>28</sup> on the customer's legal heirs at the inception of the *ijarah* financing.

G 32.10 The IFI may repossess and dispose the leased asset if the legal heirs opt to discontinue the *ijarah* financing in the event of the customer's demise or loss of legal capacity.

#### **Repossession of consumer goods and motor vehicles**

s 32.11 The IFI shall set out policies and procedures on the repossession of the leased asset in the event of default by customer on obligations under the *ijarah* financing which involve consumer goods and motor vehicles<sup>29</sup>.

s 32.12 In relation to paragraph 32.11, the IFI shall ensure that its policies and procedures on the repossession of the leased asset shall include the following:

- (a) the triggering events for the repossession of the asset;
- (b) requirement for the IFI to obtain a court order before repossessing any leased asset where the total rental paid by the customer throughout the *ijarah* period is more than 75% of the *ijarah* financing amount<sup>30</sup>;
- (c) the IFI's notification to the customer of its intention to repossess the leased asset;
- (d) rights of the customer who surrenders the asset upon receiving a repossession notice from the IFI within the notice period to not be imposed any cost of repossession, costs incidental to the repossession and cost of storage;
- (e) procedures after the IFI repossesses the asset which include the notification to the customer and any guarantor on the repossession and

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<sup>27</sup> Refers to loss of legal capacity of individual customers such as insanity and prolonged coma.

<sup>28</sup> Particularly contact details and information for identity verification.

<sup>29</sup> Consumer goods and motor vehicles as defined in paragraph 29.2(a)(iii).

<sup>30</sup> Refers to the financing principal amount.

communication on the procedures for the customer to make settlement of the financing;

- (f) obligations and restrictions of the IFI on the repossessed asset; and
- (g) procedures relating to the disposal of the repossessed asset, where the IFI must provide the customer the first option to purchase the asset if the disposal is carried out through means other than a public auction.

s 32.13 The IFI shall ensure that the rights and obligations of the customer in respect of the repossession of the leased asset as provided in the internal policies and procedures are reflected in the legal documentation of the *ijarah* financing.

s 32.14 In the event that the proceeds from the disposal of the asset by the IFI exceed the amount payable to settle the *ijarah* financing, the IFI must give the excess amount to the customer.

### **33. Financial disclosure**

s 33.1 To enhance clarity on the structure of the *ijarah* financing, the IFI shall disclose the following information in additional notes to the financial statement:

- (a) assets funded under this mode of financing are owned by the IFI throughout the tenure of the *ijarah* financing; and
- (b) ownership of the assets will be transferred to the customers *via* suitable mechanism<sup>31</sup> at the end of the *ijarah* financing.

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<sup>31</sup> For example, sale, a *hibah* or a conditional *hibah*.

## PART D OPERATIONAL REQUIREMENTS FOR AN IJARAH

### 34. Governance and oversight

- s 34.1 The IFI shall have sufficient understanding of the risk profile of the *ijarah* and ensure availability of resources with the appropriate knowledge and skill set to manage the risks.

#### Board of directors

- s 34.2 The Board shall establish a sound governance structure to facilitate an effective oversight function on the management of the *ijarah*. The adequacy of the governance structure shall commensurate with the nature, complexity and risk profile of the *ijarah*.
- s 34.3 The roles and responsibilities of the Board shall include the following:
- (a) set the IFI's business and risk strategies for the *ijarah*;
  - (b) approve and oversee policies and procedures governing operations of the *ijarah*. The policies and procedures shall at a minimum cover the following aspects:
    - (i) the criteria and method of asset acquisition or construction;
    - (ii) the appointment of agent and outsourcing of functions;
    - (iii) the valuation methodology;
    - (iv) the leasing arrangement;
    - (v) the exit strategies, particularly in the case of loss of legal capacity, asset damages and disposal of asset;
    - (vi) the risk management and internal controls including measures to mitigate market and inventory risks;
    - (vii) the permissibility of sub-lease and usage by a third party;
    - (viii) risk-informed pricing; and
    - (ix) information disclosures;
  - (c) ensure that policies and procedures pertaining to Shariah matters are endorsed by the SC;
  - (d) oversee the design and implementation of internal controls by the management that commensurate with the nature, scale and complexities of the *ijarah* transactions; and
  - (e) ensure that independent reviews are conducted regularly to assess compliance with the requirements specified by the Bank and policies and procedures established by the IFI.



