



**BANK NEGARA MALAYSIA**  
CENTRAL BANK OF MALAYSIA

***Ijarah***

Concept Paper

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As part of the objectives to strengthen the Shariah-compliance practices among Islamic financial institutions (IFIs), Bank Negara Malaysia (the Bank) is developing a Shariah-based regulatory policy with the objective to provide a comprehensive guidance to the Islamic financial industry to enhance end-to-end compliance with Shariah and therefore, ensure the integrity and sustainability of the IFI. This Shariah-based regulatory policy consists of two components, namely the Shariah requirements and operational requirements. The Shariah requirements highlight the salient features and essential conditions of specific Shariah contracts to facilitate sound understanding of a particular contract by the IFI. The operational requirements set out the expectations with respect to governance and oversight, structuring, risk management, business and market conduct, and financial disclosures.

This Concept Paper (CP) provides both the Shariah and operational requirements for *ijarah* contract. Whilst the Shariah requirements stipulated in **Part B** serves as reference to facilitate in providing feedback and comments, the Bank invites written feedback and comments only on the operational requirements of *ijarah* contract under **Part C** and **D**, including suggestions for particular issues/areas to be clarified/elaborated further and any alternative proposals that the Bank should consider. The feedback must be supported with clear rationale, accompanying evidence or illustration, as appropriate to facilitate effective review of this CP.

#### Additional instruction for IFI

In addition to providing general feedback, IFI are required to respond to the specific questions set out throughout this CP.

Please respond to the Bank by **25 July 2014** addressed to:

Pengarah  
Jabatan Perbankan Islam dan Takaful  
Bank Negara Malaysia  
Jalan Dato' Onn  
50480 Kuala Lumpur

Any queries may be directed to:  
Nurmastuji Abd. Malek: [nurmas@bnm.gov.my](mailto:nurmas@bnm.gov.my)

Khadijah Riza Atiq: [khadijah@bnm.gov.my](mailto:khadijah@bnm.gov.my)  
Suhana Alia Sidek: [suhanaalia@bnm.gov.my](mailto:suhanaalia@bnm.gov.my)

## PART A OVERVIEW

### 1. Introduction

- 1.1 Compliance with Shariah requirements is a prerequisite for legitimate Islamic financial products and services. Therefore, it is essential for IFI to establish the necessary operational framework and infrastructure in ensuring the conduct of Islamic financial transactions is consistent with Shariah. In this regard, the IFI must ensure that the entire intermediation process is carried out holistically with good governance, prudent and transparent manner. This will ensure that the integrity of Islamic finance transactions continues to be preserved and sustained.
- 1.2 One of the Shariah contracts applied by the IFI is *ijarah*. *Ijarah* is a type of “lease” that literally means “to compensate” and “to give something on rent”. Technically, *ijarah* is a contract of transfer of ownership of usufruct or service in exchange for a specified consideration. The primary objective of lease is to facilitate a lessee who does not intend to own certain assets but need to use and benefit from the utilisation of the assets against payment of certain agreed rental to the lessor.
- 1.3 In the context of Islamic financial transaction, the IFI, as the owner of the asset and usufruct, leases or transfers the usufruct of the asset for an agreed rental amount and at a specified period to the customer who is the lessee. Under the primary *ijarah* structure, the customer does not intend to own the asset but only wants to benefit from the asset. As such, at the end of lease period, the asset remains with the IFI as the lessor.
- 1.4 *Ijarah* can also be structured as a financing tool to allow customers to acquire their assets through a lease, instead of outright purchase. For this, *ijarah* would be structured with supporting arrangements and/or other contracts to finance a customer who intends to own an asset upon completion of lease period. The intention to own asset is usually reflected via a *wa’d* (promise) arrangement to purchase asset by customer upon maturity or early

termination of *ijarah* contract. For asset ownership transfer, it is reflected via an arrangement with other contracts for example *hibah* (gift) or *bai'* (sale) of the asset from the IFI to the customer. This arrangement is typically known as "*ijarah* financing".

- 1.5 In terms of risk profiling, the execution of *ijarah* would expose IFI to several types of risks depending on the *ijarah* structure. Risks inherent in *ijarah* primary structure include the operational risk arising from the asset ownership, for example maintenance costs related to 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. For *ijarah* financing, except that IFI exposes to the credit risk on the potential failure of the customer to pay the rental instalments, the other risks can be mitigated given that there is a commitment from the customer to purchase the asset and the asset will be owned by the customer eventually upon financing maturity that enable the IFI to shift ownership risk to the customer.
- 1.6 As such, it is pertinent for IFI to make an assessment on the suitability of the types of *ijarah* structure to be applied given that each *ijarah* structure will have different risk and return profiles corresponding to the degree of responsibilities and level of risk borne by IFI and customer. This would also entail IFI to establish holistic and robust financial infrastructures to support effective implementation of *ijarah* transactions, management of the risks exposures and the processes associated in accordance with the *ijarah* structure applied.

## **2. Policy objective**

- 2.1 This policy document–
- (a) provides the Shariah rulings associated with *ijarah* contract, including the Shariah rulings on the basis for *ijarah* contract as stipulated in Appendix 1;
  - (b) sets out key operational requirements with regard to the implementation

of *ijarah* contract; and

- (c) promotes end-to-end compliance with Shariah requirements and ensures sound banking practices and consumer protection measures are implemented throughout the life cycle of *ijarah* contract.

### 3. Scope of policy document

- 3.1 This CP applies to all products and services structured using the *ijarah* contract other than capital market instruments<sup>1</sup>.
- 3.2 Part B outlines Shariah requirements of *ijarah* and its optional practices to be observed by the IFIs to ensure legitimacy of *ijarah* contracts. Shariah requirements generally provide the nature of *ijarah* that transfers ownership of both **usufruct** and **service**. However, the requirements on the *ijarah* components under part B are relevant for *ijarah* that transfer the usufruct of a particular asset only.
- 3.3 Part C and D complement Part B and the relevant existing regulatory framework on risk management, capital adequacy and governance issued by the Bank. It describes five key principles for sound management and operationalisation of *ijarah* and *ijarah* financing as follows:
- (a) **Principle 1:** IFI must establish proper oversight arrangements to support *ijarah* activities that are in line with Shariah requirements and sound practices, including appropriate governance structure, comprehensive internal controls as well as policies and procedures;
  - (b) **Principle 2:** IFI must ensure the structuring and implementation of *ijarah* is supported by holistic processes and procedures, comprehensive legal documentation and adequate systems in accordance with Shariah and sound practices;
  - (c) **Principle 3:** IFI is required to institute and implement sound and integrated risk management framework to effectively manage risks in line with IFI's risk appetite throughout the life cycle of *ijarah* i.e. pre-

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<sup>1</sup> Under the purview of Securities Commission



contractual, throughout and exit from *ijarah*;

- (d) **Principle 4:** IFI shall provide adequate information to ensure fair dealings/treatment of consumers and provide meaningful disclosures to assist consumers in making informed decisions with regards to *ijarah* transactions; and
- (e) **Principle 5:** IFI shall provide adequate information to assist stakeholders' understanding and assessment of *ijarah* transactions.

#### 4. Applicability

- 4.1 This policy document is applicable to all IFI as defined in paragraph 7.2.
- 4.2 Part B of this policy document shall also apply to a licensed takaful operator under the IFSA<sup>2</sup>.

#### 5. Legal provisions

- 5.1 The requirements in this policy document:
  - (a) are specified pursuant to sections 29 (1) and (2), 57(1) and 135(1) of the Islamic Financial Services Act 2013 (IFSA) and sections 41 and 126 of the Development Financial Institutions Act 2002 (DFIA); and
  - (b) constitute a direction under section 129(3) of DFIA.

#### 6. Effective date

- 6.1 This policy document shall come into effect upon issuance of the final document.

#### 7. Interpretation

- 7.1 The terms and expressions used in this policy document shall have the same meanings assigned to them in the IFSA and DFIA, as the case may be, unless otherwise defined in this policy document.

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<sup>2</sup> For avoidance of doubt, Part C and D are not applicable to a licensed takaful operator.

7.2 For the purposes 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; and

“**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**” or “**IFI**” means:

- (a) licensed Islamic banks under the IFSA;
- (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.

7.3 Further interpretation and definition is given in Appendix 2.

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

8.1 This policy document must be read together with but not limited to such Shariah rulings and policy documents listed in Appendix 3.

## **PART B SHARIAH REQUIREMENTS AND OPTIONAL PRACTICES**

### **9. Definition**

- S** 9.1 *Ijarah* refers to a contract that transfers ownership of a permitted usufruct and/or service for a specified period in exchange for a specified consideration.

### **10. Nature**

- S** 10.1 The specific inherent nature of the contract of *ijarah* is the transfer of ownership of usufruct; or rendering service in exchange for specified consideration.
- G** 10.2 *Ijarah* is categorised as follows:
- (a) a lease contract to transfer the usufruct of a particular asset to another person in exchange for a rental; and
  - (b) a hire contract to employ a person with wages paid to him as a consideration for his services.<sup>3</sup>
- G** 10.3 In relation to paragraph 10.2(a), a leased asset may be categorised as follows:
- (a) the asset is in existence at the point of execution of the contract; or
  - (b) the asset is to be made available at a future agreed date, based on agreed specifications. This is known as *ijarah mawsufah fi zimmah*.
- S** 10.4 *Ijarah* is a binding contract which shall not be terminated unilaterally by any of the contracting parties.

## **COMPONENTS OF IJARAH**

### **11. Contracting parties**

- S** 11.1 In an *ijarah* contract, there shall be a lessor and a lessee (collectively referred to as “contracting parties”) who shall have the legal capacity<sup>4</sup> to enter into the *ijarah* contract.

