



BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Murabahah

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PART A: OVERVIEW

1. Introduction

- 1.1 Compliance with Shariah requirement is a prerequisite in ensuring legitimacy of Islamic financial products and services. Failure to observe the essential conditions of a specific Shariah contract may render the financial transactions entered between an Islamic financial institution (IFI) and a customer to be invalid and thus, may lead to adverse impact on the institutional safety and soundness. In this regard, Bank Negara Malaysia (the Bank) embarks on the development of a Shariah contract-based regulatory policy to enhance end-to-end compliance with Shariah and therefore, ensure the integrity and sustainability of the IFI.
- 1.2 The Shariah contract-based regulatory policy consists of two components, namely Shariah requirements and operational requirements. The first component highlights the salient features and essential conditions of a specific Shariah contract. Clear stipulation of Shariah rulings pertaining to a particular contract is intended to facilitate sound understanding and cohesive adoption among the IFI. The second component outlines operational requirements encompassing core principles underpinning sound banking practices, expectations for good governance, robust documentations, fair market practices and effective risk management. These regulatory expectations aim to complement and support effective application of the Shariah contract.
- 1.3 *Murahahah* contract is a type of “trust sale” contract under Shariah in which the purchaser relies upon the integrity of the seller to acquire the desired Shariah compliant asset at a reasonable cost. In line with the underpinning element of trust in *murabahah* contract, the seller is required to disclose the breakdown of the selling price to the

purchaser, which comprises the acquisition cost and the mark-up or profit margin.

- 1.4 In the context of Islamic financial transaction, an IFI perform both roles of a trader and a financier under the *murabahah* contract. As a trader, the IFI undertake to acquire a specific asset from the vendor or supplier based on the customer's specification and subsequently sells the asset to the customer with full disclosure of the asset's acquisition cost and profit margin. Typically, the IFI would accord deferred settlement terms on the agreed selling price to the customer under the *murabahah* contract to facilitate the financing arrangement.
- 1.5 An IFI may undertake direct dealing with the supplier or appoint the customer as an agent to acquire the asset on its behalf for the purpose of *murabahah* transaction. Shariah emphasises the need for the seller to secure the ownership and assume the risk associated with ownership of the asset prior to the execution of the *murabahah* contract, regardless of the preceding undertaking provided by the customer to purchase the asset.
- 1.6 In terms of risk profiling, the execution of *murabahah* transaction exposes an IFI to several types of risks that include the operational risks arising from the asset ownership, market risk associated with the potential loss in the value of the asset owned by IFI as well as credit risk arising from the losses associated with the potential failure of the customer to settle the outstanding debt obligation. As such, it is pertinent for the IFI to establish a comprehensive risk management framework to support effective management of the risks associated with *murabahah* transaction

2. Policy objectives

- 2.1 This policy document aims–
- (a) to provide reference on the Shariah rulings associated with *murabahah* contract;
 - (b) to set out key operational requirements with regard to the implementation of *murabahah* contract; and
 - (c) to promote end-to-end compliance with Shariah requirements as well as to ensure sound banking practices and consumer protection are implemented throughout the life cycle of *murabahah* contract.

3. Scope of policy document

- 3.1 This policy document covers *murabahah* contract and *murabahah* to the purchase order arrangement (MPO).
- 3.2 This policy document complements the rulings by the Shariah Advisory Council of the Bank (SAC) as well as the relevant regulatory framework on risk management, capital adequacy and governance issued by the Bank.

4. Applicability

- 4.1 The policy document is applicable to all Islamic financial institutions as defined in paragraph 8.2.

5. Legal provisions

- 5.1 The requirements in this policy document are–
- (a) specified pursuant to sections 29 (1) and (2) of the Islamic Financial Services Act 2013 (IFSA); and

- (b) issued pursuant to sections 41 and 129(3) of the Development Financial Institutions Act 2002 (DFIA).

6. Effective date

- 6.1 This policy document comes into effect on 1 January 2014.

7. Policy superseded

- 7.1 The Shariah Parameter Reference 1 – *Murabahah* issued on 26 August 2009 is superseded.

8. Interpretation

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

- 8.2 For the purpose of this policy document–

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

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

“**Islamic financial institutions**” means –

- (a) Islamic banks and takaful operators licensed under the IFSA;

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

9. Related legal and policy documents

- 9.1 This policy document must be read together with the legal and policy documents listed in Appendix 5.

PART B: SHARIAH REQUIREMENTS

Definition and Nature of *Murabahah*

10. Definition

- S** 10.1 *Murabahah* refers to a sale and purchase of an asset where the acquisition cost and the mark-up are disclosed to the purchaser.

11. Nature

- S** 11.1 *Murabahah* is a sale and purchase contract which is binding in nature. Thus, the contract shall not be terminated unilaterally by any of the contracting parties.
- S** 11.2 The specific inherent nature of the contract of *murabahah* is the sale contract which is based on the element of trust in disclosing the cost and mark-up. The common inherent nature of a sale contract is the transfer of ownership of the asset from the seller to the purchaser.

Components of *Murabahah*

12. Contracting parties

- S** 12.1 The contracting parties in a *murabahah* contract shall be a seller and a purchaser.
- S** 12.2 The contracting parties shall have the legal capacity¹ to enter into the *murabahah* contract.

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

- G** 12.3 The contracting parties in a *murabahah* contract may be a natural person or a legal person.
- G** 12.4 A party to *murabahah* contract may enter into the contract through an agent.
- S** 12.5 The *murabahah* contract shall be entered into through an offer and acceptance between the contracting parties.
- G** 12.6 The offer and acceptance may be expressed by appropriate documentation or by any other methods accepted by customary business practice (*urf tijari*) which do not contravene the Shariah principles.
- S** 12.7 Any term or condition mutually agreed upon which does not contravene the Shariah shall be binding on the contracting parties.