### Shariah Committee

- s 34.4 The roles and responsibilities of the SC shall include the following:
- (a) endorse that the Shariah requirements are appropriately applied in the relevant policies and procedures governing the *ijarah*. These policies shall at a minimum cover the following aspects:
    - (i) the eligible assets for the *ijarah* transactions and the use of the assets; and
    - (ii) the list of costs and expenses borne by the respective contracting parties;
  - (b) deliberate and endorse that the terms and conditions stipulated in legal documentations and other documentations<sup>32</sup> are in compliance with Shariah;
  - (c) ensure that Shariah review and Shariah audit on the *ijarah* are conducted;
  - (d) advise the IFI on the relevant Shariah rulings, decision or policy documents on Shariah matters issued by the Bank and, if relevant, by any other authorities; and
  - (e) perform oversight role on the application of the *ijarah* to ensure due observance of Shariah requirements.

### Senior management<sup>33</sup>

- s 34.5 The roles and responsibilities of the senior management shall include the following:
- (a) implement business strategies, internal controls and risk management mechanisms in line with the IFI's business objectives;
  - (b) establish policies and procedures governing operations of the *ijarah*, and ensure its proper communication and delegation to all relevant functions within the IFI;
  - (c) establish risk management policies and maintain adequate mechanisms that are able to identify, measure and mitigate inherent risk in the *ijarah*;
  - (d) undertake regular reviews and monitor compliance with the approved policies; and
  - (e) ensure timely disclosure of relevant information to the Board and the SC.

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<sup>32</sup> Such as product manual, promotional or marketing materials, sales illustrations and brochures.

<sup>33</sup> As defined in the *policy document on Corporate Governance and Guidelines on Corporate Governance for Development Financial Institutions*.

## 35. Structuring

- s 35.1 The IFI that carries out *ijarah* transactions shall assess the appropriate structure to operate the *ijarah* transactions either by the IFI itself or a separate entity such as a subsidiary based on the risk exposure of the transactions<sup>34</sup>.

### Sources of funds

- s 35.2 The IFI must outline the appropriate assets and liabilities management policies, particularly on the appropriate sources of funds for *ijarah* transactions, taking into consideration the risks, returns and liquidity profile of the *ijarah* transactions.
- G 35.3 The IFI may use the following sources of funding for *ijarah* transactions:
- (a) funding from Unrestricted Investment Account (UA) and Restricted Investment Account (RA)<sup>35</sup>; or
  - (b) the shareholders' funds and the Islamic deposits.
- s 35.4 In respect of paragraph 35.3(a) above, the usage of funding from a UA or RA for *ijarah* transaction is allowed provided that the UA and RA are in compliance with the policy document on Investment Account. In addition, the IFI shall ensure that any utilisation of the UA fund for the *ijarah* transactions shall be subject to conditions which would significantly mitigate liquidity risks<sup>36</sup> to the IFI.
- s 35.5 In respect of paragraph 35.3(b), the IFI must–
- (a) clearly establish its risk appetite for *ijarah* transactions; and
  - (b) ensure the investment limits<sup>37</sup> of–
    - (i) investment in each leased asset shall not exceed 25% of the IFI's total capital; and
    - (ii) the aggregate book value of investment in shares, interest-in-shares, collective investment schemes, immovable properties and leased assets other than immovable properties shall not exceed 50% of the IFI's total capital.

<sup>34</sup> For example, ownership risk and market risk.

<sup>35</sup> UA and RA refer to URIA and RIA respectively in the policy document on *Investment Account*.

<sup>36</sup> This include conditions such as matching of tenure between sources and usage of funds, redemptions only upon liquidation of underlying assets or replacement of investors other than the IFI.

<sup>37</sup> For the avoidance of doubt, leased assets funded by UA and RA operating under matching principles mentioned in paragraph 35.4 are excluded from the limits.

