The Shariah Advisory Council of Bank Negara Malaysia (SAC) Ruling on *Ar-Rahnu* Product Proposal based on *Tawarruq* SAC's 198th and 199th Meetings on 29 October 2019 and 26 November 2019

Part I: SAC Ruling, Its Effective Date and Applicability

Pursuant to section 52 of the Central Bank of Malaysia Act 2009, the SAC has made a ruling that the structuring of *ar-rahnu* product based on *tawarruq* and *rahn* is permissible subject to the following conditions:

i. For *ar-rahnu* product involving the purchase of commodity in bulk at the beginning of the business day, the *fiqh* adaptation (*takyif fiqhi*)[1] must be clear in relation to the cancellation of the commodity purchased from the commodity trading platform provider at the end of the business day;

ii. In the event of default, the customer's consent shall be obtained prior to the liquidation of the collateral;

iii. The terms and conditions of the *ar-rahnu* product shall clearly specify the following treatment in cases where a default by the customer leads to the liquidation of the underlying collateral:

   (a) where the proceeds from the liquidation of the underlying collateral exceed the liability of the customer, the excess amount shall be returned to the customer; and
   (b) where the proceeds from the liquidation of the collateral are insufficient to meet the liability of the customer, the Islamic financial institution (IFI) has the right to claim the balance from the customer;

iv. The customer shall be informed[2] on the specification and features of the transacted commodity including its location, type, quality and quantity as well as the calculation mechanism to avoid the element of uncertainty (*gharar*) and any dispute by the contracting parties; and

v. All requirements set out in Bank Negara Malaysia's (the Bank) policy documents on *Tawarruq* and *Rahn* shall be complied with.

This ruling shall be read together with the SAC ruling on the execution of *tawarruq* arrangement via straight-through processing (STP) dated 26 November 2019.

This ruling comes into effect on 1 February 2020[3] and is applicable to the following IFIs:

(a) licensed persons under the Islamic Financial Services Act 2013 (IFSA);
(b) licensed banks and licensed investment banks approved under section 15(1) of the Financial Services Act 2013 (FSA) to carry on Islamic banking business; and
(c) prescribed institutions approved under section 33B(1) of the Development Financial Institutions Act 2002 (DFIA) to carry on Islamic financial business.

[1] *Fiqh* adaptation or *takyif fiqhi* refers to the process of deriving a Shariah basis, principle or concept to a new or an emerging matter or situation for which there was no precedent.
[2] In a manner recognised by business practise (`*urf tijari*) and in accordance with Shariah.
[3] The Bank has communicated this ruling to the respective IFIs on 7 and 28 November 2019 following the SAC's 198th and 199th meetings.

In line with sections 28(1) and (2) IFSA or sections 33D(1) and (2) DFIA, as the case may be, IFIs are required to comply with this ruling as a compliance with any ruling of the SAC in respect of any particular aim and operation, business, affair or activity of such IFIs shall be deemed to be a compliance with Shariah.

Part II: Background

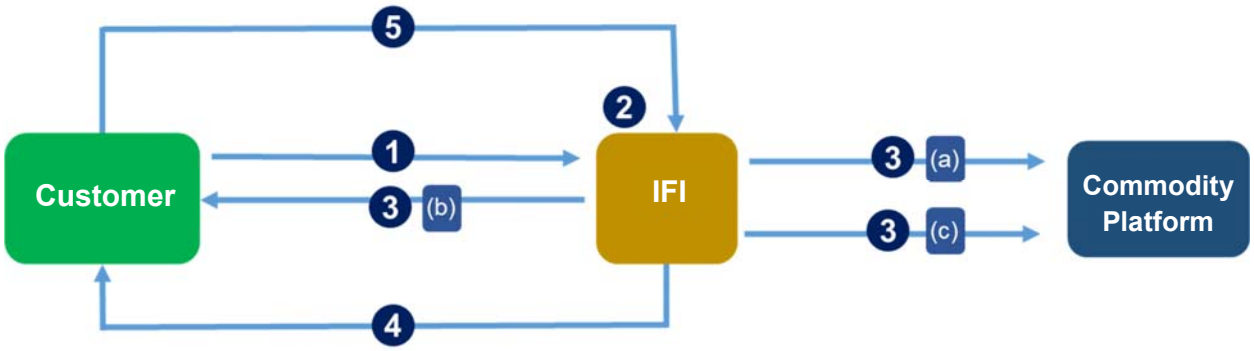
- The Bank has received proposals from several IFIs to offer *ar-rahnu* product based on *tawarruq* and *rahn* following the non-permissibility of the existing *ar-rahnu* product structure based on *qard* and *rahn.*