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<sup>3</sup> This category of *ijarah* is not covered in this document.

- G** 11.2 The contracting parties in *ijarah* contract may be a natural person or a legal entity.
- G** 11.3 A party to *ijarah* contract may conclude the contract through an agent.
- G** 11.4 The contracting parties in *ijarah* contract may involve more than one lessor or lessee.
- S** 11.5 In relation to paragraph 11.4, if an undividable asset is owned by more than one owner, consent of all owners is required before the asset is leased.

## **12. Offer and acceptance**

- S** 12.1 An *ijarah* contract shall be concluded by an offer and acceptance between the contracting parties.
- G** 12.2 The offer and acceptance may be expressed by appropriate documentation or by any other methods which do not contravene Shariah principles.
- S** 12.3 Any term or condition mutually agreed upon, which does not contravene the Shariah principles, shall be binding on the contracting parties.

## **13. Asset and usufruct**

- S** 13.1 The asset and usufruct in *ijarah* contract shall be those recognised by the Shariah, valuable, in existence, identifiable, accessible and deliverable.
- S** 13.2 The asset and usufruct shall be owned by the lessor.
- S** 13.3 If the usufruct is inaccessible within lease period, the *ijarah* contract is

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<sup>4</sup> 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.

voidable.

- G** 13.4 Pursuant to paragraph 13.3, the lessee has the option of either to terminate the contract or to request for a replacement of the leased asset.
- S** 13.5 Notwithstanding paragraph 13.1, the requirements for the leased asset to be in existence at the time of execution of contract shall not be applicable for *ijarah mawsufah fi zimmah*.
- G** 13.6 Pursuant to paragraph 13.5, the lessor may appoint the lessee or any third party as agent to acquire the asset to be leased.
- G** 13.7 The asset in *ijarah* contract may be:
- (a) physical/tangible assets such as buildings, vehicles and machines; or
  - (b) non-physical/ intangible assets such as trademark, patent and other forms of intellectual property.
- S** 13.8 In relation to paragraph 13.7(a), the tangible asset may be movable or immovable but shall be non-perishable.
- S** 13.9 Asset in *ijarah* contract shall not include an asset which is debt in nature.
- S** 13.10 An asset shall not be leased in two or more *ijarah* contracts simultaneously.
- S** 13.11 Any defect in the asset discovered by the lessee after execution of the contract shall entitle the lessee to the defect option (*khiyar `ayb*).
- S** 13.12 Notwithstanding paragraph 13.11, in the event the lessee consented to any defect discovered in the asset at the time of execution of the contract, the lessee shall not be entitled to the defect option provided that the defect does not totally eliminate the usufruct.
- G** 13.13 The lessor may sell the leased asset to a third party without obtaining

permission of the lessee during the lease period, unless agreed otherwise.

- G** 13.14 In the event the leased asset is sold to a third party during the lease period, all rights and liabilities of the lessor are thereby transferred to the third party. In the case where the third party was not informed of the existing lease agreement on the asset prior to the execution of such a sale, the third party may rescind the sale contract.

## **14. Rental**

- S** 14.1 The rental shall be determined and agreed at the point of execution of the *ijarah* contract.
- G** 14.2 The rental may be paid according to the agreement by the contracting parties such as by instalments or lump sum.
- G** 14.3 The rental may be in the form of monetary terms or in kind as agreed by the contracting parties.
- G** 14.4 The rental may be determined by fixed amount, specified benchmark or specified formula or combination of both, as agreed by the contracting parties.
- S** 14.5 In the case where the rental is determined by a specified benchmark or specific formula:
- (a) the amount of rental for the first period shall be specified and the rental for the following period may be determined based on the agreed benchmark or formula; and
  - (b) the determination of rental based on the agreed benchmark or formula shall be subject to minimum and maximum limit.
- S** 14.6 The lessor shall not increase the rental unilaterally.
- G** 14.7 The contracting parties may agree to amend the rental of a future period.
- G** 14.8 The rental may be received in advance and may be utilized by the lessor.

- S** 14.9 In the case of non-delivery of the leased asset, the lessor shall refund the rental to the lessee.
- S** 14.10 The lessee shall ensure the payment of rental be made timely, promptly and in accordance with the agreed method. Any outstanding rental arising from non-payment shall be deemed as debt due from the lessee.
- G** 14.11 In the event the lessor fails to deliver the usufruct of the leased asset to the lessee on the agreed date, no rental is due for the period between the contract date and the date of actual delivery and:
- (a) the rental shall be reduced accordingly; or
  - (b) the lease shall be extended by an equivalent period after its original expiry date.
- G** 14.12 If the lessee ceases to utilize the leased asset and returns it to the owner without the latter's consent, the lessor shall have the right to demand the rental until the end of the lease period. During the remaining period, the lessor shall not be allowed to lease the asset to another party.

## **MANAGEMENT OF *IJARAH***

### **15. Utilisation of the leased asset**

- S** 15.1 The lessee shall use the asset for the purpose as agreed by the contracting parties provided it does not contravene Shariah principles.
- G** 15.2 Where the agreement does not specify the purpose of the lease, the lessee may use the asset for any permissible purpose in accordance with the customary practice (*'urf*) of the market.
- S** 15.3 The lessee shall obtain permission from the lessor if the leased asset is to be used for permissible purposes other than its common utilisation according to the customary practice.

### **16. Rights and liabilities**

- 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 Any risk associated to the ownership of the leased asset shall be assumed by the lessor including any loss or impairment relating to the leased asset.
- S** 16.3 In relation to paragraph 16.1, any expenses incurred to maintain the availability and accessibility of the usufruct of the leased asset shall be borne by the lessor.
- G** 16.4 The lessor may mitigate other specific risks relating to physical damage, theft and/or loss or destruction of the leased asset by participating in takaful.
- G** 16.5 Notwithstanding paragraphs 16.1 and 16.3, the lessor may appoint the lessee to maintain the asset and/or to participate in takaful coverage.
- S** 16.6 Where the lesser appoints the lessee to maintain the asset and/or participate in takaful coverage, all costs incurred for such maintenance shall be reimbursed by the lessor pursuant to any claim made by the lessee.
- G** 16.7 Notwithstanding paragraph 16.5 and 16.6, and subject to the terms of *ijarah* contract, the parties may mutually agree on whom the cost of maintenance and takaful coverage of the leased asset to be borne subject to the terms of *ijarah* contract.
- S** 16.8 The lessee shall not be held liable for any loss or impairment of the leased asset unless such loss or impairment is due to the lessee's misconduct (*ta`addi*), negligence (*taqsir*) or breach of specified terms (*mukhalafah syurut*).
- S** 16.9 Pursuant to paragraph 16.8 the lessee shall be held liable unless he proves that there is no misconduct, negligence or breach of specified terms on his part that resulted to such loss or impairment.
- S** 16.10 In case where the lessee fails to prove his innocence, the lessee is



responsible for restoring the asset and bears such cost including the rental payable during the restoration period.

- G** 16.11 Notwithstanding paragraph 16.8 and 16.9, if the usufruct of the leased asset is partially impaired as a result of a natural cause or other reasons and there is no negligence on the part of the lessee, the lessor or any third party shall be responsible for restoring the usufruct and bearing such cost.

## **17. Lease period**

- S** 17.1 The period of *ijarah* contract shall be agreed and specified by the contracting parties upon the execution of the contract.
- G** 17.2 Notwithstanding paragraph 17.1, the lessor and lessee may mutually agree to amend the period of *ijarah*.
- S** 17.3 The lease period shall effectively commence from the time the lessee has the access to the usufruct of the leased asset, regardless of whether the lessee has actually utilised the asset.

## **ARRANGEMENT OF SUB-LEASE AND LEASE BACK**

### **18. Sub-lease**

- G** 18.1 A lessee may sub-lease the leased asset to a third party unless it is stated otherwise in the primary *ijarah* contract.
- S** 18.2 The sub-lease shall be valid for the period not exceeding the tenure of the primary *ijarah* contract.
- G** 18.3 The lessee may enter into a sub-lease contract with a third party for a rental that is either the same amount, higher or lower, payable on the spot or on a deferred basis as agreed in the terms of the contract.

### **19. Lease and lease back**

- G** 19.1 The lessee may lease back the leased asset to the lessor at any rental rate provided that the two *ijarah* contracts are separate and independent.
- S** 19.2 In relation to paragraph 19.1, the tenure of the subsequent *ijarah* contract shall be equal or shorter than the preceding *ijarah* contract.

## ARRANGEMENT OF *IJARAH* IN THE FUTURE

### 20. Arrangement of *ijarah* in future

- G** 20.1 Arrangement of *ijarah* in future can be in two forms:
- (a) a contract that transfers ownership of a usufruct for a specified duration in the future based on agreed specification where the asset does not exist at the time of entering the contract (*jarah mawsufah fi zimmah*); and
  - (b) a lease of an existing asset whereby the lessee and the lessor, have agreed at the time of entering the contract, that the delivery of the usufruct of the leased asset will take effect at an agreed specified future date (*ijarah mudhafah ila mustaqbal*).
- G** 20.2 The rental may be paid according to the agreement such as in advance, by instalments or lump sum.
- S** 20.3 The leased asset shall be delivered to the lessee on the specified date for a specified duration as agreed in the contract.
- S** 20.4 In the event that the asset is not delivered within the agreed time, the lessee shall have the option to terminate or to continue the contract with or without new terms.
- S** 20.5 Pursuant to paragraph 20.1(a), in the event that the delivered asset does not meet the specification, the lessee shall have the option to terminate or continue the contract.
- G** 20.6 Pursuant to paragraph 20.4, if the lessee decides to continue with the contract, he may request for a replacement of the asset or negotiate the new

terms of contract.