**Assets**

- s 35.6 The IFI shall evaluate the suitability of the types of assets to be leased and appropriateness of the useful life of the assets *vis-à-vis* the IFI's risk appetite and capability in managing the leased asset during and after the *ijarah* period has ended.
- s 35.7 The IFI shall put in place the appropriate processes and procedures to ensure that the customer has the right and sufficient time to inspect the asset on or before the commencement of *ijarah* to ensure satisfaction in terms of the condition, quality and fitness of the asset.
- s 35.8 As provided in paragraph 20.5, the IFI shall ensure that the asset under the *ijarah* contract is delivered to the customer on the specified delivery date.
- s 35.9 Pursuant to paragraphs 13.8 and 35.8, the IFI shall obtain the customer's written acknowledgement on receipt of the asset delivery. The acknowledgement shall be reflected in the certificate of acceptance and satisfaction<sup>38</sup> before or upon the execution of the *ijarah* contract to evidence that the customer is satisfied with the condition of the asset.
- G 35.10 To ensure that the asset continues to be in a good condition after the delivery, the IFI may obtain a warranty for the asset either directly or through the customer, who deals with the supplier or a third party.
- s 35.11 The IFI shall outline clear policies<sup>39</sup> for a customer to return the leased asset<sup>40</sup> to the IFI at the end of the *ijarah* period.

**Costs and expenses**

- s 35.12 The IFI must observe fair dealing practices in negotiating the cost of maintenance and the takaful coverage of the leased asset.
- s 35.13 For the takaful coverage of the leased asset, the IFI must identify the parties that benefit from any scheme to protect the leased asset.
- s 35.14 Notwithstanding paragraph 16.10 and in relation to paragraph 35.13, the cost

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<sup>38</sup> Or other document which carries the same effect of acknowledging receipt of the asset.

<sup>39</sup> For example, in the case of leasing of a vehicle for business use, the IFI may require the customer to redeliver the asset to its principal base location or any location agreed upon taking into consideration the normal wear and tear.

<sup>40</sup> Such as the location for the redelivery and the condition of asset.

for the takaful coverage for the leased asset shall be borne by the contracting party that benefit from the coverage<sup>41</sup>.

- G 35.15 In negotiating the cost of maintenance and the takaful coverage, the IFI may adopt the guiding principles in accordance with paragraph 30.12(a).
- S 35.16 In relation to paragraph 35.11, the IFI must determine the party who will bear the cost to return the leased asset to the IFI.
- G 35.17 The IFI may impose other fees and charges that are acceptable by both the customer and the IFI.
- G 35.18 The IFI may allocate a reserve fund that is intended to finance routine maintenance and service of the leased asset during a specified *ijarah* period.
- G 35.19 Notwithstanding paragraph 35.18, the IFI may require the customer to make arrangements for the servicing of the leased asset.

### **Rental**

- G 35.20 The rental amount or rate may be periodically reviewed during the *ijarah* period.
- S 35.21 In relation to paragraph 35.20, the periodical review of the rental amount or rate shall be mutually agreed by the contracting parties.
- S 35.22 In line with paragraphs 14.7, 14.9 and 20.10, where the rental is received in advance before the delivery of the leased asset, the IFI shall determine and reflect in the policies and procedures the following:
  - (a) the appropriate treatment to recognise the advance rental; and
  - (b) procedures to return the advance rental in the case of non-delivery of the asset or termination arising from the failure to meet the agreed specifications on the asset.
- S 35.23 The IFI shall clearly set out the purpose of any collection of an advance payment from the potential lessee either as a security deposit, earnest money or advance rental.

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<sup>41</sup> For example, in the case of the IFI leasing out a residential house for a year, the IFI pays for the houseowner takaful while the customer pays for the householder takaful.

**Termination**

- s 35.24 The IFI shall stipulate in the *ijarah* contract any covenant and the triggering events for the termination of the *ijarah* transaction<sup>42</sup>.
- s 35.25 The IFI shall establish its rights to claim any outstanding rental payments upon an early termination or default by the customer.