13. Asset

- S** 13.1 Asset to be traded in a *murabahah* contract shall meet the following conditions:
- (a) the asset is recognised by the Shariah, valuable, identifiable and deliverable; and
 - (b) the asset is already in existence and owned by the seller.
- G** 13.2 The *murabahah* asset may be a tangible or an intangible asset.
- S** 13.3 The following assets shall not be traded under *murabahah* contract:
- (a) asset to be constructed or asset under construction; and
 - (b) asset which is debt in nature.

- S** 13.4 Trading of the *ribawi* asset under a *murabahah* contract shall meet the following conditions:
- (a) the *murabahah* contract shall not be effected on the *ribawi* asset within the same type and category; and
 - (b) the *murabahah* contract shall not be effected on the *ribawi* asset within the same category but of different type on deferred basis.
- S** 13.5 The ownership in the *murabahah* asset must be effectively transferred from the seller to the purchaser.
- S** 13.6 The transfer of ownership is effected upon entering into a valid sale and purchase contract even though there is no legal registration of the ownership, provided that the sale and purchase is supported by evidence of transaction.
- S** 13.7 The transfer of ownership shall take effect by the seller disposing of the right of ownership (*takhliyah*) resulting in the purchaser having access to the asset (*tamkin*) and assuming its risk through any mechanism permitted by the Shariah and generally accepted by customary business practices (*'urf tijari*).
- S** 13.8 Possession of the asset shall either be in the form of physical possession (*qabd haqiqi*) or constructive possession (*qabd hukmi*).
- S** 13.9 Pursuant to paragraph 13.8, the rights and liabilities of the purchaser as the owner of the asset shall be established upon his possession of the asset.
- S** 13.10 The seller shall bear the liability for loss or damage of the asset before disposing the right of ownership (*takhliyah*), which results in the purchaser having accessibility to the asset (*tamkin*).

- S** 13.11 Multiple *murabahah* contracts shall not be entered into simultaneously on the same asset.
- G** 13.12 A *murabahah* contract may be entered into on a group of assets between the same contracting parties at the same time.
- S** 13.13 Any defect in the asset which is discovered and consented to by the purchaser at the time of entering into the contract shall disqualify the purchaser from entitlement to the defect option (*khiyar al-`ayb*) with respect to the defect.
- S** 13.14 Any defect in the asset which occurred before entering into the contract but is discovered after entering into the contract shall entitle the purchaser to the defect option (*khiyar al-`ayb*).
- G** 13.15 Pursuant to 13.14, the purchaser has the right to terminate the contract. Alternatively, the purchaser may choose to continue with the contract as it is or with any mutually agreed variations of the terms of the contract.
- G** 13.16 The contracting parties may mutually agree to specify the period for the defect option at the time of entering into the contract.
- G** 13.17 The contracting parties may mutually agree to stipulate a condition to waive liability for any defect on the asset before entering into the contract.
- G** 13.18 The seller may defer the registration of the asset in the name of the purchaser until full settlement of the selling price.

14. Price

- S** 14.1 The price and the currency used shall be determined and mutually

agreed at the time of entering into the *murabahah* contract.

- S** 14.2 The price shall be based on the disclosed acquisition cost and added mark-up at the time of entering into the contract.
- G** 14.3 Pursuant to paragraph 14.2, the mark-up may be determined either in the form of an absolute amount or a certain percentage of the acquisition cost or a reference rate such as the Base Lending Rate (BLR), the Base Financing Rate (BFR), Kuala Lumpur Interbank Offered Rate (KLIBOR) or Cost of Funds (COF).
- S** 14.4 Pursuant to paragraph 14.3, any reference rate adopted to determine the mark-up shall be specified.
- G** 14.5 The acquisition cost, which forms the cost portion of the *murabahah* price, may include direct expenses, which refer to costs incurred to enable the acquisition of asset by the seller and the delivery of the asset to the purchaser. This includes valid expenses which are established by customary business practices (*`urf tijari*).
- S** 14.6 Indirect expenses to a particular *murabahah* transaction, such as premise rental, utility bills, staff wages and labour charges, shall not be included in the acquisition cost.
- G** 14.7 Cost of services integral to an asset such as installation cost may be included in the cost portion of the acquired asset.
- S** 14.8 Any direct expenses to be incurred after entering into the *murabahah* contract shall not form part of the acquisition cost and shall be borne by the purchaser.
- S** 14.9 Any discount on the acquisition cost obtained upon purchase by the seller shall be reflected as a reduction in the acquisition cost.

- G** 14.10 Any asset acquired by the seller may be sold to the purchaser in any other agreed currency provided that the seller discloses the currency used in acquiring the asset.
- G** 14.11 A *murabahah* contract may be entered into on a cash or deferred basis.
- G** 14.12 The contracting parties may agree to make payment of the instalments or full settlement in a currency different from the currency specified in the contract at the agreed prevailing exchange rate on the payment or settlement date respectively.
- G** 14.13 The contracting parties may agree to extend or reschedule the payment period of the remaining debt without any increase in amount to the remaining debt.
- G** 14.14 Notwithstanding paragraph 14.13, the contracting parties may agree to settle the outstanding debt obligation by entering into a new contract that may results in a new debt obligation.
- G** 14.15 For the purpose of rescheduling the outstanding debt, the seller may demand additional securities from the purchaser to secure the payment of the rescheduled debt.
- G** 14.16 In the event of default, the seller may purchase the same asset or part thereof from the defaulting purchaser in cash at a mutually agreed price. The proceeds of the sale may be used to settle the outstanding debt on the basis of set-off (*muqassah*).
- G** 14.17 Pursuant to paragraph 14.16, upon acquisition of the asset by the seller, the asset may be leased to the purchaser on the basis of a lease which ends with acquisition of ownership of the asset (*ijarah muntahia bi al-tamlik*).