- S** 20.7 In the event that the asset is not delivered and the lessee decided to terminate the contract, the advance rental shall be returned to the lessee.
- S** 20.8 Pursuant to paragraph 20.5, in the event the contracting parties agree to enter into any other *ijarah* contract subsequent to *ijarah mawsufah fi zimmah*, the commencement of the subsequent *ijarah* contract shall take effect after the specified duration to satisfy the delivery of usufruct to the lessee.

## ARRANGEMENT OF *IJARAH* WITH OTHER CONTRACT OR CONCEPT

### 21. Sale and lease

- G** 21.1 A party may sell an asset to another party and subsequently lease the asset from the latter.
- S** 21.2 Pursuant to paragraph 21.1, both the sale and *ijarah* contracts shall be executed separately in accordance to the correct sequence.
- S** 21.3 The *ijarah* contract shall not be stipulated as a condition of the sale contract.

### 22. *Ijarah Muntahiyah bi Tamlik*

- S** 22.1 *Ijarah muntahiyah bi tamlik* is an *ijarah* contract that is accompanied with an option to transfer the ownership of the leased asset to the lessee at the end of the lease period.
- S** 22.2 The transfer of ownership of the leased asset shall take place as follows:-
- (a) where the transfer is by way of sale, the sale contract shall be executed separately after the expiry or termination of the *ijarah* contract;
  - (b) where the transfer is by way of conditional *hibah*, the transfer shall be effective once the condition is fulfilled; or
  - (c) where the transfer is by way of promise to *hibah*, the *hibah* shall be executed after the expiry of *ijarah* contract.

- S** 22.3 Pursuant to paragraph 22.2, the arrangement of the contracts shall be executed according to the correct sequence.
- G** 22.4 The lessor, at the inception of the contract may request the lessee to give a binding promise (*wa`d mulzim*) to purchase the asset upon default or breach of *ijarah* contract that lead to termination of the contract.
- G** 22.5 Lessor and lessee may agree on a specific method of price calculation in the case where the leased asset is acquired prior to the expiry of the lease period.
- G** 22.6 Subject to agreement between the parties, in the event when the lessee decides to discontinue the lease, he may transfer his rights and liabilities to another party who will continue the lease and will ultimately own the asset
- G** 22.7 Pursuant to paragraph 22.6, in the event where the lessee (promisor) breaches his promise to purchase the asset upon default or breach of *ijarah* contract that leads to termination of the contract, the lessor (promisee) may sell the asset to a third party as per agreed terms and conditions.
- G** 22.8 Pursuant to paragraph 22.6, in the event the promisor fails to perform his *wa`d* upon invocation by the promisee and the promisee sells the asset to a third party, the promisee may claim the difference between the promised purchase price and the actual sale price.
- G** 22.9 The sale of the leased asset to a third party may be conducted based on the following approaches:

#### **Approach 1**

- (a) The promisee invokes the promise to purchase and where the promisor fails to perform the promise, the promisee may sell the asset to a third party as per the agreement.
- (b) The proceeds of the sale shall be used to settle the promised purchase price of the leased asset based on an agreed price which may include rental due (if any) and costs related to liquidation.

- (c) In the event where the proceeds is inadequate to meet the claim under paragraph (b), the promisee may demand the remaining difference from the promisor.
- (d) The promisee may claim the rental due (if any) from the promisor if it is not included in the price calculation under paragraph (b).

### **Approach 2**

- (a) The promisee may invoke the promise to purchase and where the promisor fails to perform the promise, the promisee may subsequently sell the leased asset to the promisor on credit based on agreed price by both parties.
- (b) The promisee may take the asset as collateral to secure the payments of the purchase price as agreed under paragraph (a).
- (c) In the case where the promisee as the creditor liquidates the collateral, the following may be applied:
  - (i) the promisee may claim the rental due, the purchase price as agreed in the promise to purchase and costs related to liquidation of the collateral.
  - (ii) in the event where the proceeds from the liquidation of the collateral is inadequate to meet the claim under paragraph (i), the promisee as creditor may demand the remaining difference from the promisor.
  - (iii) if there is any excess amount from the proceeds of the collateral liquidation after the deduction of claims under paragraph (i), the excess amount shall belong to promisor.

- G** 22.10 The contracting parties are free from any contractual obligations upon;
- (a) completion of the transfer of ownership of the leased asset to the lessee at the end of the lease period; or
  - (b) fulfilment of all consequential obligations arising from default or breach of *ijarah* contract that lead to termination of the contract.

## **23. *Ijarah with istisna'***

- G** 23.1 The contracting parties under *ijarah mawsufah fi zimmah* may enter into an *istisna'* contract whereby the lessor may request the lessee to construct the future leased asset.
- S** 23.2 The contract of *ijarah mawsufah fi zimmah* shall be executed separately from the *istisna'* contract.

#### **24. *Ijarah with wa`d***

- G** 24.1 The arrangement of *ijarah with wa`d* may include the following;
- (a) a person promises to lease an asset from the owner upon latter's acquisition of the asset;
  - (b) the lessor promises to give the leased asset as *hibah* contingent upon an agreed event;
  - (c) the lessor promises to sell the leased asset to the lessee at a mutually agreed price upon early settlement or expiry of lease period; or
  - (d) the lessee promises to purchase the asset upon default in rental payment or breach of specified *ijarah* terms that lead to termination of the contract.
- G** 24.2 Pursuant to paragraph 24.1 (c) and (d), the purchase price may be the market value, fair value, face value or based on mutual agreement.
- S** 24.3 The *ijarah* contract shall be executed separately and independently from *wa`d*.
- G** 24.4 Pursuant to paragraph 24.3, the *wa`d* may be incorporated in other legal document such as:
- (a) a master agreement provided that the master agreement does not carry the effect of *ijarah* contract; or
  - (b) a stand-alone document.
- S** 24.5 The promisor who has promised to lease and take delivery of the asset but refused to enter into the *ijarah* contract upon the promisee's purchase of the asset as per the agreed terms shall be held liable for breach of *wa`d*.

- S** 24.6 Pursuant to paragraph 24.5, the promisor shall compensate the promisee 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).

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

- G** 25.1 For the purpose of assurances, *ijarah* contract may be arranged with other contracts or concepts such as *kafalah*, takaful coverage, *rahn*, security deposit (*hamish jiddiyah*), or earnest money (*`urbun*).

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

- G** 25.2 A guarantee (*kafalah*) may be arranged to secure the rental payment due.

### **b) Assurance of *ijarah* through *rahn***

- G** 25.3 A *rahn* may be arranged to secure the rental payment due.

- G** 25.4 Notwithstanding paragraph 25.3, the contracting parties may agree to include the following claims from the collateral:

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

- S** 25.5 Collateral (*marhun*) in an *ijarah* contract (if any) shall be a Shariah-compliant asset.

- G** 25.6 Notwithstanding paragraph 25.5, an 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.

### **c) Assurance of *ijarah* through *hamish jiddiyah***

- G** 25.7 The lessor may require the lessee to place a security deposit to secure the *wa`d* to lease the asset.

- G** 25.8 The security deposit may be used to compensate against actual loss incurred in the event the lessee breaches the *wa`d* to lease the asset.
- S** 25.9 Pursuant to paragraph 25.8, the lessor shall only claim up to the actual loss and the excess portion of the security deposit after compensation against actual losses shall be returned to the lessee.
- G** 25.10 Upon execution of *ijarah* contract, the security deposit may be treated as part of the payment of the agreed rental for the *ijarah* contract.
- S** 25.11 In the event that the security deposit is not treated as part of the payment of the *ijarah* rental, it shall be returned to the lessee.

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

- G** 25.12 Upon execution of the *ijarah* contract, the lessee may place earnest money with the lessor, and the lessee is given a specified time period to continue or terminate the contract.
- S** 25.13 In the event the lessee does not exercise the option to continue the contract within the specified time, the *ijarah* contract is terminated and the earnest money is forfeited.

**e) Arrangement of *ijarah* with *ta`widh* and/or *gharamah***

- G** 25.14 The contracting parties may agree to include a clause in the *ijarah* contract stipulating late payment charges as determined by the relevant authorities.
- S** 25.15 Pursuant to paragraph 25.14, the late payment charges shall consist of:
- (a) compensation (*ta`widh*) for actual loss borne by the lessor, which may be recognised as income to the lessor; and/or
  - (b) penalty (*gharamah*), which shall not be recognised as income. Instead, it shall be channelled to charitable bodies.

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



## **26. Dissolution of *ijarah***

- S** 26.1 An *ijarah* contract is dissolved under the following circumstances:
- (a) mutual agreement by the contracting parties to terminate the contract;
  - (b) any of the contracting parties exercises the mutually agreed options to terminate the *ijarah* contract within the agreed time period;
  - (c) the lessee in an *ijarah* contract with earnest money (*`urbun*) does not exercise the option to continue the contract within the specified time; or
  - (d) total destruction of the leased asset.
- S** 26.2 With the exception of paragraph 26.1(c), upon dissolution of the *ijarah* contract, the asset shall be returned to the lessor and any advance rental paid shall be returned to the lessee.
- G** 26.3 The demise of the either of the contracting parties of an *ijarah* contract does not dissolve the *ijarah* contract: the legal heirs may exercise the right to continue the contract or otherwise.

## **27. Completion of *Ijarah***

- S** 27.1 The *ijarah* contract shall complete upon the expiry of lease period and payment of all rental obligations.
- S** 27.2 Upon completion of the *ijarah* contract, the contracting parties shall be free from any contractual obligations.

