

**Pronouncement of the Shariah Committee of Bursa Malaysia Islamic Services Sdn Bhd**

*In the Name of Allah, the Most Gracious the Most Merciful*

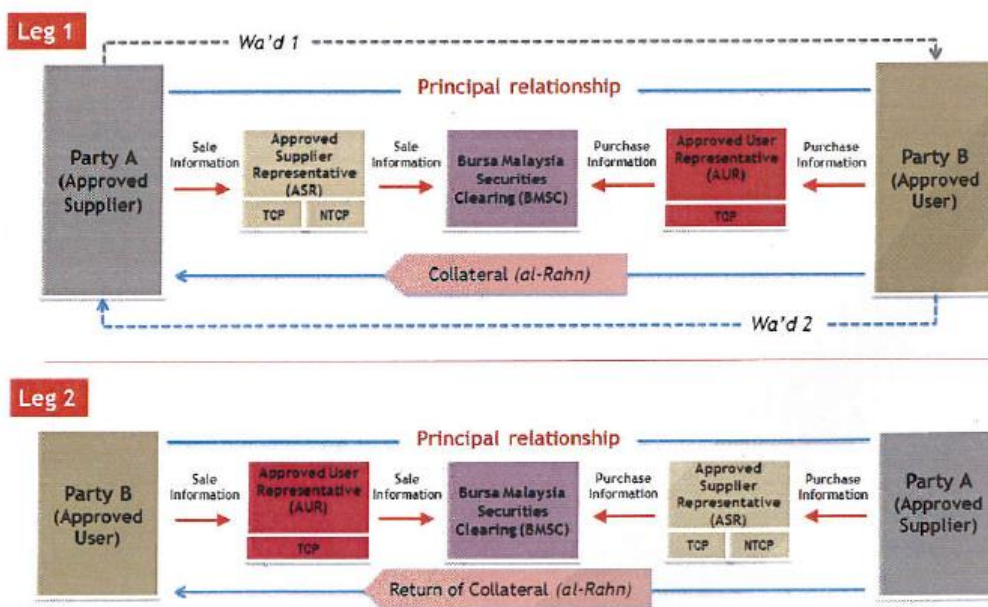
19 Jamadil Akhir 1436H – 9 April 2015

**Subject: Islamic Securities Selling and Buying Negotiated Transaction Model (iSSB-NT)<sup>1</sup>**

*All praise is due to Allah, prayers and peace be upon the last Prophet Mohammad, and be upon his relatives and all his companions,*

The Shar’ah Committee of Bursa Malaysia Islamic Services Sdn Bhd (“BMIS”) in its meeting held on 22 July 2014 at its Main Office in Kuala Lumpur, endorsed Bursa Malaysia’s proposal (SC Memo No. 8 and No. 12 of 2014) concerning the structure of iSSB-NT as a Shari’ah compliant alternative to Securities Borrowing and Lending (“SBL”). With the objective to further refine the model based on the review and comments received from the relevant stakeholders, the Committee had on 9 April 2015 via the Shari’ah Committee Memorandum No. 10 of 2015 dated 9 April 2015 endorsed the revised iSSB-NT structure as presented in the iSSB-NT Concept Paper ver. 5.0 dated 9 April 2015.

The iSSB-NT structure is designed based on the Securities Borrowing and Lending-Negotiated Transaction model (‘SBL-NT’) with customisation, as illustrated below;



<sup>1</sup> This Pronouncement supersedes the Shariah Committee’s Pronouncement entitled: Islamic Securities Selling and Buying (iSSB) dated 22<sup>nd</sup> July 2014.



Party A	: Approved Supplier (AS) – acting as the Seller for Leg 1 and the Buyer for Leg 2
Party B	: Approved User (AU) – acting as the Buyer for Leg 1 and the Seller for Leg 2
ASR	: Approved Supplier Representative
AUR	: Approved User Representative
TCP	: Local Brokers
NTCP	: Local Custodian
BMSC	: Bursa Malaysia Securities Clearing Sdn Bhd, acts as “Clearing House”

The key criteria of the iSSB-NT model as endorsed by the Shari’ah Committee of BMIS are as follow;