- G** 14.18 The seller may impose on the defaulting purchaser all actual costs incurred to recover the defaulted payment, including but not limited to the costs of legal expenses and fees which the seller has incurred to recover the outstanding payment.
- G** 14.19 The *murabahah* contract may contain a clause binding the purchaser to settle all outstanding debt before the maturity date if he defaults on any instalment payment.

ARRANGEMENT OF *MURABAHAH* WITH OTHER CONTRACT OR CONCEPT

15. Arrangement of *murabahah* with *wa`d* (*murabahah* to the purchase orderer)

- S** 15.1 *Murabahah* to the purchase orderer (MPO) refers to an arrangement whereby the purchase orderer (purchaser) promises (*wa`d*) to purchase an identified and specified asset from a seller on *murabahah* terms upon the latter's acquisition of the asset.
- S** 15.2 The *wa`d* to purchase the asset shall be binding on the purchase orderer when the seller has taken an action to acquire the asset.
- S** 15.3 The *wa`d* shall be executed separately from, and before entering into the *murabahah* contract.
- G** 15.4 Pursuant to paragraph 15.3, the *wa`d* may be incorporated in other legal document such as–
- (i) a master agreement provided that the master agreement does not carry the effect of *murabahah* contract; or
 - (ii) in a stand-alone document.
- S** 15.5 The purchase orderer who promised to purchase and take delivery of

the asset but refused to enter into the *murabahah* contract upon the seller's purchase of the asset as per the agreed terms shall be held liable for breach of *wa`d*.

- S** 15.6 Pursuant to paragraph 15.5, the purchase orderer shall compensate the seller for actual costs incurred in the acquisition of the asset and its disposal to a third party and the shortfall in the disposal price compared to the purchase price (if any).
- S** 15.7 The *murabahah* contract shall not be entered into prior to the purchase of the *murabahah* asset by the seller.
- S** 15.8 In the event that the purchase orderer has purchased the asset from the supplier, the seller in the MPO arrangement shall establish his ownership of the asset either by terminating the purchase contract and entering into a new purchase contract with the supplier, or by any other means of transfer of ownership which is in compliance with Shariah.
- G** 15.9 The purchase orderer may request the seller to purchase the assets intended for the *murabahah* transaction from a specific market place or a supplier. However, the seller may decline this request for whatever reason deemed reasonable by the seller as long as the assets fulfil the agreed specifications.
- S** 15.10 Upon acquisition of an asset by the seller and until the *murabahah* contract is entered into with the purchase orderer, the seller shall assume the ownership risk of the asset.
- G** 15.11 Pursuant to paragraph 15.10, the seller may obtain *takaful* coverage on the asset acquired before selling it to the purchase orderer. The *takaful* contribution paid by the seller may be added to the acquisition cost.

- S** 15.12 Under the MPO, at the stage of acquisition from the supplier, the seller shall not require the purchase orderer to subscribe to *takaful* coverage to ensure the payment of the price by the seller to the supplier.
- G** 15.13 Assets purchased by the seller according to the purchase orderer's requirements may be delivered to the purchase orderer to be held as a trust before entering into the *murabahah* contract.
- S** 15.14 Pursuant to paragraph 15.13, loss or damage of asset in the possession of the purchase orderer before entering into the *murabahah* contract due to negligence of the purchase orderer shall be borne by the purchase orderer.
- G** 15.15 The purchase orderer at the stage of *wa`d* may act as a *kafil* to the seller to guarantee the safe delivery of the asset by the supplier to the seller.
- S** 15.16 Pursuant to paragraph 15.15, any loss incurred due to late delivery of the asset to the seller shall be borne by the purchase orderer as the *kafil*. Damage or defects that arise after the delivery of the asset to the purchase orderer shall not be covered under this guarantee arrangement.
- S** 15.17 Loss or damage of assets in the possession of the purchaser (seller under the MPO) after acquisition of the asset from the supplier and prior to sale to the purchase orderer shall be borne by the purchaser.
- G** 15.18 The purchase orderer may seek recourse from the seller for any defect of asset delivered to the purchase orderer based on the defect option (*khiyar al-`ayb*).
- G** 15.19 Notwithstanding paragraph 15.18, both parties may agree to incorporate in the contract a clause to exempt the seller from any

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defect in the asset and assign the right of recourse to the purchase orderer against the supplier for the defect subject to the consent of the supplier.

16. Arrangement of *murabahah* to the purchase orderer with *wakalah*

- G** 16.1 The seller may appoint the purchase orderer as its agent (purchasing agent) to purchase the asset from the supplier on behalf of the seller as the principal (*muwakkil*).
- S** 16.2 The appointment shall be in a separate document from the *murabahah* contract.
- G** 16.3 Pursuant to paragraph 16.2, the *wakalah* may be incorporated in other legal document such as–
- (a) a master agreement provided that the master agreement does not carry the effect of the *murabahah* contract; or
 - (b) in a stand-alone document.
- G** 16.4 The name of the principal in the agency (*wakalah*) contract may be disclosed in all documents related to the sale contract between the supplier and the principal that are executed by the purchasing agent on behalf of the principal.
- G** 16.5 Notwithstanding paragraph 16.4, the purchasing agent and the principal may agree that only the name of the purchasing agent may be disclosed in all documents related to the sale contract between the supplier and the purchasing agent.
- S** 16.6 In the event that the principal requires the purchasing agent to provide several quotations for the asset, the principal shall clearly indicate to the purchasing agent the quotation which the principal has chosen.