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

### **28. Introduction**

- 28.1 The regulatory expectations set out in Part C emphasize on instituting effective policies and procedures to facilitate governance and oversight function, structuring, risk management, information disclosure as well as consumer and market conduct for *ijarah* financing. The policy intent of these operational requirements is to provide adequate safeguard to stakeholders' interest, promote orderly implementation of business and risk management strategies and drive the development of necessary systems, processes and control measures while preserving the Shariah requirements.
- 28.2 IFI may adopt existing governance and oversight structure, policy on product structuring, risk management, disclosure and reporting as well as consumer and market conduct requirements that are in line with the expectations for *ijarah* financing transaction. Specifications under Part C are additional requirements for *ijarah* financing to address the peculiarities arising from the usage of additional contracts or concepts to transfer the ownership of *ijarah* asset after the *ijarah* has ended.

### **29. Governance and oversight**

- S** 29.1 The Board of Directors (the Board) shall ensure sufficient oversight arrangements for *ijarah* financing which include setting business strategies and risk appetite, and approving policies and procedures and internal controls, to ensure that the application of *ijarah* financing is conducted with sound practices and comply with Shariah. The adequacy of governance structure shall commensurate with the nature, complexity and risk profile associated with *ijarah* financing activities.

- G** 29.2 Pursuant to paragraph 29.1, the IFI is allowed to utilise existing governance structure<sup>5</sup> for the application of *ijarah* financing should the oversight arrangements embedded in the existing governance structure sufficiently address the inherent risks of *ijarah* financing, including Shariah non-compliance risk.
- S** 29.3 Pursuant to paragraph 29.2, the Shariah Committee (SC) is additionally expected to:
- (a) ensure fair rights and obligations between the IFI and customer are specified in the relevant agreement and documentation; and
  - (b) endorse the application of Shariah in relevant policies and procedures governing the application of *ijarah* for financing transaction including:
    - (i) eligible assets for *ijarah* financing and purposes of usage of asset;
    - (ii) list of costs and expenses borne by respective contracting parties;
    - (iii) sale of *ijarah* financing to a third party during the term of *ijarah*;
    - (iv) mechanism on transfer of asset ownership for *ijarah* financing; and
    - (v) mechanism of settlement or termination of contract prior to maturity and settlement amount, including those arising from:
      - refinancing practices;
      - event of default;
      - loss of legal capacity of either contracting parties;
      - total loss of asset due to force majeure events; and
      - total loss of asset due to incidents other than force majeure.

## **30. Structuring**

### **Structure**

- S** 30.1 Pursuant to paragraph 22.2, the IFI shall identify and determine the appropriate arrangement involving other contracts in structuring an *ijarah* financing product from inception to resolution which include:
- (a) any promise either to reflect customer's intention to own asset or the IFI's intention to transfer ownership; and/or

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<sup>5</sup> Shall include roles and responsibilities of the Board, Senior Management and Shariah Committee, policies and procedures and accountabilities of all relevant parties.

(b) a contract or an arrangement for the ownership transfer.

- G** 30.2 Pursuant to paragraph 30.1, the IFI may structure its *ijarah* financing using one of the following mechanisms for asset ownership transfer upon maturity:
- (a) *wa'd* to purchase by customer;
  - (b) *wa'd* to give *hibah* by the IFI;
  - (c) *wa'd* to sell by the IFI; or
  - (d) conditional *hibah* by the IFI.
- S** 30.3 Pursuant to 30.2, where the structure of the *ijarah* financing involves a *wa'd*, the IFI shall ensure that a subsequent contract is executed to transfer the ownership of asset.
- G** 30.4 In determining which mechanism to use for asset ownership transfer upon maturity, the IFI may adopt the most practical and convenient mechanism for IFI's operation.

**Question 1:**

- (a) What is your institution's current practice on mechanism for asset ownership transfer upon maturity (according to each type of *ijarah* asset)?
- (b) What is your comment if the mechanism for asset ownership transfer is standardised to conditional *hibah* by the IFI by virtue that the customer has already settled all financial obligations and this is considered as the most convenient mechanism i.e. no additional documentation to be executed?

- S** 30.5 The IFI shall ensure that these contracts or arrangements are effective in accordance to the correct sequence irrespective of the sequence of execution of the contracts or arrangements<sup>6</sup>.
- S** 30.6 In developing *ijarah* financing product, the IFI shall clearly determine the

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<sup>6</sup> For example, IFI must ensure it has obtained ownership of the *ijarah* asset before executing the *ijarah* contract with customer; and the sale (*bai'*) contract of *ijarah* asset to customer must be effective only after the *ijarah* financing period has ended or terminated, although the sale contract is signed at inception.

appropriate treatment of any deposits paid by the potential lessee to the dealer/supplier either as security deposit, rental deposit, or share of ownership.

- S** 30.7 The IFI shall observe the consequential treatment of the deposits paid by customer from any termination of the *ijarah* financing.

### **Cost and Expenses**

- S** 30.8 Pursuant to paragraph 16.7, IFI shall ensure fair dealings in negotiating cost of maintenance and takaful (protection) of asset.

- G** 30.9 In negotiating cost of maintenance and protection of asset, the IFI may take into consideration:

(a) **Adjusted rental**

Where the customer agrees to bear the cost of maintenance and protection of asset, the customer may enjoy a lower or a more competitive rental; and/or

(b) **Quiet enjoyment rights<sup>7</sup>**

The IFI may negotiate the cost of maintenance and protection to be borne by the customer whereby the customer has the right to total enjoyment of the *ijarah* asset during the *ijarah* period specified in the *ijarah* financing agreement<sup>8</sup>.

- S** 30.10 The IFI must determine other related charges<sup>9</sup> that may be incurred by the customer in line with the *Guidelines on Imposition of Fees and Charges on Financial Products and Services*.

<sup>7</sup> Quiet enjoyment is a right to the undisturbed use and enjoyment of an asset given to the lessee.

<sup>8</sup> For example, in the case of *ijarah* financing for vehicle, customer may make modification on the vehicle so long it does not impair the usufruct of the vehicle and rental instalments are paid within the stipulated period.

<sup>9</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 *ijarah* financing.

**Question 2:**

- (a) In practice, the IFI shifts ownership costs to the customer on the basis that there is a commitment from the customer to purchase the asset and the asset will be owned by the customer eventually upon financing maturity. Given this, please specify the costs and expenses that are borne by your institution and those that are transferred to customer?
- (b) In relation to paragraphs 30.8 and 36.10, how does your institution ensure fair dealings in negotiating cost of maintenance and protection of asset?

**Rental**

- G** 30.11 Pursuant to paragraph 14.7, the IFI may conduct periodical review on the rental during the *ijarah* financing period subject to obtaining mutual agreement by lessee.
- S** 30.12 The IFI shall establish an internal policy and procedures for review of rental including the variables that would tantamount to revision of rental<sup>10</sup>.
- S** 30.13 Where rental is received in advance before the delivery of usufruct, the IFI shall ensure the following:
- (a) recognition of the advance rental as income only after the effective delivery of the usufruct; and
- (b) the appropriate treatment of the advance rental<sup>11</sup>.

**Question 3:**

What would be the impact to your institution if use of memorandum account becomes a standard requirement?

<sup>10</sup> For example changes in the economic conditions, increase of 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 *New Reference Rate Framework*) for financing.

<sup>11</sup> For example reduction in the principal amount, setting-off the amount from any *ijarah* rental or whether a memorandum account needs to be created to monitor collection of the advance rental.

### ***Ijarah* Period**

- S** 30.14 The IFI shall specify the *ijarah* period that is mutually agreed by the contracting parties.
- G** 30.15 In the case that IFI and customer enter into separate contracts of *ijarah mawsufah fi zimmah* contract and subsequently *ijarah* contract once asset is delivered, at minimum, the specified duration as per paragraph 20.8 may be one day to to satisfy the delivery of usufruct to the customer before the commencement of actual *ijarah*.

### **Termination**

- S** 30.16 The IFI shall establish early termination triggers prior to maturity. Early termination triggers shall include early settlement of financing and breach of terms such as the events of default.
- S** 30.17 The IFI shall establish appropriate resolution mechanism according to different trigger events such as event of default, partial and total loss event in structuring *ijarah* financing product. Example of the resolution mechanism in the event of default is illustrated in Appendix 5.

#### **Question 4:**

Please provide your institution's settlement and resolution mechanism in the following events:

- (a) loss of legal capacity of either contracting parties (such as death and insanity); and
- (b) impairment of asset arising from force majeure event.

### **Documentation**

- S** 30.18 The IFI shall develop comprehensive and legally enforceable documentation<sup>12</sup> for *ijarah* financing and supporting arrangements that comply with Shariah. These documents shall specify the agreed terms on

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<sup>12</sup> 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.

asset ownership, leasing of the asset and transfer of asset ownership.

- S** 30.19 The IFI shall ensure the following is documented in writing and executed in sequence by the contracting parties:
- (a) documentation evidencing the asset ownership by the IFI;
  - (b) documentation of leasing/ *ijarah* financing;
  - (c) documentation on mechanism for transfer of asset ownership upon maturity or early termination; and
  - (d) documentation evidencing asset ownership transfer to the customer.
- S** 30.20 The use of Arabic terminology in documents shall 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.

#### ***Asset ownership***

- S** 30.21 Pursuant to paragraph 13.2, the IFI must ensure it has the relevant document evidencing its ownership on the asset prior executing *ijarah* financing agreement.
- G** 30.22 Ownership of asset may be via acquisition of asset by the IFI through asset purchase from supplier or customer (in case of sale and lease-back), constructions of asset (in the case of *ijarah mawsufah fi zimmah*) or via other sale-based contracts. The IFI may appoint an agent to undertake the acquisition of asset on behalf of the IFI.
- S** 30.23 Where applicable, IFI must ensure it has relevant document evidencing *wakalah* (agency) appointment where the IFI appoints a *wakeel* (agent) for the purchase of asset.

