BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Islamic Collateralised Funding
Exposure Draft

Applicable to:
1. Licensed Islamic banks
2. Licensed International Islamic banks
3. Licensed banks
4. Licensed investment banks
5. Prescribed institutions

Issued on: 2 October 2023

BNM/RH/ED 028-25

Islamic collateralised funding is imperative to the liquidity management in the Islamic Interbank Money Market (IIMM). This exposure draft (ED) outlines the proposed standards and guidelines in relation to Islamic financial instruments used in the IIMM comprising sell and buy back (SBBA) and collateralised commodity murabahah (CCM) transactions used to source and provide funding for liquidity management in the IIMM.

Bank Negara Malaysia invites written feedback on the proposals in this exposure draft. The written feedback should be supported with clear rationale, accompanying evidence or appropriate illustrations to facilitate an effective review of this exposure draft.

Responses must be submitted electronically to the Bank by 31 October 2023 to immu@bnm.gov.my.

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PART A OVERVIEW

1. Introduction

1.1 Islamic collateralised funding is imperative to the liquidity management in the Islamic Interbank Money Market (IIMM). In this regard, sell and buy back (SBBA) transaction and collateralised commodity *murabahah* (CCM) transaction are Islamic financial instruments used to source and provide funding for liquidity management in the IIMM.

1.2 This policy document aims to-

(a) set out the scope of an SBBA transaction and a CCM transaction that can be conducted by a banking institution participating in the IIMM;

(b) set out regulatory requirements and Bank Negara Malaysia's (the Bank) expectations in relation to an SBBA transaction or a CCM transaction entered into by a banking institution;

(c) promote sound risk management practices by a banking institution for the conduct of an SBBA transaction or a CCM transaction; and

(d) ensure compliance by a banking institution with Shariah principles when it enters into an SBBA transaction or CCM transaction.

2. Applicability

2.1. This policy document is applicable to a banking institution as defined in paragraph 5.2 who is participating in the IIMM where the banking institution enters into any of the following transactions as a principal:

(a) an SBBA transaction or a reverse SBBA transaction involving SBBA securities denominated in ringgit or foreign currency, including any outright sale or purchase of SBBA securities with an intention to repurchase or resell the SBBA securities at a future date and agreed price; or

(b) a CCM transaction or a reverse CCM transaction, including any pledge of CCM securities with an intention to repledge the CCM securities at a future date and agreed price,

where the substance of a transaction prevails over its form in determining whether a transaction is subject to this policy document.

2.2. Notwithstanding paragraph 2.1, this policy document does not apply when a transaction listed in paragraph 2.1 is entered into–

(a) by an overseas branch of a banking institution; or

(b) with the Bank.

3. Legal provisions

3.1 The requirements in this policy document are specified pursuant to-

(a) section 43 of the Central Bank of Malaysia Act 2009 (CBA);

(b) sections 57(1), 152(1), 155 and 156 of the Islamic Financial Services Act 2013 (IFSA);

(c) sections 47(1), 143 and 144 of the Financial Services Act 2013 (FSA); and

(d) sections 41 and 116 of the Development Financial Institutions Act 2002 (DFIA).

3.2 The guidance in this policy document is issued pursuant to section 277 of the IFSA, section 266 of the FSA and section 126 of the DFIA.

4. Effective date

4.1. This policy document comes into effect on 1 January 2024.

5. Interpretation

5.1 The terms and expressions in this policy document shall have the same meanings assigned to them in the CBA, IFSA, FSA and DFIA 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 interpretative, 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 recommendations that are encouraged to be adopted;

"**banking institution**" means–

(a) a licensed Islamic bank including a licensed international Islamic bank as defined under section 2(1) of the IFSA;

(b) a licensed bank or licensed investment bank as defined under section 2(1) of the FSA; or

(c) a prescribed institution as defined in section 3(1) of the DFIA;

"collateralised commodity *murabahah*" or **"CCM"** means an arrangement where

a CCM pledgor buys commodity from a CCM pledgee based on the Shariah principle of *murabahah* with deferred payment term, and the CCM pledgor pledges CCM securities as collateral for deferred payment obligation under the *murabahah* contract;

"**CCM pledgee"** means a party that sells commodity to a CCM pledgor through a *murabahah* contract and is provided with CCM securities as collateral for deferred payment obligation under the *murabahah* contract;

"CCM securities" means Shariah-compliant securities pledged by a CCM pledgor with a CCM pledgee as collateral for deferred payment obligation under the *murabahah* contract;

"CCM pledgor" means a party that buys commodity from a CCM pledgee through a *murabahah* contract and provides CCM securities as collateral for deferred payment obligation under the *murabahah* contract;

"non-resident" refers to-

(a) a non-resident as defined in section 213(1) of the FSA or 224(1) of the IFSA; or

(b) a person declared as a non-resident under section 214(6)(a) of the FSA or 225(6)(a) of the IFSA;