- G** 16.7 The purchasing agent may advance his own money for partial payment of the purchase price to the supplier.
- S** 16.8 Pursuant to paragraph 16.7, the advanced amount shall be reimbursed by the principal or shall be offset from the selling price which is to be concluded with the purchasing agent.
- S** 16.9 Once the purchasing agent has purchased the asset on behalf of the principal, the *murabahah* contract must be entered into to sell the asset to the purchase orderer (purchasing agent).
- S** 16.10 The principal shall remain liable for the asset purchased by the purchasing agent.

17. Arrangement of *murabahah* contract with assurances

- G** 17.1 For the purpose of assurances, *murabahah* contract may be arranged with other contracts or concepts such as *kafalah*, *takaful* coverage, *rahn*, *hamish jiddiyah* (security deposit), or *`urbun* (earnest money).

a) Assurance of *murabahah* contract through *kafalah*

- G** 17.2 A guarantee may be arranged to guarantee the purchase of the *murabahah* asset in the case of default by the purchase orderer upon its acquisition by the seller.
- G** 17.3 A guarantee may also be arranged to guarantee the payment of the outstanding debt amount of the *murabahah* sale in the case of default by the purchaser.

b) Assurance of *murabahah* contract through *takaful* coverage

- G** 17.4 Upon entering into the contract, the seller may require the purchaser to

contribute to a *takaful* coverage to guarantee the payment of the debt obligation under *murabahah* contract in the event of loss of legal capacity by the purchaser.

- G** 17.5 The contracting parties may agree to exclude *takaful* contribution (for coverage of the asset under the seller's possession before selling it to the purchaser) from the acquisition cost and the purchaser may agree to absorb the *takaful* cost before entering into the *murabahah* contract.

c) Assurance of *murabahah* contract through *rahn*

- S** 17.6 Collateral (*marhun*) in a *murabahah* contract (if any) shall be a Shariah-compliant asset.
- G** 17.7 Notwithstanding paragraph 17.6, interest bearing debt based asset such as Conventional Fixed Deposit Certificate, may be used as collateral provided the collateral is valued up to the principal amount.
- S** 17.8 The collateral shall be utilised to recover payment of the outstanding debt amount.
- G** 17.9 The contracting parties may agree to include the claim on actual costs incurred for the recovery of the outstanding debt payment from the collateral.

d) Assurance of *murabahah* contract through *hamish jiddiyah*

- G** 17.10 The seller may require the purchaser to place a security deposit (*hamish jiddiyah*) to secure the undertaking to purchase the asset.
- G** 17.11 The security deposit may be used to compensate against actual loss incurred in the event the purchaser fails to purchase the asset from the seller.

- S** 17.12 Pursuant to paragraph 17.11, the excess portion of the security deposit after compensation against actual loss shall be returned to the purchaser.
- G** 17.13 Upon entering into the *murabahah* contract, the security deposit may be treated as part of the payment of the agreed selling price for the *murabahah* contract.
- S** 17.14 The security deposit shall be returned to the purchaser if it is not treated as part of the payment of the *murabahah* selling price.

e) Assurance of *murabahah* contract through *`urbun*

- G** 17.15 Upon entering into the *murabahah* contract, the purchaser may place earnest money (*`urbun*) with the seller, and the purchaser is given a specified time period to continue with or terminate the contract.
- S** 17.16 The earnest money shall be treated as part payment of the agreed selling price if the purchaser exercises the option to continue with the contract within the specified time.
- S** 17.17 In the event the purchaser fails to exercise the option to continue with the contract within the specified time, the *murabahah* contract is terminated and seller shall be entitled to the earnest money.

18. Incorporation of rebate (*ibra'*) in *murabahah* contract

- G** 18.1 The seller may consider waiving part of the outstanding debt in the form of a discount to the purchaser upon pre-payment and/or early settlement.

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- S** 18.2 A rebate clause shall be incorporated in the *murabahah* contract provided that it is a requirement imposed by the authority.
- G** 18.3 In the event that the *murabahah* contract involves payment of the deferred price in instalment, the seller may provide periodic *ibra'* based on certain benchmark agreed by the contracting parties.

19. Arrangement of *murabahah* with *ta`widh* and/or *gharamah*

- G** 19.1 The contracting parties may agree to include a clause in the *murabahah* contract stipulating late payment charges as determined by the relevant authorities.
- S** 19.2 Pursuant to paragraph 19.2, the late payment charges shall consist of–
- (a) *ta`widh* (compensation) for actual loss borne by the seller, which may be recognised as income to the seller; and/or
 - (b) *gharamah* (penalty), which shall not be recognised as income. Instead, it shall be channelled to charitable bodies.

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DISSOLUTION (*FASAKH*) AND COMPLETION (*INTIHA'*) OF *MURABAHAH* CONTRACT

20. Dissolution of *murabahah* contract

- S** 20.1 A *murabahah* contract is dissolved under the following circumstances:
- (a) the purchaser in a *murabahah* arrangement with earnest money (*`urbun*) exercises the option not to continue the contract within the specified time;
 - (b) the purchaser exercises the defect option (*khiyar al-`ayb*) to terminate the *murabahah* contract;
 - (c) any of the contracting parties exercises the mutually agreed options to terminate the *murabahah* contract within the agreed time period;
 - (d) the contracting parties exercise the option to terminate the *murabahah* contract due to breach of terms; or
 - (e) both contracting parties mutually agree to terminate the sale contract.
- S** 20.2 Upon dissolution of the *murabahah* contract, the asset shall be returned to the seller and with the exception of paragraph 20.1 (a), any amount paid shall be returned to the purchaser.
- S** 20.3 Pursuant to paragraph 20.2, the dissolution of contract shall be effective provided that the asset can be returned to the seller.