#### ***Leasing/ Ijarah Financing***

- S** 30.24 IFI must clearly stipulate the terms, conditions, rights, duties and obligations of contracting parties in the *ijarah* financing document. At minimum, the document must:



- (a) clearly specify relationship between contracting parties;
- (b) clearly specify other features of *ijarah* contract, including;
  - (i) description and specification of *ijarah* asset including whether the asset is new or second-hand;
  - (ii) agreed *ijarah* period;
  - (iii) event of default and event of total loss, along with the treatment and any applicable recovery processes for each occurrence;
  - (iv) compensation due to IFI where total loss event is caused by customer's negligence, misconduct or breach of specified terms;
  - (v) event of total loss due to force majeure event;
  - (vi) formula for purchase price in the event of default & total loss;
  - (vii) other events such as demise or loss of legal capacity; and
  - (viii) terms on early settlement and late payment.
- (c) clearly stipulate rights, duties and obligations of parties to contract which includes:
  - (i) periodic rental amount and total rental (if IFI uses fixed rate);
  - (ii) first rental amount, benchmark or formula, and applicable minimum and maximum limits (if IFI uses floating rate);
  - (iii) costs and expenses to be borne by contracting parties and liable party for any impairment of asset;
  - (iv) customer's responsibility to ensure good condition of asset throughout the *ijarah* period and utilize asset according to Shariah and applicable laws; and
  - (v) permissibility of customer to sub-lease the *ijarah* asset to a third party, in which approval from lessor is required.

### ***Mechanism of transfer of asset ownership***

- S** 30.25 The IFI must ensure relevant document for mechanism of asset ownership transfer as specified in paragraph 30.2 is documented separately from the leasing document<sup>13</sup>.

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<sup>13</sup> For example, if *wa'd* to purchase by the customer is employed, the *wa'd* document must be separated from *ijarah* financing agreement.

### **Transfer of asset ownership**

- S** 30.26 The IFI must ensure document evidencing the transfer of asset ownership upon maturity or early termination must be independent and separate from the leasing document.
- S** 30.27 The IFI must ensure documentation for transfer of ownership from IFI to customer reflects the mechanism of transfer of asset as agreed by the contracting parties<sup>14</sup>.
- S** 30.28 Where the sale contract to transfer ownership upon maturity is signed at inception by the customer, the IFI must ensure the document is effective after *ijarah* has ended.

### **Supplementary documents**

- G** 30.29 IFI may choose to execute additional documentation as supplementary, which includes:
- (a) document for any deposits paid by the potential lessee to the dealer/supplier either as security deposit, rental deposit, or share of ownership;
  - (b) documentation evidencing IFI's beneficial ownership over the *ijarah* asset to ensure IFI have recourse to asset throughout *ijarah* period;
  - (c) document to acknowledge acceptance and satisfaction on the conditions of the asset by the customer;
  - (d) document to provide guarantee for the payment of outstanding rental or any amounts owing to IFI by lessee;
  - (e) document to provide IFI with indemnification against loss or damage arising from the use of asset by lessee; and
  - (f) any other relevant legal documents as advised by IFI's legal advisor.
- G** 30.30 A master agreement may be drawn up covering the whole transaction of *ijarah* financing transaction.

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<sup>14</sup> For example, upon maturity, customer has provided *wa'd* to purchase the asset from the IFI, and therefore sale contract must be executed to evidence the transfer of ownership through sale.

**Question 5:**

Is there any additional legal cost in fulfilling the requirements in paragraphs 30.18 to 30.28? Please roughly provide estimation of the additional cost.

**31. Risk management**

- S** 31.1 IFI must effectively manage risks throughout the life cycle of *ijarah* financing, which includes:
- (a) assessment and implementation of suitable risk management techniques such as setting prudent financing-to-value limit, limiting maximum tenure of financing based on useful life of *ijarah* asset, collecting security deposit prior to purchasing of asset from supplier and ensuring existence of *takaful* for *ijarah* asset; and
  - (b) identification and adoption of the most viable exit strategies that enable the IFI to minimise possibility of losses.
- G** 31.2 Pursuant to paragraph 31.1(b), the exit strategies may include requirement on *takaful* coverage related to utilisation of *ijarah* asset by the customer, requirement on the customer providing *wa'd* to purchase upon event of default, and requiring nomination in the case of demise or other loss of legal capacity of the customer and upon its occurrence allowing legal heirs to continue the *ijarah* financing.
- S** 31.3 Pursuant to paragraph 30.29(b), IFI must ensure that it has recourse to *ijarah* asset or other collateral (if any) through binding and irrevocable documentation taking into account any legal constraints and differences in jurisdictions, and registering its interest on the asset where applicable.
- S** 31.4 IFI shall outline policies regarding permissibility and conditions on sub-lease as well as usage of the *ijarah* asset by a third party. If the IFI allows practices of sub-lease, it must observe the following:
- (a) the usage 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>15</sup>.

- S** 31.5 For financing of asset under construction that is to be leased by the customer in the future, the IFI shall undertake due diligence to assess capacity of manufacturer or contractor to fulfil the contractual obligations.
- S** 31.6 Pursuant to paragraph 31.5, the IFI shall keep track of the progress on asset completion throughout the construction period and ensure timely delivery by the manufacturer or contractor.

## **32. Business and market conduct**

### **Information Disclosure**

- S** 32.1 Additional disclosures required in the Product Disclosure Sheet<sup>16</sup>, the IFI shall disclose the following for *ijarah* financing:
- (a) ensure the usage of appropriate terminology which reflects the true nature of *ijarah*<sup>17</sup>;
  - (b) clarify the role of the IFI and the customer as well as describe the rights and liabilities arising from the establishment of contractual relationship between the parties;
  - (c) for *ijarah mawsufah fi zimmah*, where the rate during the construction period is different from the rate after the delivery of usufruct, the IFI shall disclose the rental rate during the construction period;
  - (d) mechanism for asset ownership transfer<sup>18</sup> procedure and its impact if any breach of *wa'd* to ensure consumer are fully aware of their obligation on the *wa'd*;
  - (e) purpose of paying deposit, whether treated as advance rental or security deposit which can be forfeited in the case of breach of terms or discontinuation of contract;
  - (f) treatment of advance rental that need to be returned in case of non-

<sup>15</sup> For example through requirement on takaful covering the usage by the sub-lessee or the third party, and the liability of *ijarah* financing customer is maintained in the case of any losses caused negligence, misconduct or breach of specified terms by the sub-lessee or the third party.

<sup>16</sup> Or alternative document such as General Terms and Conditions for non-retail customers.

<sup>17</sup> For example rental schedule as opposed to instalment schedule.

<sup>18</sup> For example, *wa'd* to purchase by customer.

delivery of asset for *ijarah*;

- (g) minimum and maximum limits together with the formula to arrive at the agreed rental price for the floating rate *ijarah* financing; and
- (h) calculation for settlement prior to maturity of *ijarah* financing.

**S** 32.2 The IFI shall inform the customer on the mechanism for asset ownership transfer<sup>18</sup> procedure and its impact if any breach of *wa'd* to ensure consumer are fully aware of their obligation on the *wa'd*.

### **Fair Dealings**

**S** 32.3 Internal policies and procedures on business and market conduct must ensure fair dealing practices which include the following:

- (a) suitability and affordability assessment of contracting parties;
- (b) information to be disclosed is provided in a timely manner to contracting parties and shall be accurate, clear, and not misleading;
- (c) charges payable by customers (if any); and
- (d) IFI must take reasonable care to ensure suitability of advice and recommendation to customers.

**S** 32.4 In dealing with the case of demise and loss of legal capacity, the IFI shall require the customer at inception to appoint legal heirs for the IFI to engage upon the demise of the customer on whether to continue or discontinue the *ijarah* financing.

**S** 32.5 Pursuant to paragraph 32.4, should the legal heirs opted to discontinue the *ijarah* contract, the IFI may repossess and disposes off the asset. Where there is a shortfall between the outstanding financing and proceeds from the disposal, the IFI is not allowed to claim the shortfall from the legal heirs.

## **33. Financial disclosures**

**S** 33.1 The IFI shall maintain accounting records and other records in a timely manner that sufficiently enable the preparation and reporting of true and fair financial statements.

- S** 33.2 The IFI shall also observe the requirements of applicable Malaysian Financial Reporting Standards (MFRS) and technical release related to leasing/*ijarah* issued by the Malaysian Accounting Standards Board (MASB).
- S** 33.3 In enhancing the disclosure by the IFI and reflecting the Shariah requirement on ownership, the IFI shall disclose its ownership on *ijarah* assets (for the *ijarah* financing transactions) in additional notes to the financial statement.
- S** 33.4 The IFI shall also disclose that the ownership of *ijarah* assets will be transferred to the lessee at the end of the *ijarah* period via any mechanism to transfer ownership<sup>19</sup>.

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<sup>19</sup> For example, sale, *hibah* or conditional *hibah*.

## **PART D OPERATIONAL REQUIREMENTS FOR *IJARAH***

### **34. Introduction**

- 34.1 The regulatory expectations set out in Part D emphasize on the establishment of effective policies and procedures to facilitate oversight function, conduct of *Ijarah* primary transaction that is compliance with Shariah, risk management, business conduct and consumer protection. As opposed to *ijarah* financing where the customer has the intention to own the *ijarah* asset at the end of *ijarah* period, the primary objective of the *ijarah* transaction (also known as lease, tenancy, hire or let) is to facilitate a customer who does not intend to own certain assets but need to use and benefit from the utilisation of the assets against payment of certain agreed rental to the IFI.
- 34.2 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.