- i. Each transfer of securities from a principal contracting party to another is supported by a contract of sale (*bay’*).
- ii. The concept of *wa’dan*<sup>2</sup> (two unilateral promises/undertakings) is applicable to reflect the commitment of the principal contract parties.
- iii. Under the principle of *khiyar al-shart*, Party B may be granted a certain grace period to rescind the Leg 1 transaction and return the purchased securities to Party A without any cost to be incurred. For the avoidance of doubt, provided Party B is the owner and in possession of the purchased securities, it reserves the right to exercise the option (*khiyar*) based on mutually agreed terms and condition. Party B may lose the right should there be any impediments that would prevent from returning the securities to Party A, e.g., disposal of the purchased securities.
- iv. A group of securities being sold at each Leg 1 and Leg 2 would normally be considered as two (2) different assets of sale. In principle, the purchased set of securities at Leg 1 could have been sold earlier (short selling), and the securities sold later at Leg 2 could be another set of securities but from the same counter or using the same stock code. Further, it can be of the same of different number or units, e.g., in the case of partial recall<sup>3</sup>.

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<sup>2</sup> *Wa’d* in Arabic denotes one or single unilateral promise while *wa’dan* is two unilateral promises. *Wa’d* as defined by Bank Negara Malaysia (BNM) in the “*Wa’d – Shariah Requirements and Optional Practices*”, Exposure Draft, pf. 4; literally, is a promise or undertaking, refers to an expression of commitment given by one party to another to perform certain action(s) in the future.

<sup>3</sup> Party A, when it exercises its rights to buy the similar securities from Party B, may purchase either the same number of units of similar securities as sold at Leg 1, or a portion of it. This may be due to the need of Party B to utilise the rest of the securities or Party A is not in the need to purchase it at a single moment, or any reason as agreed based on terms & condition of the agreement between the contracting parties.

- v. In the event the purchased securities at Leg 1 are no longer in existence due to corporate action (such a merger and acquisition), winding up or delisting of the company; Leg 2 is to take place upon certain trigger event.
- vi. All risks and liabilities of the securities will be borne by the legal owner at any particular point in time. The legal owner has complete right or ownership on the securities, including selling it to a third party.
- vii. Imposition of minimum time gap of two (2) market days (T+1) between Leg 1 and Leg 2 is applicable.
- viii. Sales value for both legs takes into consideration market price of the securities at contracted date, fees, and dividend payout, as demonstrated by the following formula;

Leg 1: **Selling Price = MPt x Q**

Where,

MPt : Market Price of the shares at Leg 1 contracted date

Q : Quantity of the shares

Leg 2: **Exercise Price = (MPt x Q) – MI – D**

Where,

MI : Monthly Installment (reflects the “lending fee” in conventional SBL)

D : Dividend

- ix. The indebtedness shall be secured against acceptable collateral which must be in the following order;
  - a. Cash or cash equivalent instruments
  - b. Shariah compliant securities
  - c. Sukuk (Malaysia)
  - d. Sukuk (Foreign)
  - e. Sovereign bonds (Foreign)

For item ix (b) above, in the event the pledged securities turns to be Shariah non-compliant, immediate replacement with an approved substitute is obligatory.

For item ix (e) above, discounting the coupon component, pledged sovereign bonds will only be valued up to the principal amount.

- x. The imposition of compensation charges at actual loss is permissible on defaulting party.

The Committee had also resolved on the major potential Shari’ah issues in anticipation, amongst others;

**(i) Resemblance to *Bay’ al-‘Inah***

*Bay’ al-‘Inah* refers to an arrangement that involves sale of an asset to the purchaser on a deferred basis and subsequent purchase of the asset at a cash price lower than the deferred sale price or vice versa, and which complies with the specific requirements of *Bay’ al-‘Inah*<sup>4</sup>.

Given the fact that same parties involved in executing two (2) sale transactions and dealing with similar asset of sale, the iSSB features would trigger the issue of close resemblance to *bay’ al-‘inah*.