- The proposed structure applies *tawarruq* as the underlying contract to create indebtedness between the customer and IFI. Similar to the existing *ar-rahnu* structure, the customer then pledges gold to the IFI. However, no safekeeping fee will be charged to the customer. IFIs will generate income from the *murabahah* transaction in the *tawarruq* arrangement.

Shariah Issue

Does the proposed *ar-rahnu* structure based on *tawarruq and rahn* fulfil the requirements of Shariah?

General illustration of the *ar-rahnu* product structured based on *tawarrruq*



1. Customer approaches the IFI to apply for *ar-rahnu* financing with gold as collateral.
2. The IFI will appraise the value of the gold that will be pledged to determine the financing amount that the customer can apply.
3. Execution of *tawarruq**:
   a) IFI purchases commodity from the commodity supplier through the commodity trading platform provider;
   b) IFI then sells the commodity to the customer based on the approved financing amount plus the profit amount as determined by the IFI on a deferred payment term. IFI as an agent will accept the sale of the commodity on behalf of the customer; and
   c) The customer then sells the commodity to the commodity trading platform provider on cash basis (IFI as an agent will sell the commodity on behalf of the customer).
4. The proceeds from the sales are disbursed to the customer after the *tawarruq* arrangement is completed.
5. Customer will pay the profit to the IFI every 6 months and the principal amount will be paid at maturity of the financing. In the event of default, the IFI has the right to auction the collateral to settle the financing amount.

* Note: there are various methods proposed in executing the *tawarruq* arrangement which include:
(i) Purchase of commodity in bulk by the IFI at the beginning of the business day based on the total estimated financing amount to be applied by the customer. The sale of the commodity to the customer will be conducted based on the financing amount applied by an individual customer. The commodity will be sold back to the commodity trading platform provider either in batches at a designated time throughout the business day or will be sold back in bulk at the end of the business day.
(ii) Execution of *tawarruq* via straight-through processing (STP) based on the financing amount applied by customer (Please refer to the SAC ruling at its 199th meeting on the permissibility of *tawarruq* execution via STP).

Part III: Key Discussion

Whether the proposed ar-rahnu structure based on tawarruq and rahn fulfils the requirements of Shariah

- The SAC discussed whether the profit generated in the *ar-rahnu* structure based on *tawarruq* and *rahn* is in line with Shariah principles.

- The SAC ruled that the combination of both contracts does not lead to matters prohibited in Shariah such as *riba*, the combination of loan and sale contracts (*bai` wa salaf*) and loan that gives benefit to the lender (*qard jarra naf`an*).

- As such, the SAC ruled that the application of *tawarruq* and *rahn* contracts for *ar-rahnu* is in line with the requirements of Shariah and the application of collateral in a financing contract is permissible to safeguard the interest of the financier in the event of default.