### **35. Governance and oversight**

- S** 35.1 While the broad principles and requirements on corporate governance as stipulated in Bank Negara Malaysia's Corporate Governance Policy Documents<sup>20</sup> can be applied to *ijarah*, greater emphasis should to be given on the management and implementation of *ijarah* in view of the distinct risk profile of *ijarah*. The emphasis includes additional expectations on the roles of the Board, the SC and the senior management.
- S** 35.2 The IFI shall possess sufficient understanding of the risk profile of *ijarah* and ensure availability of resources with appropriate expertise and skill set to carry out the implementation of *ijarah* in various phases.

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<sup>20</sup> Refer to *Guidelines on Corporate Governance for Licensed Institutions*, *Guidelines on Corporate Governance for Licensed Islamic Banks* and *Guidelines on Corporate Governance for Development Financial Institutions*.

### **Board of Directors (the Board)**

- S** 35.3 The Board is responsible to establish sound governance structure to facilitate effective oversight function on the management and implementation of *ijarah*. The adequacy of governance structure shall commensurate with the nature, complexity and risk profile associated with *ijarah* activities.
- S** 35.4 The roles and responsibilities of the Board with regards to *ijarah* shall include:
- (a) set and oversee implementation of business strategies and risk appetite for *ijarah*;
  - (b) approve and oversee policies and procedures governing operations of *ijarah*;
  - (c) ensure policies and procedures pertaining to Shariah matters are endorsed by the SC. The policies and procedures shall cover the following aspects:
    - (i) criteria and method of asset acquisition or construction;
    - (ii) appointment of agent and outsourcing of functions;
    - (iii) valuation methodology;
    - (iv) leasing arrangement;
    - (v) exit strategies particularly in the case of loss of legal capacity and asset damages, and disposal of asset;
    - (vi) risk management and internal controls; and
    - (vii) information disclosures.
  - (d) oversee the design and implementation of internal controls by the management which commensurate with the nature, scale and complexities of *ijarah* transactions; and
  - (e) ensure independent reviews are conducted regularly to assess compliance with the standards issued by the Bank and internal policies established by IFI.

### **Shariah Committee (SC)**

- S** 35.5 The SC shall perform the following:
- (a) endorse that the Shariah requirements are appropriately applied in relevant policies and procedures governing *ijarah*. These policies shall cover the following aspects:



- (i) eligible assets for *ijarah* transactions and purposes of usage of *ijarah* assets; and
- (ii) list of costs and expenses borne by respective contracting parties.
- (b) deliberate and endorse that the terms and conditions stipulated in legal documentation and other documentation<sup>21</sup> are in compliance with Shariah;
- (c) conduct review on *ijarah* periodically and advise the IFI on relevant Shariah rulings, decision or guidelines on Shariah matters issued by the Bank and, if relevant, any other authorities; and
- (d) perform oversight role on the application of *ijarah* to ensure due observance of Shariah.

### Senior Management<sup>22</sup>

- S** 35.6 The roles and responsibilities of senior management shall include the following:
- (a) implement business strategies, internal control and risk management requirements with regards to *ijarah*;
  - (b) set out policies, processes and procedures governing operations of *ijarah*, and ensure they are properly communicated and delegated to all relevant functions within the IFI;
  - (c) establish risk management policies and maintain adequate mechanisms that are able to identify, measure and mitigate risk inherent in *ijarah*;
  - (d) undertake regular reviews and monitor compliance of the approved policies;
  - (e) establish a systematic process to review and update the policies, procedures and internal concentration limits taking into consideration developments in the IFI and the industry;
  - (f) incorporate research and surveillance process to collect and analyse relevant information, either from stakeholders or external sources<sup>23</sup>, relating to or that which may have impact on *ijarah*; and
  - (g) ensure timely disclosure of relevant information to the Board and Shariah

<sup>21</sup> Such as product manual, marketing advertisement, sales illustrations and brochures

<sup>22</sup> As defined in *Guidelines on Corporate Governance for Licensed Institutions, Guidelines on Corporate Governance for Licensed Islamic Banks* and *Guidelines on Corporate Governance for Development Financial Institutions*.

<sup>23</sup> Such as market reports, intelligence and expert surveys.

Committee.

### 36. Structuring

- S** 36.1 The IFI that conducts *ijarah* shall assess the appropriate structure to operate *ijarah* transaction either direct set-up or via a separate entity such as a subsidiary set-up based on:
- (a) the risk exposure of the *ijarah* asset<sup>24</sup>; and
  - (b) the additional operational requirements specified under part D of this CP.

#### Question 6:

Based on observation, IFIs have yet to fully explore the *ijarah* product as compared to *ijarah* financing.

- (a) What is the reason for not offering *ijarah* and please state if there are any constraints from offering *ijarah* to customers?
- (b) Does your institution has any interest to offer *ijarah*? If yes, under which structure as defined in paragraph 36.1 and why?
- (c) Please provide your opinion if the Bank extends the applicability of this policy document to cover subsidiaries of IFIs?

#### Sources of funds

- S** 36.2 The IFI must outline appropriate assets and liabilities management policies, particularly in matching *ijarah* activities with different sources of funds, considering risk, return and liquidity profile of *ijarah* transaction.
- S** 36.3 Determination of sources of funding for *ijarah* activities are subject to the following requirements:
- (a) funding from Unrestricted Investment Account (URIA) and Restricted Investment Account (RIA)<sup>25</sup> are allowed subject to ensuring that matching principles are in place, including conditions that effectively mitigate<sup>26</sup> liquidity risks; and

<sup>24</sup> For example ownership risk, inventory risk and market risk

<sup>25</sup> As defined under the policy document on *Investment Account*

<sup>26</sup> This may include mechanisms such as matching of tenure between source and usage of funds, allowing redemptions only upon liquidation of underlying assets or replacement of investors other than the IFI.

- (b) shareholder funds and deposits are allowed subject to:
- (i) the IFI maintaining adequate capital commensurate with risk exposure as required under the *Capital Adequacy Framework<sup>27</sup> for Islamic Banks (Capital Components)* and *Capital Adequacy Framework (Capital Components)*;
  - (ii) the IFI clearly establishing its risk appetite for *ijarah* activities; and
  - (iii) Investment limits<sup>28</sup> of:
    - Investment in each *ijarah* asset shall not exceed 25% of the IFI's total capital; and
    - the aggregate book value of investment in shares, interest-in shares, collective investment schemes, immovable properties<sup>29</sup> and *ijarah* assets other than immovable properties shall not exceed 50% of the IFI's total capital.

### Assets

- S** 36.4 In ensuring the sustainability of *ijarah*, the IFI shall assess and evaluate the suitability of the types of asset to be leased and economic life of the assets are appropriate to the IFI's risk appetite and capability to manage the *ijarah* asset during and after the *ijarah* period has ended.

#### Question 7:

With reference to paragraph 36.4, what is the method used by your institution to determine economic life of different types of assets?

- S** 36.5 The IFI shall put in place the appropriate processes and procedures to ensure that the customer inspects the asset on or before commencement of *ijarah* period or upon delivery of asset to satisfy the condition, quality, suitability and fitness of the asset for the customer's purpose.

<sup>27</sup> Refers to *Capital Adequacy Framework for Islamic Banks, Capital Adequacy Framework and Capital Adequacy Framework for Development Financial Institutions*.

<sup>28</sup> For avoidance of doubt, *ijarah* assets funded by URIA and RIA operating under matching principles mentioned in paragraph 33.3(a) are excluded from the limits.

<sup>29</sup> Refers to the exposure defined in the *Guidelines on Property Development and Property Investment Activities by Islamic Banks*.

- S** 36.6 In complying with the requirement in paragraph 20.3, the IFI shall ensure that the *ijarah* asset is delivered to the customer on the specified delivery date.
- S** 36.7 Pursuant to paragraph 13.11 and 36.6, the IFI shall obtain the certificate of acceptance and satisfaction from the customer before or upon commencement of the *ijarah* to ensure that the lessee accepts the delivery and is satisfied with the condition of the asset.
- G** 36.8 In ensuring that the asset is in a good condition after the acceptance of the asset, the IFI may obtain warranty for the asset directly or through the customer, who deals with the supplier or a third party.
- S** 36.9 The IFI must identify the requirements on return of asset by the customer including the location for delivery and condition of the asset to ensure that the asset is returned accordingly to the IFI<sup>30</sup>.

### **Cost & Expenses**

- S** 36.10 Pursuant to paragraph 16.7, the IFI must ensure fair dealings in negotiating cost of maintenance and protection of asset.
- S** 36.11 For protection of asset, the cost shall be borne by the party that benefit from the protection.
- G** 36.12 In negotiating cost of maintenance and protection of asset, IFI may adopt the guiding principles as per paragraph 30.9.
- S** 36.13 In relation to paragraph 36.9, the IFI must determine the party to bear the cost of return of asset by the customer.
- S** 36.14 The IFI must determine other related charges that may be incurred by the customer<sup>31</sup> in line with the *Guidelines on Imposition of Fees and Charges on*

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<sup>30</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, and specify that the asset be painted all white, considering normal wear and tear.

*Financial Products and Services.*

- G** 36.15 The IFI may set a maintenance reserve fund that is intended only for routine maintenance and servicing of the *ijarah* asset during a specified *ijarah* period. Any excess in this maintenance reserve fund may be refunded to lessee at the end of the *ijarah* period.
- G** 36.16 Notwithstanding paragraph 36.15, the IFI may require the customer to make arrangements for servicing of the *ijarah* asset.