**Documentation**

- s 35.26 The IFI shall develop a set of comprehensive and legally enforceable documentation for the *ijarah* transaction and the supporting documentations that comply with Shariah requirements provided in Part B.
- s 35.27 The IFI shall ensure that the *ijarah* transaction is supported by documentary evidence which includes the following:
- (a) the ownership of the leased asset by the IFI; and
  - (b) terms and conditions of the *ijarah*.
- s 35.28 At a minimum, the terms and conditions for the documentation specified in paragraph 35.27 shall provide the following:
- (a) the terms and conditions similar to *ijarah* financing specified in paragraphs 30.29 to 30.31 except for the formula for the purchase price of the leased asset under paragraph 30.31(b)(vi), provision on repossession of the leased asset under paragraph 30.31(b)(vii) and provision on early settlement of financing in accordance with paragraph 30.31(b)(ix);
  - (b) the responsibility of the customer to return the leased asset at the end of the *ijarah* tenure and description on the procedures and conditions of such process;
  - (c) list of fees and charges borne by the customer; and
  - (d) applicable covenant and trigger events for the termination of the *ijarah* contract.
- s 35.29 The IFI shall ensure that the terms and conditions for the leased asset to be returned to the IFI upon the expiration or early termination of the *ijarah* contract is ascertained and agreed upon in the legal documentation at the inception of the contract.

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<sup>42</sup> Such as non-payment of rentals by the customer or customer's own intention to terminate the *ijarah*.

- G 35.30 The IFI may execute additional supplementary documentation on the following:
- (a) appointment of agent for the customer to undertake purchase of the asset which also outlines the treatment on the deposits payable by the customer to the dealer/supplier either as a security deposit, earnest money, rental deposit or share of ownership;
  - (b) guarantee by a third party on the payment of rental or any other obligations owing to the IFI;
  - (c) agreement of the customer to indemnify the IFI against a loss or damage arising from the negligence or misuse of the asset by the customer; and
  - (d) any other relevant legal documents.

## **36. Risk management**

- S 36.1 With regards to the risk management policies on *ijarah*, the IFI shall take into consideration the following:
- (a) the identification and measurement of risks;
  - (b) the appropriate valuation methodology for the leased assets;
  - (c) the pricing policy;
  - (d) the risk exposure limits including risk concentration;
  - (e) the risk mitigation techniques; and
  - (f) the monitoring and reporting mechanisms, particularly information on events that pose significant risk to the IFI or information that require swift action by the senior management.

### **Pre-contractual stage**

- S 36.2 The IFI shall outline and implement an assessment methodology to determine the appropriate asset for an *ijarah* contract and shall consider the following:
- (a) Shariah requirements;
  - (b) commercial viability; and
  - (c) risk assessment.
- G 36.3 In relation to paragraph 36.2, the IFI may consider the following factors in determining the appropriate leased assets:
- (a) ready demand to lease out the asset and useful life of the asset;

- (b) marketability<sup>43</sup> of the asset;
- (c) experience and skill set possessed by the IFI in managing the asset; and
- (d) other constraints such as Shariah, legal and taxation based on geographical location of the asset in terms of acquisition, lease, repossession and disposal of the asset.

s 36.4 The IFI shall ensure the adoption of a sound valuation methodology for the assets with sufficient frequency of revaluation to reflect its current value. In this regards, the IFI shall–

- (a) identify and monitor factors<sup>44</sup> that may cause changes to the valuation, and appropriately adjust such valuation;
- (b) put higher emphasis to the leased assets that are large in value or complex or pose higher risk<sup>45</sup> to the IFI. These assets are known as 'significant leased assets';
- (c) validate or back-test the result of valuation against actual prices, any material deviations on the valuation shall be rectified accordingly; and
- (d) where the valuation function is outsourced<sup>46</sup> to a third party service provider, the IFI must undertake due diligence review on the expertise of the third party service provider and understand the underlying assumptions used in the valuation.

s 36.5 The IFI shall undertake asset acquisition process based on policies approved by the Board.

s 36.6 For the purpose of paragraph 36.5, the IFI shall conduct prior assessment on a supplier or vendor of the asset to be leased, which include the following:

- (a) verification on the supplier or vendor legitimate business; and
- (b) its capabilities to deliver the asset to be leased, particularly for significant leased assets.

s 36.7 The IFI shall establish policies to mitigate inventory risk, such as maximum length of storage, method of storage and the takaful coverage.

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<sup>43</sup> Such as existence of a secondary market, the time taken to dispose the asset, complexity of the asset and reliability of market pricing to estimate residual value.

<sup>44</sup> For example, economic recession, technological advancement, poor upkeep and launching of a new model.

<sup>45</sup> For example, highly customized assets, breakthrough innovation and assets with a high rate of obsolescence such as IT devices.

<sup>46</sup> Subject to *Guidelines on Outsourcing*.