"original price" refers to the amount paid by an SBBA buyer to an SBBA seller as consideration for the purchase of SBBA securities under an SBBA transaction;

"principal" means a party to an SBBA transaction or a CCM transaction who acts on its own behalf or who authorises an agent to act on its behalf;

"profit rate" refers to-

(a) in the context of SBBA, an amount to be added to the original price in order to arrive at the sale price for which an SBBA buyer will sell back an SBBA Securities or its equivalent to an SBBA seller;

(b) in the context of CCM, an amount to be added to the cost price at which a CCM pledgee sources a commodity from the market to arrive at the sale price at which the CCM pledgee sells the commodity to a CCM pledgor,

expressed as a percentage per annum;

"RENTAS" means the Real-time Electronic Transfer of Funds and Securities System, which is a multi-currency real time gross settlement system for inter-bank funds transfer, a securities settlement system and a scripless securities depository for all unlisted debt instruments;

"RENTAS securities" means securities deposited under RENTAS;

"resident" refers to-

(a) a resident as defined in section 213(1) of the FSA or 224(1) of the IFSA; or

(b) a person declared as a resident under section 214(6)(a) of the FSA or 225(6)(a) of the IFSA;

"reverse CCM" means an arrangement where a CCM pledgee sells commodity to a CCM Pledgor based on Shariah principle of *murabahah* with deferred payment term, and the CCM pledgee is provided with CCM securities as collateral for deferred payment obligation under the *murabahah* contract;

"reverse SBBA" refers to an arrangement comprising separate transactions in the following sequence:

(a) an outright purchase of SBBA securities by an SBBA buyer from an SBBA seller at an original price;

(b) a promise, which may be in any of the following forms:

(i) a unilateral promise by the SBBA buyer to sell the same or equivalent SBBA securities to the SBBA seller on a future date at a sale price;

(ii) a unilateral promise by the SBBA seller to buy back the same or equivalent SBBA securities from the SBBA buyer on a future date at a sale price; or

(iii) a bilateral promise by the SBBA seller to buy back and by the SBBA buyer to sell the same or equivalent SBBA securities on a future date at a sale price; and

(c) an outright sale of the same or equivalent SBBA securities by the SBBA buyer to the SBBA seller;

"SBBA buyer" means the party who purchases SBBA securities and agrees/commits to sell back the same or equivalent SBBA securities on a certain date in the future at the original price plus the profit rate;

"SBBA securities" means underlying Shariah-compliant securities in an SBBA transaction;

"SBBA seller" means the party who sells SBBA securities for cash consideration and agrees/commits to buy back the same or equivalent SBBA securities on a certain date in the future at the original price plus the profit rate;

"sell and buy back" or **"SBBA"** refers to an arrangement comprising separate transactions in the following sequence:

(a) an outright sale of SBBA securities by an SBBA seller to an SBBA buyer at an original price;

(b) a promise, which may be in any of the following forms:

(i) a unilateral promiseby the SBBA seller to buy back the same or equivalent SBBA securities from the SBBA buyer on a future date at a sale price;

(ii) a unilateral promise by the SBBA buyer to sell the same or equivalent SBBA securities to the SBBA seller on a future date at a sale price; or

(iii) a bilateral promise by the SBBA buyer to sell and by the SBBA seller to buy back the same or equivalent SBBA securities on a future date at a sale price; and

(c) an outright purchase of the same or equivalent SBBA securities by the SBBA seller from the SBBA buyer; and

"Shariah-compliant securities" means securities issued in accordance with Shariah;

6. Related legal instruments and policy documents

6.1. This policy document shall be read together with other policy documents, guidelines and instruments issued by the Bank, in particular-

(a) Capital Adequacy Framework (Basel II – Risk Weighted Assets) for Islamic banks issued on 3 May 2019;

(b) Capital Adequacy Framework (Basel II – Risk-Weighted Assets) issued on 3 May 2019;

(c) Capital Framework for Development Financial Institutions issued on 9 April 2014.

(d) Code of Conduct for Malaysia Wholesale Financial Markets issued on 31 December 2021;

(e) Foreign Exchange Policy Notices issued on 1 June 2022;

(f) *Murabahah* issued on 23 December 2013;

(g) Net Stable Funding Ratio issued on 31 July 2019;

(h) Principles for a Fair and Effective Financial Market for the Malaysian Financial Market issued on 17 October 2017;

(i) *Rahn* issued on 18 July 2018;

(j) Single Counterparty Exposure Limit for Islamic banking institutions issued on 9 July 2014;

(k) Single Counterparty Exposure Limit issued on 9 July 2014;

(l) STATsmart Reporting Requirements on Data Submission for Reporting Entities issued on 29 March 2019; and

(m) *Tawarruq* issued on 28 December 2018.

(n) Any other relevant legal instruments and policy documents issued pursuant to the laws administered by the Bank from time to time.

7. Policy document superseded

7.1. This policy document supersedes the Guidance Notes on Sell and Buy Back Agreement (BNM/RH/GL/007-7) issued on 28 June 2013.