21. Completion of *murabahah* contract

- S** 21.1 The *murabahah* contract ends upon fulfilment of the contracting parties' obligations which include the following:
- (a) full settlement of the selling price;
 - (b) transfer of the obligation to pay the selling price to a third party (*hiwalah*);

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- (c) waiving the right by the seller to receive the selling price through a rebate (*ibra'*); or
- (d) set-off (*muqassah*) of debt obligations between the contracting parties.

S 21.2 Upon completion of the *murabahah* contract, the contracting parties are free from any contractual obligations.

PART C: OPERATIONAL REQUIREMENTS

The regulatory expectations set out in this part emphasise on the establishment of effective policies and procedures to facilitate oversight function, conduct of *murabahah* transaction, information disclosure, and risk management. The policy intent of these operational requirements is to provide adequate safeguard to stakeholders' interest, promote cohesive implementation of business and risk management strategies and drive the development of necessary systems, processes and control measures while preserving Shariah requirement.

22. Oversight Functions

Principle 1: IFI must establish comprehensive internal policies and procedures to ensure *murabahah* transaction comply with Shariah and are conducted based on sound practices as well as within proper oversight arrangement.

- S** 22.1 The Board of Directors (the Board) shall ensure—
- (a) all requirements pertaining to Shariah matters are endorsed by the Shariah Committee (SC);
 - (b) application of *murabahah* contract is aligned with the IFI's business and risk management strategies;
 - (c) relevant internal policies governing the *murabahah* transaction are established, approved and adhered to at all times by the IFI. These policies (at minimum) shall cover the following aspects:
 - (i) asset acquisition and asset sale;
 - (ii) risk management; and
 - (iii) information disclosures.
 - (d) internal policy and procedure on inventory management are established if IFI undertake to acquire and safe keep or maintain tradable assets for the purpose of conducting *murabahah* transaction;
 - (e) the internal policies are regularly reviewed in order to remain relevant, current and effective in managing the overall operational

conduct and risk exposure associated with *murabahah* transaction. Therefore, the IFI are required to clearly determine and specify the terms and frequency of review exercise and events that warrant for each policy governing the *murabahah* transaction be reviewed; and

- (f) independent reviews are conducted regularly to assess compliance with the standards issued by the Bank and internal policies established by the IFI.

S 22.2 The SC shall–

- (a) endorse the application of Shariah in relevant internal policies and procedures governing the application of *murabahah* contract;
- (b) deliberate and endorse the terms and conditions stipulated in legal documentation and other documents including product manual, marketing advertisement, sales illustrations and brochures are in compliance with Shariah; and
- (c) perform oversight role on the application of *murabahah* contract to ensure due observance of Shariah.

S 22.3 The senior management² shall–

- (a) formulate and implement the internal policies, processes and procedures governing the *murabahah* transaction. At minimum the internal policies shall–
 - (i) identify legal documentation in *murabahah* transaction as well as procedures to be observed in executing such transaction to ensure that the transaction is valid and enforceable in accordance with the terms of the contract;
 - (ii) identify the accountabilities to undertake various activities under *murabahah* transaction including processing

² Means a person having authority and responsibility for planning, directing or controlling the activities of the IFI including the chief executive officer, the chief operating officer, members of decision-making committees and other person performing key function such as risk management, compliance, internal audit or other functions as specified by the Bank.

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- customer's application to purchase asset , asset acquisition, asset sale transaction, communication, compliance monitoring and review function;
- (iii) set out appropriate scope, methodology and process in assessing the capability of contracting parties to fulfill contractual obligations;
 - (iv) outline eligibility criteria of asset³ that qualifies for *murabahah* transaction;
 - (v) outline parameters on direct expenditures that qualify to form part of *murabahah* acquisition cost;
 - (vi) establish risk management system and maintain adequate mechanism to identify, measure and mitigate risk associated with *murabahah* transaction;
 - (vii) provide reference to the applicable *Shariah* rulings⁴; and
 - (viii) provide cross reference to the applicable policies, such as policy on financing and credit risk management.
- (b) where applicable, set out policies and procedures for the appointment of agent, valuation methodology for inventories and disposal of inventories;
 - (c) clearly communicate the approved policies to internal stakeholders to facilitate effective implementation; and
 - (d) undertake regular review and monitor compliance on the approved policies.

³ Appendix 3 highlights the general qualifying parameter on permissible assets under *Shariah*.

⁴ Refers to rulings issued by the Bank's *Shariah* Advisory Council (SAC) and *Shariah* Committee of the IFI.

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23. Documentations, Internal Policies & Procedures

Principle 2: IFI must identify and establish legal documentation, policies and procedures to ensure the transaction is valid and implemented in accordance with Shariah.

f) Documentary requirements

- S** 23.1 IFI must develop a complete set of legal documentation⁵ for *murabahah* transaction that complies with Shariah. These documentations shall specify the agreed terms on asset acquisition, asset sale and financing arrangement.
- S** 23.2 IFI shall ensure that the following is documented in writing and executed by contracting parties:
- (a) legal documentation evidencing the *murabahah* contract and financing arrangement;
 - (b) legal documentation evidencing the asset ownership and purchase cost; and
 - (c) where applicable, legal documentation evidencing agency appointment and purchase undertaking.
- S** 23.3 IFI must clearly stipulate the terms, conditions, rights, duties and obligations of contracting parties in the respective documentations.
- S** 23.4 IFI shall ensure that the order or application by the customer for the purchase of asset is supported by a written document. At minimum, the document shall outline the following:
- (a) description and quantity of the asset to be acquired;
 - (b) estimated purchase price; and
 - (c) proposed supplier of the asset (if applicable).

⁵ Covers contracts, agreements, 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.