- s 36.8 The IFI shall develop a risk-informed pricing policy<sup>47</sup> that is consistent with the risk appetite for the *ijarah* transactions approved by the Board taking into consideration the following:
- (a) the objectives of the pricing framework and its relation to business and risk strategies;
  - (b) the pricing components of the *ijarah* taking into account potential losses from impairment of asset, funding costs, overhead costs and other costs and liabilities borne by the IFI;
  - (c) the events where deviations to pricing policy is permitted, its approval authority, corresponding limits for the deviations and measures to address risk of under-pricing from the deviations; and
  - (d) if the IFI engages in the practice of profit cross-subsidisation<sup>48</sup>, the impact to overall profitability and capital position should the profits from the other product or service fail to materialise.
- s 36.9 The IFI shall ensure that the *ijarah* contract provides right for the IFI to inspect the leased asset and access the books and records of the customer or the person acting on behalf of the customer in the event of suspicion on negligence, misconduct or breach of the specified contractual terms.
- s 36.10 For the purpose of paragraph 36.9, the IFI shall identify the trigger events to conduct the inspection and any other policies and processes on periodic inspection and audit.
- s 36.11 In relation to paragraph 36.10, the IFI shall provide a reasonable notice prior to conducting any inspection of the leased asset to ensure that the IFI does not infringe the customer's quiet enjoyment right.
- s 36.12 The IFI shall identify exit strategies from the *ijarah* transaction, particularly upon the following trigger events:
- (a) damages (partial or total loss) of the leased assets arising from customer's<sup>49</sup> negligence, misconduct and breach of the specified terms;
  - (b) damages of the leased assets due to the action of an unrelated third party;
  - (c) *force majeure*;

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<sup>47</sup> In line with policy document on *Risk-Informed Pricing*.

<sup>48</sup> Refers to the practice of assuming that profits generated from other products will continue to be sufficient to subsidise *ijarah* originated at unprofitable rates.

<sup>49</sup> Shall include a person or persons acting on behalf, under, together with the customer and sub-lessee (if any).



- (d) demise or other loss of legal capacity of the customer; or
  - (e) default on payments or other contractual obligations.
- G 36.13 The IFI may collect a security deposit from the customer to cover against losses arising from default on rental payments or other obligations, and damages to the leased asset which is caused by the customer, a third party acting with or on behalf of the customer or a sub-lessee.
- S 36.14 The IFI shall assess the capability of a potential customer to meet contractual obligations.
- S 36.15 The IFI shall outline policies regarding permissibility and conditions on sub-lease and whether the use of the leased asset by a third party is allowed.
- S 36.16 In respect of paragraph 36.15, where the IFI allows the leased asset to be sub-leased to a third party, the IFI shall observe the following:
- (a) the usage of the leased asset by the sub-lessee or the third party is restricted to Shariah-compliant purposes only; and
  - (b) the risks arising from such practices are effectively mitigated<sup>50</sup>.
- S 36.17 Prior to entering into an *ijarah* contract, the IFI shall inspect and record the conditions of the asset to be leased, as well as equipment or accessories attached to the asset. The IFI shall also ensure that the customer has made a written confirmation on the acceptance and condition of the asset.
- G 36.18 Notwithstanding paragraph 36.17, the IFI may arrange for an expert third party service provider to undertake inspection of significant leased assets. For other types of assets, the customer or a third party service provider as an agent may accept delivery and undertake inspection on the asset.
- S 36.19 In the case where the inspection is undertaken by a third party, the IFI shall obtain report from the party on the acceptance and condition of the asset.

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<sup>50</sup> For example, through requirement on takaful covering the usage by the sub-lessee or the third party, and the liability of the *ijarah* customer to the IFI is maintained in the case of any losses caused by negligence, misconduct or breach of specified terms by the sub-lessee or the third party.

**During the *ijarah* period**

- s 36.20 The IFI shall monitor any recurring late payment of rentals from the customers and other factors that may impair the ability to meet the rental obligations.
- s 36.21 The IFI shall monitor the risk exposures throughout the *ijarah* period to ensure that the exposure is within the risk appetite set by the Board. Any anomalies must be reported immediately to the senior management<sup>51</sup> for further action.
- s 36.22 The IFI shall undertake periodic valuation as described in paragraph 36.4, and monitor any factor that may require adjustments to the valuation assumption or methodology.
- G 36.23 The IFI may mitigate risks through employing risk mitigation mechanism such as takaful on the leased asset.
- s 36.24 Where the customer is responsible to obtain takaful coverage, the IFI shall sufficiently describe the coverage and risk events that should be covered such as fire, theft, flood and *etc.*
- s 36.25 The IFI shall put in place rigorous stress testing framework to enable periodical risk assessment of the *ijarah* transactions and its implications.