Part IV: Basis of Ruling

Permissibility of tawarruq

- The application of *tawarruq* is permissible based on the following verse of the Quran which implies the general permissibility of sales contract including *tawarruq*:

وَأَحَلَّ ٱللَّهُ ٱلْبَيْعَ وَحَرَّمَ ٱلرِّبَوٰا۟

"...whereas Allah SWT has permitted trading and forbidden usury (riba)".[4]

Permissibility of rahn

- The contract of *rahn* is permissible based on the following verse of Quran:

۞ وَإِن كُنتُمْ عَلَىٰ سَفَرٍ وَلَمْ تَجِدُوا۟ كَاتِبًا فَرِهَٰنٌ مَّقْبُوضَةٌ ۖ فَإِنْ أَمِنَ بَعْضُكُم بَعْضًا
فَلْيُؤَدِّ ٱلَّذِى ٱؤْتُمِنَ أَمَٰنَتَهُۥ وَلْيَتَّقِ ٱللَّهَ رَبَّهُۥ ۗ وَلَا تَكْتُمُوا۟ ٱلشَّهَٰدَةَ ۚ وَمَن يَكْتُمْهَا
فَإِنَّهُۥٓ ءَاثِمٌ قَلْبُهُۥ ۗ وَٱللَّهُ بِمَا تَعْمَلُونَ عَلِيمٌ ﴿٢٨٣﴾

[4] *Surah al-Baqarah*, verse 275 (*Tafseer Ar-Rahman* interpretation of the meaning of the Qur'an).

"If you are on a journey (and then you wish to have a contract of debt with one another), but you cannot find a scribe (to write down the document), then let a pledge be taken in hand (by the one who provides the debt). But if any of you entrusts one another with a pledge (without a document of contract, witnesses or the pledged goods as security), let the one who is trusted fulfils his trust; and let him be mindful of Allah, his Lord. And let him (who stand as witnesses) to not conceal testimony, for whoever hides it is sinful at heart. And (remember) that Allah has full knowledge of all that you do".[5]

- The following *hadith* implies the general permissibility of *rahn*:

عَنْ عَائِشَةَ رَضِيَ اللَّهُ عَنْهَا أَنَّ النَّبِيَّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ اشْتَرَى طَعَامًا مِنْ يَهُودِيٍّ إِلَى أَجَلٍ وَرَهَنَهُ دِرْعًا مِنْ حَدِيدٍ.

Aishah RA narrated that the Prophet (peace be upon him) bought some food from a Jew on deferred payment, and he (peace be upon him) pledged his steel armour as security for it.[6]

The permissibility of combining several contracts in one product structure

- In general, the combination of several contracts in a master agreement is allowed based on the following *fiqh* maxim:

الأصل في المعاملات الإباحة, إلا ما دل الدليل على حرمته

According to the original method of ruling, mu`amalah is permissible, except when there is a provision prohibiting it.[7]

- The combination of contracts that are contingent upon each other is allowed provided that the objective of each contract is met and the combination of the contracts supports each other in achieving the main objective of combining each contract.[8]

Part V: Implication of SAC Ruling

- The proposed product structure is Shariah-compliant and is intended to replace the existing *ar-rahnu* product which is based on *qard* and *rahn* as its underlying contracts.

[5] *Surah al-Baqarah*, verse 283 (*Tafseer Ar-Rahman* interpretation of the meaning of the Qur'an).
[6] Al-Bukhari, *Sahih al-Bukhari, Dar Tawwaq al-Najah,* Lebanon, *j.3, h. 56, hadith no. 2068.*
[7] Ibn Uthaimin, *Al-Syarh al-Mumti` `ala Zad al-Mustaqni`*, Dar Ibni al-Jauzi, j. 8, h. 241.
[8] SAC at its 140th meeting on 28 October 2013 and its 166th meeting on 23 February 2016 ruled that the combination between several contracts that are contingent upon each other is permissible. This is subject to the condition that the combination does not:
  i. lead to the element of interest, uncertainty (*gharar*) and gambling (*maysir*);
  ii. result in any contradiction between the objectives of each contract (*muqtada `aqd*); and
  iii. lead to any element prohibited by Shariah.