PART B POLICY REQUIREMENTS

8. General requirements

S 8.1. The conduct of an SBBA transaction or a CCM transaction must be in line with the principle of professionalism and integrity, as outlined under Principles for a Fair and Effective Financial Market for the Malaysian Financial Market issued by the Bank in order for the SBBA market and CCM market to operate in a sound and orderly manner.

S 8.2. A banking institution shall not in any circumstances enter into an SBBA transaction or a CCM transaction which limit the availability of SBBA securities or CCM securities with intention of creating a false or misrepresented market in SBBA, CCM, SBBA securities or CCM securities.

S 8.3 For SBBA, a banking institution shall ensure that the legal ownership of the SBBA securities sold under an SBBA or reverse SBBA shall be transferred to the purchaser of the SBBA securities.

G 8.4 For CCM, the CCM securities pledged by a CCM pledgor under a CCM transaction may be transferred to the CCM pledgee.

S 8.5 A banking institution shall ensure that the maximum tenure of an SBBA transaction or a CCM transaction does not exceed five (5) years.

G 8.6 The standard lot for an interbank SBBA transaction or a CCM transaction involving ringgit is Ringgit Malaysia Ten (10) million. An SBBA transaction or a CCM transaction involving foreign currency may be based on the standard lot or minimum market lots practised in the relevant markets of such foreign currency. A banking institution that wishes to transact an SBBA transaction or a CCM transaction for an amount which is different from the standard lot or minimum market lots may specify the amount when requesting for, or providing, quotes.

S 8.7 Prior to undertaking an SBBA transaction or a CCM transaction, a banking institution shall ensure the following:

(a) only dealers duly authorised by the banking institution can undertake an SBBA transaction or a CCM transaction;

(b) a list of authorised dealers is maintained and updated from time to time;

(c) policies, procedures and internal controls are established to ensure that any SBBA transaction or CCM transaction including selection of underlying SBBA securities or CCM securities have been properly authorised; and

(d) infrastructures are put in place to support the SBBA transaction or CCM transaction including systems for securities valuation and management, credit control, risk management and record keeping purposes.

9. Legal documentation

S 9.1. A banking institution shall ensure every SBBA transaction or CCM transaction is governed by a written agreement (the "Agreement") that specifies all the terms and conditions of the SBBA transaction or CCM transaction and the duties and obligations between the parties.

S 9.2. At minimum, the Agreement shall provide for-

(a) in the case of an SBBA transaction, the absolute transfer of the legal title of the SBBA securities from the seller to the buyer including any security transferred through substitution or mark-to-market adjustment;

(b) marking-to-market of transactions;

(c) use of risk management tools including haircut and margin maintenance, where relevant;

(d) events of default and the consequential rights and obligations of the parties to the transactions including provision on close-out netting;

(e) full set off of claims between the parties to the transaction in the event of default;

(f) the rights of the parties regarding substitution of SBBA securities and CCM securities and the treatment of coupon payments in respect of the SBBA securities and CCM securities subject to it,including for example, the timing of payments; and

(g) the governing law of the Agreement as agreed between the parties.

G 9.3 For SBBA and Reverse SBBA it is recommended for banking institution to adopt bilateral promise.

10. Risk management

S 10.1. A banking institution shall establish a risk management framework which enables identification, measurement and continuous monitoring of all relevant and material risks arising from all SBBA transactions or CCM transactions, taking into account their financial capacity to assume such risks prior to entering into a SBBA transaction or CCM transaction.

S 10.2. A banking institution shall formulate and implement risk management measures to address risks arising out of an SBBA transaction or a CCM transaction. These measures must include counterparty credit assessment, net counterparty exposure limits and adoption of risk mitigation techniques which involve the use of prudent haircuts, margin maintenance and timely margin call to maintain effective control of risk exposure.

11. Foreign exchange policy

S 11.1. An SBBA transaction or a CCM transaction carried out by a banking institution must be in compliance with the prevailing foreign exchange policy on borrowing and lending by resident and non-resident.

S 11.2. A banking institution involved in the hedging of Ringgit-denominated SBBA securities or CCM securities arising from an SBBA transaction or a CCM transaction must comply with the prevailing foreign exchange policy on buying and selling of foreign currency against the ringgit.

G 11.3. The Foreign Exchange Policy Notices issued by the Bank are available on the Bank's website at bnm.gov.my/fep

12. Reporting and settlement requirements

S 12.1. For an SBBA transaction or a CCM transaction involving RENTAS securities, a banking institution shall report to Bursa Malaysia Electronic Trading Platform.

S 12.2. For an SBBA transaction or a CCM transaction involving RENTAS securities as collateral, collateral for substitution or margin transfer, such transactions shall be settled through RENTAS.

S 12.3. For both RENTAS and non-RENTAS securities, a banking institution shall disclose the details of the SBBA transaction or CCM transaction in the Bank's Statistical Mart for Analysis and Reporting (STATsmart).