**Termination or exit from *ijarah***

- s 36.26 Upon occurrence of events specified in paragraph 36.12, the IFI must assess and opt for the exit strategy that will minimise the losses or maximise value from the *ijarah* transaction to the IFI.
- s 36.27 Pursuant to paragraph 36.26 and when the leased asset is returned by the customer, the IFI must ensure that it has identified the conditions and procedures<sup>52</sup> for the exit strategies and the IFI shall give particular emphasis for significant leased assets to ensure timely and cost-effective exit from the *ijarah*.
- s 36.28 The IFI shall inspect the condition of the asset and the status of any other obligations of the customer<sup>53</sup> to ensure that the asset is in an acceptable

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<sup>51</sup> Including any other party required under the governance structure of the IFI such as Risk Management Committee.

<sup>52</sup> For example, conditions and procedures on storage, handling and disposal.

<sup>53</sup> For example, utilities, summon and maintenance of asset (if applicable).

condition and all obligations has been settled by the customer in the event that the customer returns the leased asset to the IFI or the IFI conducts repossession of the asset.

- G 36.29 The IFI may appoint a third party service provider to conduct the inspection under paragraph 36.28, on its behalf.
- G 36.30 The security deposit referred to in paragraph 36.13 may be deducted if there are any damages not due to normal wear and tear or any unsettled obligations by the customer.

## **37. Business and market conduct**

### **Information disclosure**

- s 37.1 At the pre-contractual stage, the IFI shall provide adequate and relevant information to the customer regarding the *ijarah* transaction.
- s 37.2 The IFI shall provide additional disclosures in the Product Disclosure Sheet<sup>54</sup> on the following:
- (a) the roles, responsibilities, rights and liabilities of the contracting parties;
  - (b) the rental amount and whether it is fixed or subject to periodical review, and the basis for revision (if any);
  - (c) clarification on permissible purposes and any restriction on the use of asset; and
  - (d) applicability of deposits, clarification on the purpose of the deposits whether as an advance rental, security deposit or earnest money and the implication from any breach of terms or discontinuation of the *ijarah* contract.
- s 37.3 At the inception of the *ijarah* contract, the IFI shall inform the customer his responsibility to immediately notify the IFI of any occurrence of incidents that may cause damages to assets or claims by a third party, together with the procedures for the notification<sup>55</sup>.

### **Fair dealings**

- s 37.4 To enable potential customers to match their preferences with the asset for

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<sup>54</sup> Or alternative document such as General Terms and Conditions for non-retail customers.

<sup>55</sup> For example, notify the IFI's headquarter or branch which extended the financing within 72 hours after the occurrence of such incident.

the *ijarah* transaction, the IFI shall disclose the condition of the asset, or grant the right to physically access the asset to the customer at the pre-contractual stage.

- s 37.5 Pursuant to paragraph 37.4, where the IFI does not grant the right to physically access the asset and the actual condition of the asset does not meet the specifications which was mutually agreed between the contracting parties, the IFI shall ensure that the customer is provided with the following options:
- (a) terminate the *ijarah* transaction;
  - (b) request for a replacement of the asset which meets the mutually agreed specifications, subject to the IFI's agreement; or
  - (c) accept the asset with rectification or renegotiate terms in line with paragraphs 20.8 to 20.9.
- s 37.6 Where the IFI intends to sell the leased asset to a third party, the customer shall be notified on the matter and any changes in the arrangements of the *ijarah* transaction<sup>56</sup>.

## **PART E SUBMISSION REQUIREMENT**

### **38. Submission requirement**

- s 38.1 IFIs that currently offer a product or service that is structured based on *ijarah* contract must assess the consistency of such product or service with this policy document and develop an implementation plan to ensure full compliance with this policy document by 1 August 2018. The implementation plan shall be endorsed by the SC and approved by the Board.
- s 38.2 The IFI shall submit the gap analysis of specific products and implementation plan to address the gaps to Jabatan Perbankan Islam dan Takaful (JPIT) no later than 30 December 2016.
- s 38.3 The IFI must immediately notify JPIT if the IFI identifies any cause that will affect full compliance latest by 1 January 2018.