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- S** 23.5 IFI must ensure it has relevant document evidencing its ownership on the asset prior executing *murabahah* contract.
- S** 23.6 The documentation on *murabahah* transaction or sale of asset shall include the following:
- (a) description of the asset or subject matter of sale;
 - (b) total selling price⁶, asset acquisition cost⁷ and profit amount (mark up)
 - (c) the settlement terms of the selling price;
 - (d) provision of rebate due to early settlement of selling price; and
 - (e) clause on compensation due to events of default.
- S** 23.7 If an agent is employed, IFI must establish legal documentation evidencing the appointment of the agent and outline specific roles, duties, rights and obligations to be undertaken by the agent on behalf of the IFI. The agency documentation must be separated from *murabahah* contract.
- S** 23.8 If a purchase undertaking (*wa'd*) is employed, IFI shall document the purchase undertaking provided by the customer separately from *murabahah* contract. IFI must ensure that the purchase undertaking document is legally enforceable and provides adequate right for IFI to claim compensation for losses⁸ suffered due to any breach of terms by the customer.

⁶ Asset selling price is equivalent to the summation of total asset acquisition cost and profit amount.

⁷ Total asset acquisition cost means the asset's purchase price *plus* direct expenses incurred for asset acquisition *minus* any discount received from the supplier. General guidance on the component of acquisition costs is provided in Appendix 4.

⁸ In the event the purchase orderer does not fulfill his obligation under the purchase undertaking, the purchase orderer shall compensate the seller for actual costs incurred in the acquisition of the asset, disposal of asset to a third party and any shortfall in the disposal price compared to the purchase cost.

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- S** 23.9 The use of Arabic terminology in the documents must be sufficiently clarified or translated to facilitate understanding of the contracting parties and where available, terminologies as provided or endorsed by the SAC shall be adopted and reflected accordingly.

a) Acquisition of asset

- S** 23.10 IFI must undertake asset acquisition process based on the approved policies.
- S** 23.11 IFI must ensure the asset acquisition transaction undertaken for the purpose of *murabahah* contract is genuine and evidenced by proper and sufficient documentation.
- G** 23.12 Pursuant to paragraph 23.11, IFI may conduct assessment on the supplier, which includes verification on its legitimate establishment and capabilities to deliver the desired asset prior to the execution of the asset acquisition process.
- S** 23.13 IFI must perform the necessary process as set out in the approved policies to ensure that the customer has the capability and credibility to satisfy his obligations under the *murabahah* contract and/or agency document prior to performing the asset acquisition process.
- S** 23.14 IFI must implement appropriate mechanism to ensure the asset acquired by the agent satisfies the customer's requirements.
- G** 23.15 IFI may specify the duty of the agent in the agency documentation to ensure the assets acquired on behalf of the institutions satisfies the customer's requirements.
- G** 23.16 IFI may require the purchase orderer or customer to place security deposits as a control measure to affirm latter's commitment to enter into

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murabahah contract.

b) Sale of asset

- S** 23.17 IFI must ensure that it has secured ownership of the asset prior to entering into *murabahah* contract or sale of asset agreement with the customer. The ownership rights in the asset shall be represented by enforceable documentary evidence.
- S** 23.18 The agreed currency of settlement associated with the sale of asset must be clearly stipulated in the *murabahah* contract.
- S** 23.19 The determination of the agreed selling price and the deferred settlement terms or financing terms must be in accordance with the approved policies governing the financing and pricing of *murabahah* transaction.
- S** 23.20 Ownership of the asset sold under *murabahah* contract shall be effectively transferred to the customer in accordance with the terms agreed in the sale document.

c) Inventory management

- S** 23.21 If IFI acquires and safe keeps or maintains tradable assets for the purpose of conducting *murabahah* transaction, a policy that covers the following aspects must be established, approved by the Board and adhered to by the IFI:
- (a) procedures to ensure the acquired asset is securely kept and properly maintained;
 - (b) measures to assess the conditions of the asset;

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- (c) mechanism on asset valuation, which includes the applicable valuation methodology⁹ and the frequency of valuation exercise;
- (d) procedures to monitor asset that is maintained by the appointed agent; and
- (e) procedures to dispose the inventories, which include identifying events that potentially trigger the need for the IFI to dispose such asset and the appropriate disposal mechanism.

24. Information Disclosure

Principle 3: IFI shall provide relevant information to enable relevant stakeholders understand *murabahah* transaction

- S** 24.1 IFI shall provide complete and accurate information to customer with regard to the application of *murabahah* contract. At minimum, information to be disclosed in the product disclosure sheet or marketing materials shall include the following:
- (a) objective of the financial product and *murabahah* transaction;
 - (b) overview of the transaction structure;
 - (c) roles, responsibilities, rights and obligations of the contracting parties;
 - (d) key terms and conditions of the contract;
 - (e) description of eligible asset to be financed under *murabahah* contract;
 - (f) parameter or basis used to determine the acquisition cost and profit margin;
 - (g) fees and charges, including compensation charges following the customer's failure to fulfill the promise to purchase the asset; and
 - (h) where applicable, the terms and conditions as well as rights and obligation of contracting parties with regard to the placement of security deposit or advance payment.

⁹ The IFI must refer to relevant regulatory requirement on prudent valuation, particularly the Capital Adequacy Framework for Islamic banks in conducting asset valuation.

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- G** 24.2 IFI may provide illustration to the customer on the adopted methodology or parameter to determine the profit margin in *murabahah* contract.
- G** 24.3 In addition, IFI may highlight or explain to the customer the mechanism on rebate arising from early settlement of the outstanding selling price.

25. Risk Management

Principle 4: IFI must institute and implement sound risk management system to effectively manage risks associated with *murabahah* contract

Risk management policies

- S** 25.1 At minimum, the risk management policies shall address the following:
- (a) process and procedures for the identification, measurement, monitoring, reporting and control of all risks exposure associated with *murabahah* contract;
 - (b) internal limits on risk exposure (concentration) in line with the IFI's risk appetite and capacity;
 - (c) type of funding source used to finance *murabahah* transaction;
 - (d) appropriate risk mitigation measures to minimise risk arising from *murabahah* transaction; and
 - (e) type, nature and frequency of reporting to the Board, senior management and Shariah Committee.