**Rental**

- G** 36.17 Pursuant to paragraph 14.7, the IFI may conduct periodical review on the rental during the *ijarah* period subject to obtaining mutual agreement by customer.
- S** 36.18 The IFI shall establish an internal policy and procedures to review the rental rate including the variables that would tantamount to revision of rental<sup>32</sup>.
- S** 36.19 The IFI shall clearly specify the purpose of any collection of advance payment from the potential lessee either as security deposit, rental deposit or advance rental.

**Termination**

- S** 36.20 The IFI shall specify in the *ijarah* contract any covenant and the triggers either from non-payment rentals by the lessee or lessee's own intention to terminate the *ijarah*.
- S** 36.21 The IFI shall secure its rights to claim any outstanding rental payments upon early termination or default of the lessee.

**Documentation**

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<sup>31</sup> For example arising from late payment of rental obligations.

<sup>32</sup> For example changes in the economic conditions, increase of cost of maintaining the asset caused by increase in cost of takaful, new regulations by the authority, or changes in the market rate

- S** 36.22 The IFI shall develop comprehensive and legally enforceable documentation for *ijarah* and supporting arrangements that comply with Shariah. These documents shall specify the agreed terms on asset ownership and leasing of the asset.
- S** 36.23 The IFI shall ensure the following is documented in writing and executed in sequence by the contracting parties:
- (a) documentation evidencing the asset ownership by the IFI; and
  - (b) documentation of leasing.
- S** 36.24 The terms and conditions for the documentation listed in paragraph 36.23 shall be as specified in paragraphs 30.21 to 30.24, except for formula for asset purchase price.
- S** 36.25 In addition to paragraph 36.24 upon expiration or earlier termination of the *ijarah*, the IFI shall ensure that all terms and conditions of redelivery of movable asset or mechanism to surrender immovable asset be negotiated and agreed upon in the legal documentation at inception.
- G** 36.26 The IFI may choose to execute additional documentation as supplementary, which includes:
- (a) document for any deposits paid by the potential lessee to the dealer/supplier either as security deposit, rental deposit, or share of ownership.
  - (b) document to provide guarantee for the payment of outstanding rental or any amounts owing to the IFI by the lessee;
  - (c) document to provide the IFI with indemnification against loss or damage arising from the use of asset by the lessee; and
  - (d) any other relevant legal documents as advised by the IFI's legal advisor.

## **37. Risk management**

- S** 37.1 The risk management policies and procedures shall cover, at minimum the following:
- (a) identification and measurement of risks;
  - (b) appropriate valuation methodology for *ijarah* assets;
  - (c) pricing policy;
  - (d) risk exposure limits including risk concentration;
  - (e) risk mitigation techniques; and
  - (f) monitoring and reporting mechanisms, particularly information on risks that pose significant risk to the IFI or information that require swift action by the management.

**Pre-contractual stage**

- S** 37.2 The IFI must outline and implement an assessment methodology to determine qualifying asset for the purpose of *ijarah*, taking into account Shariah requirements, commercial viability and risk perspectives.
- G** 37.3 Among the factors that may be considered in determining qualifying assets are:
- (a) ready demand to lease out the asset and useful life of the asset;
  - (b) marketability of the asset, such as existence of secondary market, the time taken to dispose the asset, complexity of the asset and reliability of market pricing to estimate residual value;
  - (c) experience and skill-set possessed by the IFI in managing the asset; and
  - (d) other constraints such as legal provision based on geographical location of the asset in acquisition, lease, repossession and disposal of asset.
- S** 37.4 The IFI shall ensure adoption of a sound and objective valuation methodology for *ijarah* assets with sufficient frequency of revaluation to reflect the current value. In this regards, the IFI must:
- (a) identify and monitor factors<sup>33</sup> that may cause changes to an evaluation, and appropriately adjust such valuation;

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<sup>33</sup> For example economic recession, technological advancement, poor upkeep and launching of new model

- (b) put higher emphasis to *ijarah* assets that are large in value, complex and/or pose higher risk<sup>34</sup> to the IFI. These assets are known as 'significant *ijarah* assets';
  - (c) validate or back-test the result of valuation against actual prices, any material deviations on the valuation should be rectified accordingly; and
  - (d) where the valuation function is outsourced<sup>35</sup>, 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** 37.5 IFI must undertake asset acquisition process based on policies approved by the Board.
- S** 37.6 For the purpose of paragraph 37.5, IFI should conduct prior assessment on the supplier/vendor, which includes verification on its legitimate establishment and capabilities to deliver the asset, particularly for significant *ijarah* assets.
- S** 37.7 IFI must set and implement policies to mitigate inventory risk, such as maximum length of storage, method of storage and *takaful*.
- S** 37.8 IFI shall outline a risk-informed pricing policy<sup>36</sup> that is consistent with risk appetite for *ijarah* approved by the Board. At minimum, the policy shall cover:
- (a) objectives of pricing framework and relation to business and risk strategies;
  - (b) pricing components of *ijarah* taking into account potential losses from impairment of asset, funding costs, overhead costs, and other costs and liabilities borne by the IFI;
  - (c) 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>37</sup>, the IFI

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<sup>34</sup> For example, highly customized assets, breakthrough innovation and assets with high rate of obsolescence such as IT devices.

<sup>35</sup> Subject to Guidelines on Outsourcing issued by the Bank.

<sup>36</sup> In line with policy document on *Risk-Informed Pricing*



must assess and manage the impact to overall profitability and capital position, in the case of profits from the other product/service fail to materialise.

- S** 37.9 Rights to inspect the asset by the IFI must be established, including the rights to access the books and records of the customer or the person acting on behalf of the customer, where the IFI has sufficient reason to believe of any negligence, misconduct or infringement of contractual terms.
- S** 37.10 For the purpose paragraph 37.9, the IFI must identify trigger events to conduct such inspection and audit.
- G** 37.11 The IFI may establish rights to inspect the asset during business-as-usual, however, must do so with reasonable prior notice to ensure the IFI does not infringe customer's quiet enjoyment right<sup>7</sup>.
- S** 37.12 The IFI is required to identify exit strategies from *ijarah*, particularly for the following events:
- (a) asset damages (partial or total loss) arising from customer's<sup>38</sup> negligence, misconduct and breach of specified terms;
  - (b) asset damages due to an unrelated third party;
  - (c) force majeure events;
  - (d) demise or other loss of legal capacity of the customer; and
  - (e) default on payments or other contractual obligations.
- The exit strategies may include several options of exiting, which minimise potential losses and maximise value to the IFI.
- G** 37.13 The IFI may collect security deposit from customer to cover against losses from default by customer on rental payments or other obligations, and damages to asset which is caused by the customer, third party acting with or

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<sup>37</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>38</sup> Shall include a person or persons acting on behalf, under, together with the customer and sub-lessee (if any).

on behalf of the customer or sub-lessee.

- S** 37.14 For *ijarah* with longer tenor (such as more than 1 year), the IFI shall assess capability of potential customer to meet contractual obligations.
- S** 37.15 The IFI shall outline policies regarding permissibility and conditions on sub-lease as well as usage of the *ijarah* asset by a third party. If the IFI allows such practices, it must observe the following:
- (a) the usage 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, for example, through requirement on takaful covering the usage by the sub-lessee or the third party, and the liability of *ijarah* customer is maintained in the case of any losses caused negligence, misconduct or breach of specified terms by the sub-lessee or the third party.
- S** 37.16 Prior to leasing, the IFI shall inspect and record conditions of the asset to be leased, as well as any equipment or accessories attached to the asset. The IFI shall also ensure that the customer made written confirmation on the acceptance and condition of the asset upon the *ijarah* period.
- G** 37.17 Notwithstanding paragraph 37.16, the IFI may arrange for an expert third party service provider to undertake inspection of significant *ijarah* assets. For other types of asset, the customer or third party service provider as agent may accept delivery and undertake inspection on the asset. In this arrangement, the IFI shall obtain report from the party on the acceptance and condition of the asset.

**Throughout *ijarah* period**

- S** 37.18 The IFI shall monitor any recurring late payment of rentals from the customers and other factors that may impair ability to meet the rental obligations.
- S** 37.19 The IFI shall monitor risk exposures throughout the *ijarah* period to ensure the

exposure is within risk appetite set by the Board. Any anomalies must be reported immediately to senior management for further action.

- S** 37.20 The IFI shall undertake periodic valuation described in paragraph 37.4, and to monitor any factors that may require adjustments to the valuation assumption or methodology.
- G** 37.21 The IFI may mitigate risks through employing risk mitigation mechanism such as takaful.
- S** 37.22 Where the customer is responsible to ensure coverage of takaful, the IFI shall sufficiently describe the amount of coverage and risk events that should be covered such as fire, theft, flood etc.
- S** 37.23 The IFI shall have in place a rigorous stress testing framework that would enable periodical assessment of *ijarah* activities and its implications for the financial condition of the IFI.
- S** 37.24 The IFI shall ensure review mechanism to ensure that Shariah requirements, applicable laws and regulations, policies set out by the Bank, and internal policies are complied with in the operation of *ijarah*.

#### **Termination or exit from *ijarah***

- G** 37.25 Upon occurrence of events specified in paragraph 37.12, the IFI may assess and opt for the exit strategy that minimise losses or maximise value to the IFI.
- S** 37.26 Pursuant to paragraph 37.25 and when asset is returned by the customer, the IFI shall ensure that it has identified the conditions and procedures for the exit strategies. Particular emphasis should be given for significant *ijarah* assets to ensure timely and profitable or cost-effective exit from *ijarah*.