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<sup>56</sup> Such as changes in the arrangements for rental payment, customer services and return of the leased asset.

## APPENDICES

### Appendix 1 Legitimacy of *ijarah*

1. The legitimacy of the *ijarah* contract is derived from the *Quran* and founded on the *Sunnah* of Prophet Muhammad (peace be upon him), the consensus of the muslim jurists (*ijma`*) and analogy (*qiyas*).

#### The *Quran*

2. The following verse of the *Quran* implies the permissibility of *ijarah* contract:

قَالَ إِنِّي أُرِيدُ أَنْ أُنكِحَكَ إِحْدَى ابْنَتَيَّ هَاتَيْنِ عَلَى أَنْ تَأْجُرَنِي ثَمَنِي حَبِيبٌ فَإِنْ  
 أَتَمَمْتَ عَشْرًا فَمِنْ عِنْدِكَ وَمَا أُرِيدُ أَنْ أَشُقَّ عَلَيْكَ سَتَجِدُنِي إِنْ شَاءَ  
 اللَّهُ مِنَ الصَّالِحِينَ ﴿٢٧﴾

*And said one of them (the two women):" O my father! Hire him! Verily, the best of men for you to hire is strong, the trustworthy. He said: I intend to wed one of these two daughters of mine to you, on condition that you serve me for eight years, but if you complete ten years, it will be (a favor) from you. But I intend not to place you under a difficulty. If Allah will, you will find me one of the righteous".*<sup>57</sup>

The above verses describe the story of the Prophet Musa (peace be upon him) being hired for a certain period of time to undertake a specific task. The compensation for the task undertaken by the Prophet is deemed as payment for the outstanding dowry for his marriage.

<sup>57</sup> *Surah al-Qasas, verse 27.*

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

3. The following *hadith* implies the general permissibility of the *ijarah*:

(a) عن عبد الله بن عمر، قال: قال رسول الله صلى الله عليه وسلم: " أعطوا الأجير أجره قبل أن يجف عرقه."

*Abdullah Ibn Umar narrates, the Prophet (peace be upon him) said: "Pay the hired worker his wages before his sweat dries off."*<sup>58</sup>

(b) عن أبي هريرة عن النبي صلى الله عليه و سلم: "... ومن استأجر أجيروا فليعلمه أجره."

*The Prophet (peace be upon him) is reported to have said: "... He who hires a person should inform him of his fee."*<sup>59</sup>

(c) عن عبد الله رضي الله عنه، قال: " أعطى رسول الله صلى الله عليه وسلم خيبر اليهود: أن يعملوها ويزرعوها، ولهم شطر ما يخرج منها"، وأن ابن عمر حدثه: "أن المزارع كانت تكرر على شيء."

*Abdullah ibn Umar narrates, "Allah's Apostle gave the land of Khaybar to the Jews to work on and cultivate and take half of its yield." Ibn Umar added, "The land was used to be rented for a certain portion (of its yield)."*<sup>60</sup>

### Consensus of the muslim jurists (*Ijma`*)

4. The *ijarah* has been unanimously approved by the companions of the Prophet Muhammad (peace be upon him) and prominent jurists of the recognized schools of Islamic law. They view that the need to utilize the usufruct of different articles (goods and services) is similar to the need to utilize the articles. When the contract of sale of such goods and services is permitted, the lease of its usufruct shall also be permitted on the grounds of public interest (*maslahah*) and needs.<sup>61</sup>

<sup>58</sup> Ibn Majah, *Sunan Ibn Majah*, hadith no. 2443.

<sup>59</sup> Al-Bayhaqi, *al-Sunan al-Kubra*, hadith no. 11761.