Risk identification

- S** 25.2 IFI must identify and assess risks inherent in *murabahah* transaction.
- S** 25.3 IFI shall clearly specify and document the methodologies and parameters adopted to identify risks profile of *murabahah* transaction.
- G** 25.4 IFI may adopt various established approaches such as the Business Process Mapping, Risk Control Self Assessments (RCSA) and Scenario

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analysis to perform risks identification and assessment process on *murabahah* transaction. The outcome of this process enables IFI to identify individual risk type, risk interdependencies and assess any weakness that may exist in the overall risk management and control system.

Risk Measurement

- S** 25.5 IFI must establish appropriate mechanism to measure risks exposure associated with *murabahah* transaction.
- S** 25.6 IFI must adopt and implement prudent methodologies¹⁰ to measure the potential financial losses arising from the identified risk events associated with *murabahah* transaction. These methodologies must be documented and shall commensurate with the nature and complexity of IFI's risk exposures under *murabahah* contract.
- G** 25.7 IFI may compile relevant internal and external data to support the basis of risks measurement, which may include–
- (a) financial losses attributed to operational risk events such as theft, fraud, natural disaster, failure on the part of the customer to fulfill promises and other obligations;
 - (b) prices of relevant goods or assets; and
 - (c) where applicable, the estimated holding cost of inventories and time taken to dispose asset.

Risk Controls and Mitigation

- S** 25.8 IFI must establish strong control environment that uses policies, processes, systems, appropriate internal controls and risk mitigation

¹⁰ The IFI shall be guided by regulatory guidance on prudent valuation as specified in the Capital Adequacy Framework for Islamic banks in performing asset valuation.

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measures to ensure IFI have an effective operation relating to *murabahah* transaction. The control and mitigation measures must commensurate with the complexity and materiality of institutions' risk exposure on *murabahah* transaction.

- S** 25.9 If agency (*wakalah*) and/or purchase undertaking is employed as a measure to mitigate risk associated with the acquired assets, the IFI shall ensure the agency document and/or purchase undertaking (*wa'd*) document is executed before the acquisition of the *murabahah* asset.
- G** 25.10 IFI may employ risk transfer mechanism such as through *takaful* cover in line with internal policies approved by the Board. For instance, IFI may provide *takaful* coverage on the asset acquired for the purpose of *murabahah* contract. Such protection may minimise potential losses arising from any damage to assets or inventories owned by the IFI.
- S** 25.11 IFI that employ risk transfer mechanism shall ensure that the mechanism:
- (a) is consistent with the policy approved by the Board;
 - (b) shall compliment rather than replacement for, internal operational risk control; and
 - (c) shall effectively reduce the risks exposure to *murabahah* transaction and does not create additional risk.
- G** 25.12 IFI may maintain a list of approved alternative suppliers to facilitate acquisition of asset in the event that the original supplier fails to deliver the desired asset.

Risk monitoring and reporting

- S** 25.13 IFI must establish robust risk monitoring system to ensure—
- (a) *murabahah* transaction complies with Shariah;
 - (b) risk exposure associated with *murabahah* transaction are

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comprehensively and accurately measured;

- (c) value of collateral and security deposits are sufficient to mitigate potential losses;
- (d) appropriate provisioning is duly allocated on impaired assets;
- (e) risk concentration is maintained within approved limits;
- (f) counterparties satisfy their contractual obligations; and
- (g) implication arising from the changes in the operating and economic environment are adequately measured and assessed against the capital adequacy of the institution.

S 25.14 IFI shall have in place systems and procedures to monitor risks exposure associated with *murabahah* transaction.

S 25.15 The reporting to senior management and the Board must be objectively undertaken and supported with–

- (a) comprehensive risk assessment and recommendation to enable IFI in deciding whether the application of *murabahah* contract is consistent with the IFI's risk appetite and capacity;
- (b) risk analysis on potential changes or migration of risk profiling (e.g. disruption in the market that may reduce the supply of the asset); and
- (c) recommendations to improve or enhance risk management framework and infrastructure to address risks arising from the application of *murabahah* contract.

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Appendices

Appendix 1: Legitimacy of *murabahah* contract

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

The Quran

25.17 The following verse of the Quran implies the general permissibility of sales contract including *murabahah*:

وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرِّبَا

“...whereas Allah SWT has permitted trading and forbidden usury...” (*Surah al-Baqarah, verse 275*)

The Sunnah of Prophet Muhammad (peace be upon him)

25.18 There is no direct juristic authority from the Sunnah of the Prophet (peace be upon him) regarding the legitimacy of the *murabahah* contract. It is deemed permissible based on the general permissibility of sales in Islamic law.

25.19 The following *hadith* implies the general permissibility of *murabahah* contract:

عن رفاعة بن رافع - رضي الله عنه - أن النبي - صلى الله عليه وسلم - سئل: أي الكسب أطيب؟ قال: عمل الرجل بيده, وكل بيع مبرور.

The Prophet Muhammad (peace be upon him) was reported to have said: “The best earning is what a man earns with his own hands and from a permissible trade” (Narrated by Hakim, *Al-Mustadrak, Hadith* no. 2160)

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Consensus of the Muslim jurists (*Ijma'*)

25.20 The Muslim jurists have reached *ijma'* on the permissibility of *murabahah* contract.

Analogy

25.21 Since the Prophet Muhammad (peace be upon him) approved the *tawliyah* sale (sale based on cost price), the sale on mark-up will be equally permissible on the basis of analogy on the *tawliyah* sale.