- S** 37.27 The IFI, or a third party acting on behalf of the IFI shall inspect the condition of asset and the status of any other obligations of the customer<sup>39</sup> upon voluntary return by the customer or repossession to ensure that the asset is in the agreed condition and all obligations has been settled by the customer.
- G** 37.28 The security deposit may be deducted if there are any damages not due normal wear and tear or any unsettled obligations by the customer.

## **38. Business and market conduct**

### **Information Disclosure**

- S** 38.1 The IFI shall conform to the existing *Guidelines on Product Transparency and Disclosure* on the overall conduct of the business. However, this standard will further outline additional guidance for disclosure to customer in safeguarding the interest of both parties involves in *ijarah* transaction.
- S** 38.2 The IFI must ensure the usage of appropriate terminology which reflects the true nature of *ijarah*, i.e. rental schedule as opposed to instalment schedule.
- S** 38.3 The IFI shall also clearly clarify the role of IFIs and customer as well as describe the right and liabilities arising from the establishment of contractual relationship between the parties.

### **Fair Dealings**

- S** 38.4 The IFI shall disclose or illustrate the condition of the asset to customer or customer should have right to physically view and inspect the asset to be leased prior to the *ijarah* transaction.

#### **Question 8:**

What is your comment if the Bank requires IFI to grant the right to potential lessee to

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<sup>39</sup> For example utilities

physically view and inspect the asset prior to the execution of *ijarah*?

- S** 38.5 The IFI shall clearly inform the customer in written form on the purpose of paying deposit or a security deposit which will be treated as advance rental or security deposit.
- S** 38.6 In the case of deposit treated as advance rental payment or any other advance rental payment made by customer, customer shall be informed on the right of lessor to set off the advance rental against the rental payment due.
- S** 38.7 In the event where the IFI sells the *ijarah* asset to a third party, the IFI shall inform the customer on the arrangement.

**Question 9:**

In your opinion, what should be the mode of communication and information disclosure involved when informing the *ijarah* customer on the sale of *ijarah* asset to a third party?

- S** 38.8 In any event or incident which may give rise to any claim by a third party or asset damages, which may affect the usage and operations of the asset, the IFI shall clearly inform on the customer's responsibility to swiftly notify the IFI, and the procedure for notification<sup>40</sup>.

## **39. Financial disclosures**

- S** 39.1 The IFI shall observe the requirements stipulated in the *Guidelines on Financial Reporting for Islamic Banking Institutions, Guidelines on Financial Reporting for Development Financial Institutions* issued by the Bank and all applicable MFRS issued by the MASB.

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<sup>40</sup> For example notify the IFI's headquarter or branch which extended the financing within seventy-two (72) hours after the occurrence of such incident

## 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 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”. (Al-Qasas: verse 27)

The above verse s describe the story of the Prophet Musa (a.s) 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.

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

3. The following *hadith* implies the general permissibility of *ijarah*.
  - (a) The Prophet (SAW) said: “Pay the hired worker his wages before his sweat dries off.” (Sunan Ibn Majah).

- (b) The Prophet (SAW) is reported to have said: “He who hires a person should inform him of his fee.” (Al-Sunan al-Kubra li Al-Baihaqi).
- (c) Abdullah ibn Umar narrates, “Allah’s Apostle gave the land of Khaibar 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).” (Sahih Bukhari)

#### **Consensus of the Muslim Jurists (*Ijma*)**

4. *Ijarah* has been unanimously approved by the companions of the Prophet Muhammad (SAW) 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.

## Appendix 2 Glossary

Terms	Explanation
<i>Gharamah</i>	Penalty.
<i>Hamish jiddiyyah</i>	A deposit placed to secure performance of specified action.
<i>Hibah</i>	Transfer of ownership of an asset from the donor to the donee during the lifetime of the donor without any consideration or reward.
<i>Ijma`</i>	Consensus of Muslim jurists.
<i>Istisna`</i>	An agreement to sell 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 of the <i>istisna`</i> asset.
<i>Kafalah</i>	A contract of conjoining guarantor's liability to the guaranteed party's liability in a way that the obligation of the guaranteed party is established as a joint liability of the guarantor and guaranteed person.
<i>Khiyar `ayb</i>	Option arising from a defect; the option of dissolving or continuing the contract upon discovery of a defect in the asset purchased.
<i>Mudarabah</i>	Profit-sharing contract.
<i>Mukhalafah syurut</i>	Breach of terms and conditions.
<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>	Common business practice which is acceptable by the community and does not contradict the Shariah rulings.
<i>Wa`d</i>	Promise or undertaking
Usufruct	The right to use or enjoy something that belongs to another
Force Majeure	A legal term that is frequently used in construction contracts to protect the parties in the event that a segment of the contract cannot be performed due to causes that are outside the control of the parties, such as natural disasters, that could not be evaded through the exercise of due care.

### **Appendix 3 Related Shariah rulings and policy documents**

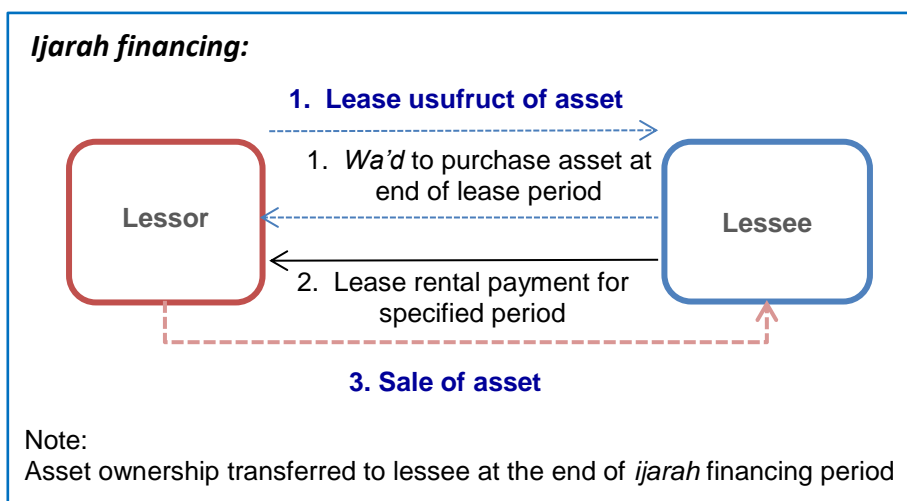
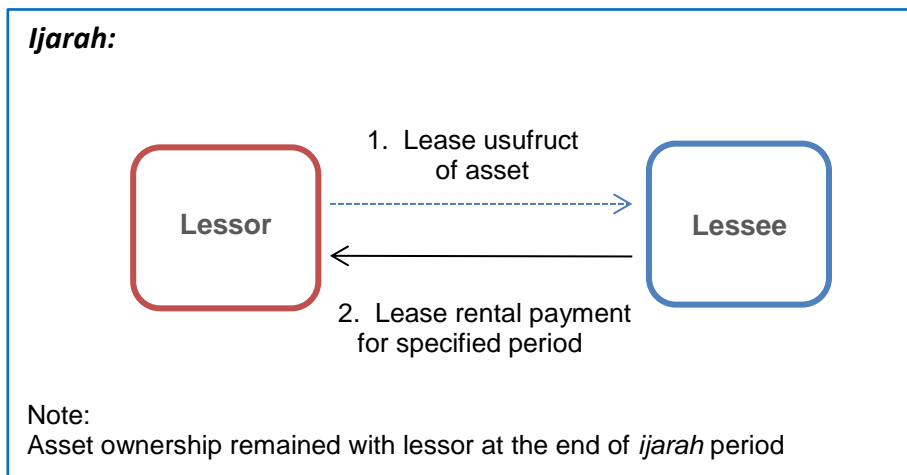
This CP must be read together with the following Shariah rulings and policy documents:

- (a) Any Shariah Advisory Council (SAC) rulings published by the Bank Negara Malaysia<sup>41</sup>;
- (b) Shariah Governance Framework for Islamic Financial Institutions;
- (c) Guidelines on Corporate Governance for Licensed Institutions;
- (d) Guidelines on Corporate Governance for Licensed Islamic Banks;
- (e) Guidelines on Corporate Governance for Development Financial Institutions;
- (f) Risk Governance;
- (g) Risk-Informed Pricing;
- (h) Guidelines on Investment in Shares, Interest in Shares and Collective Investment Schemes;
- (i) Capital Adequacy Framework for Islamic Banks (Risk-Weighted Assets);
- (j) Risk-Weighted Capital Adequacy Framework (Risk-Weighted Assets);
- (k) Capital Framework for Development Financial Institutions;
- (l) Guidelines on Product Transparency and Disclosure;
- (m) Guidelines on Financial Reporting for Islamic Banking Institutions;
- (n) Guidelines on Financial Reporting for Development Financial Institutions;
- (o) Guidelines on Property Development and Property Investment Activities by Islamic Banks;
- (p) Reference Rate Framework;
- (q) Guidelines on the Imposition of Fees and Charges on Financial Products and Services;
- (r) Guidelines on *Ibra'* ( Rebate) for Sale-based Financing;
- (s) Guidelines on Late Payment Charges for Islamic Financial Institutions;
- (t) Responsible Financing;
- (u) Guidelines on Outsourcing of Islamic Banking Operations;
- (v) Guidelines on Outsourcing of Banking Operations; and
- (w) Guidelines on Outsourcing for Development Financial Institutions.

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<sup>41</sup> Including Shariah resolutions in Islamic Finance, standards, circulars or any directive pertaining to Shariah matters issued by the Bank

## Appendix 4 Illustration of structures of *ijarah* and *ijarah* financing



**Appendix 5 Resolution mechanism in the event of default**