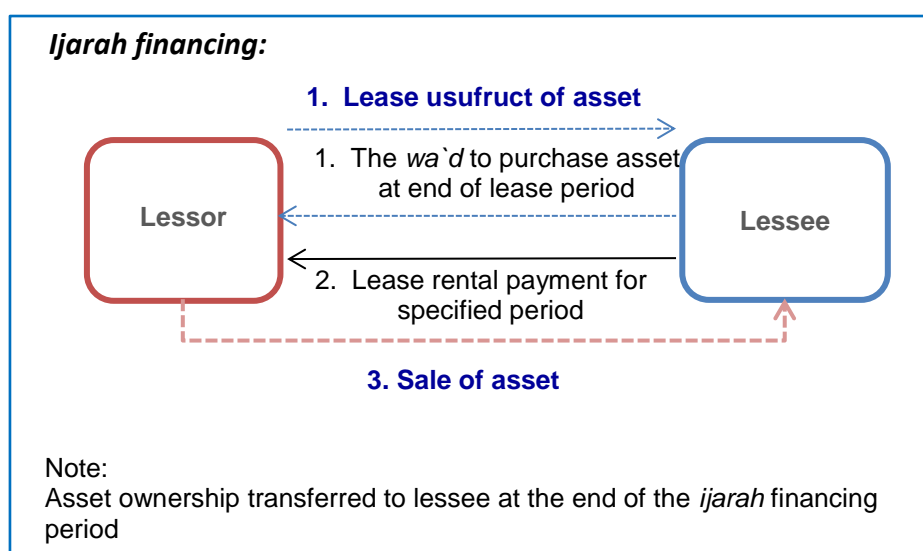
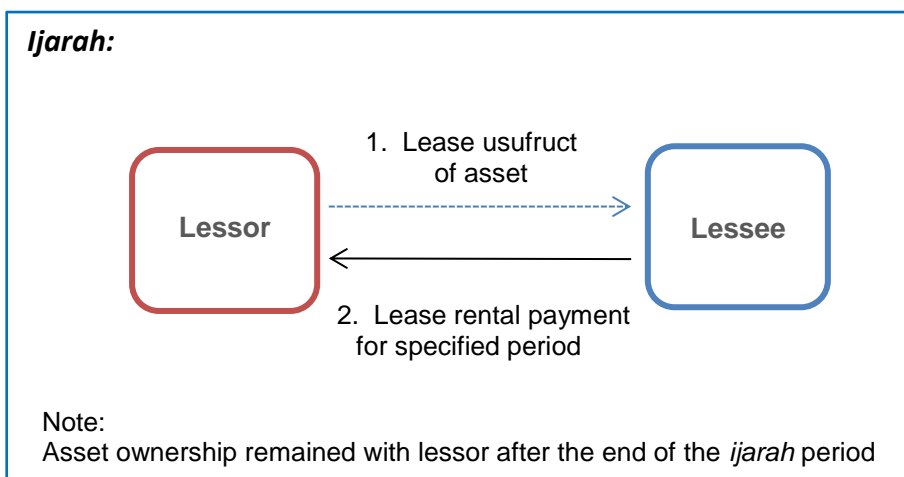
<sup>60</sup> Al-Bukhari, *Sahih al-Bukhari*, hadith no. 2165.

<sup>61</sup> Ibn al-Munzir, *al-Ijma`*, Maktabah al-Furqan, 1999, p. 133.

## Appendix 2 Glossary

Terms	Definition
<i>Gharamah</i>	Penalty.
<i>Hamish jiddiyyah</i>	A security deposit placed to secure the undertaking to purchase an asset before entering into the sale and purchase agreement.
<i>Hibah</i>	A transfer of ownership of an asset from a donor to a donee without any consideration.
<i>Ijma`</i>	Consensus of the muslim jurists.
<i>Istisna`</i>	A contract by which a seller sells to a purchaser a non-existent asset that is to be constructed, built or manufactured according to the agreed specifications and delivered on a specified future date at a pre-determined price.
<i>Kafalah</i>	A contract where the guarantor conjoins the guaranteed party in assuming the latter's specified liability.
<i>Mukhalafah al-shurut</i>	Breach of specified terms.
<i>Qiyas</i>	Analogy.
<i>Rahn</i>	Pledge/Charge.
<i>Ta`addi</i>	Misconduct.
<i>Ta`widh</i>	Compensation.
<i>Taqsir</i>	Negligence.
<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</i>	Customary 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.

### Appendix 3 Illustration of structures of *ijarah* and *ijarah* financing





**Appendix 4 Resolution mechanism in the event of default**