25.22 The determination of cost and making the cost known to the purchaser is common in both the *tawliyah* and *murabahah* sales.

Appendix 2: Glossary

Terms	Explanation
Acquisition cost	The cost of acquiring an asset, including its price and direct expenses
Direct expense	Costs or expenses incurred to directly enable the acquisition of asset by the IFI and delivery of the asset to the customer
<i>Gharamah</i>	Penalty
<i>Hamish jiddiyah</i>	A security deposit placed to secure the undertaking to purchase an asset before entering into the sale and purchase agreement.
<i>Hiwalah</i>	Assignment of debt from the liability of the original debtor to the liability of a third person so that the original debtor becomes free of liability
<i>Ibra'</i>	Rebate
<i>Ijarah muntahia bi al-tamlik</i>	Lease contract which ends with acquisition of ownership of the asset by the lessee
<i>Ijma`</i>	Consensus of Muslim jurists
Indirect expense	Expense indirectly incurred and not directly chargeable to a specific acquisition, project or task
<i>Kafil</i>	Guarantor
<i>Khiyarah-`ayb</i>	Option arising from a defect; the option of dissolving the contract on discovery of a defect in the asset purchased
<i>Muqassah</i>	Offsetting
Purchase orderer	A person who enters into an arrangement with a seller to place an order for a particular asset and undertakes to subsequently purchase the said asset upon its acquisition by the seller.
<i>Qabd haqiqi</i>	Physical possession. It refers to a state where a person has actual possession and the rights to control an asset
<i>Qabd hukmi</i>	Constructive possession. It refers to a state where a

	person does not have actual possession but has the legal rights to control an asset
<i>Qiyas</i>	Analogy
<i>Rahn</i>	Pledge/Charge
<i>Ribawi asset</i>	<p>Assets which are subject to specific rules in sales to avoid the implication of <i>riba</i>. These assets consist of six (6) types and are classified into two (2) categories:</p> <ul style="list-style-type: none"> (a) Medium of exchange (currency) represented by gold and silver and any items used as currency; and (b) Staple food represented by wheat, barley, dates, and salts. <p>If an exchange involves the same type of asset such as gold for gold or wheat for wheat, then it must be of equal counter-value and on-spot basis. If the exchange involves assets of different type but within the same category such as the exchange of gold for paper currency, then it has to be done on spot basis.</p>
<i>Takhliyah</i>	Relinquishing or abandoning the rights of ownership
<i>Tamkin</i>	Enabling the person who has the ownership of an asset transferred to him to make full use and assume liability of the asset
<i>Ta`widh</i>	Compensation
<i>Tawliyah</i>	Sale of an asset at its cost price
<i>'Urbun</i>	Earnest money paid to secure purchase of an asset in an exchange contract which is considered part of the price if the purchaser decides to continue the contract and is not refundable.
<i>'Urf tijari</i>	Common business practice which is acceptable by the community and does not contradict the Shariah rulings
<i>Wa`d</i>	Promise or undertaking
<i>Wakalah</i>	Agency contract

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Appendix 3: General parameter on underlying assets

25.23 Minimum criteria that needs to be fulfilled to ensure that the underlying asset complies with Shariah requirement:

- (a) The asset must exist and identifiable in terms of its location, quantity and quality. Assets under construction are not eligible for *murabahah* contract.
- (b) The asset must be permissible under Shariah, valuable and beneficial to the purchaser.
- (c) The asset must be transferable (i.e. something that can be delivered to customers).
- (d) Debt instruments (e.g. Islamic accepted bills and negotiable Islamic debt certificates) are not qualified to be traded under *murabahah* contract.

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Appendix 4: General guidance on the components of acquisition costs

25.24 The acquisition cost refers to direct expenses incurred for the acquisition of asset by IFI and delivery of the asset to customer, which includes:

- (a) transportation;
- (b) storage;
- (c) assembly (e.g. cost of services such as installation cost);
- (d) taxes;
- (e) cost arising from insurance or *takaful* coverage on the asset acquired before selling it to customer. The *takaful* contribution paid by IFI may be added to the cost of acquisition; and
- (f) any valid expenses established by customary practice. This should be deliberated and approved by SC of IFI.

25.25 Additional direct expenses that are incurred subsequent to completion of *murabahah* contract and not specified in the legal documentation shall not form part of the *murabahah* selling price.

25.26 Overhead expenditure or indirect cost shall not form part of the acquisition. These expenses include staff wages or labour charges that are not due to asset acquisition activities.

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Appendix 5: Related legal and policy documents

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

- (a) Shariah Advisory Council (SAC) rulings published by the Bank¹¹;
- (b) Shariah Governance Framework for Islamic Financial Institutions;
- (c) Guidelines on Corporate Governance for Islamic Bank;
- (d) Guidelines on Corporate Governance for Development Financial Institutions;
- (e) Risk Governance;
- (f) Capital Adequacy Framework for Islamic Banks (Risk-Weighted Assets);
- (g) Capital Framework for Development Financial Institutions;
- (h) Capital Adequacy Framework for Islamic Banks (CAFIB) - Disclosure Requirements;
- (i) Guidelines on Product Transparency and Disclosure;
- (j) Guidelines on Financial Reporting for Islamic Banking Institutions;
- (k) Guidelines on Financial Reporting for Development Financial Institutions ;
- (l) Guidelines on Property Development and Property Investment Activities by Islamic Banks;
- (m) Guidelines on the Imposition of Fees and Charges on Financial Products and Services;
- (n) Guidelines on rebate (*ibra'*) for Sale-based Financing;
- (o) Guidelines on Late Payment Charges for Islamic Financial Institutions; and
- (p) Guidelines on Responsible Financing.

¹¹ Including *Shariah* resolutions in Islamic Finance, standards, circulars or any directive pertaining to *Shariah* matters issued by the Bank