Item	Issues	Resolution
<b>(a)</b>	<b>Purpose/Concept</b>	
	<p>The main purpose of executing <i>‘inah</i> is for one of the contracting parties to obtain immediate <b>cash</b> while the other is obtaining a so called ‘profit’ by executing a sale contract followed by an instant repurchase of the same asset.</p> <p>This creates the perception that <i>‘inah</i> is adopting the concept of <i>hiyal</i> (tricks) in order to legalise the transaction of loan with interest (<i>riba</i>). Therefore, it is prohibited according to some scholars under the principle of <i>sadd al-zarai’</i> (blocking of the means) as the transaction is tantamount to <i>riba</i><sup>5</sup>.</p>	<p>iSSB is to facilitate regulated short selling activities in a Shariah compliant manner via an outright sale transactions with effective transfer of ownership of the asset to the purchaser. Whilst the seller in Leg 1 is not expecting the same asset to be ‘returned’ via another sale contract at Leg 2.</p> <p>Further, there is no instant cash movement from any of the contracting parties in iSSB. In fact, there is no indication of the intention of the parties in iSSB to obtain immediate cash (“loan”) out of the trade transactions.</p> <p><i>‘Inah</i> as stated in <i>Al-Mawsu’ah Al-Fiqhiyyah Al-Kuwaitiyyah</i> refers to “a loan in the form of a sale in order to make the increase appear lawful”. Whereas the proposed iSSB-NT model does not promote such an activity. In fact, there is possibility of Leg 2 may not take place for any reason whatsoever.</p>
<b>(b)</b>	<b>The asset of sale (<i>al-mabi’</i> or <i>al-ma’qud ‘alaih</i>)</b>	
<b>(i)</b>	The asset of sale in <i>bay’ al-‘inah</i> is referring to an absolutely the <b>same</b> asset.	Under iSSB, there is no element of selling and repurchasing the same asset of sale between two parties in the form that tantamount to <i>‘inah</i> . Leg 2 of iSSB-NT transaction involves similar

<sup>4</sup> Bank Negara Malaysia, Bai’ ‘Inah: Shariah Requirements and Optional Practices, Exposure Draft, pg. 4

<sup>5</sup> *Al-Fiqh al-Islami wa Adillatuhu* by Dr Wahbah Az-Zuhaili, Vol. 4, pg, 239

Item	Issues	Resolution
	.	<p>Securities and not the same securities that were transacted in Leg 1. This shows that if the owner of the securities (upon execution of Leg 1) has sold the securities partially or fully to any third party, a new set of similar securities should be purchased from the market before Leg 2 transaction could take place. This indicates the real economic effect where the owner of the securities is taking full risk and liability on the movement of the price of the securities in the market. The same risk and liability cannot be found in <i>'inah</i> since the same and exact underlying asset is sold back to the original seller and there is no need to source it from the market.</p>
(ii)	<p>Returning of the asset bought by a purchaser to the original seller is highly expected.</p>	<p>In iSSB, there is possibility of worst case scenario whereby Leg 2 shall not take place for any reason whatsoever,</p> <p>Each transaction of Leg 1 and Leg 2 is outright sale.</p> <p>Upon execution of each sale transaction, risks and liabilities arising from the asset of sale will lie with the owner of the asset and will pass in the same instance when ownership of the asset passes. There is a minimum time gap of two (2) market days (T+1) imposed between Leg 1 and Leg 2 whereby the owner of the securities will take full liability and responsibility over the purchased securities during that period. The owner is having full rights to freely deal with the asset without any restriction/limitation imposed explicitly as well as implicitly. Both contracting parties contribute to real economic benefit whenever dealing with the asset.</p>
(c)	<b>Payment</b>	
	<p>Given the objective is for a party to have immediate cash, <i>'Inah</i> involves deferred (credit) and cash payments features.</p>	<p>In iSSB, payment of the selling price of the two transactions is settled via offsetting between the two prices on the maturity date/effective date of Leg 2 transaction. In fact, 'deferred' and 'spot' are among the acceptable payment terms from Shariah perspective which is not necessarily part of <i>'inah</i>.</p>

**(ii) Resemblance to *Bay' al-Wafa'***

*Al-Mawsu'ah al-Fiqhiyyah* defines *bay' al-wafa'* as;

البيع بشرط أن البائع متى رد الثمن يرد المشتري المبيع إليه، و إنما سمي بيع الوفاء لأن المشتري يلزمه الوفاء بالشرط<sup>6</sup>

Sale on the condition that the seller be allowed to get back the asset upon paying its price. It is named as *bay' al-wafa'* due to that purchaser is obliged to fulfil the condition.

The Islamic Fiqh Academy of the Organisation of Islamic Conference (OIC) issued a resolution declaring that the reality of this sale is that it is “a loan with added benefits”, so it is a ruse to circumvent the prohibition of *riba*. It is invalid according to the majority of the jurists; thus, it remains a prohibited contract<sup>7</sup>.

Item	Issues	Resolution
<b>(a)</b>	<b>Ownership Rights</b>	
	<p><i>Bay' al-wafa'</i> expects the same asset of sale to be returned to the seller upon payment of purchase price. Such expectation indicates that the seller is so called enforcing an ‘encumbrance’ to the asset which limits the right of the purchaser as a rightful owner to deal with this asset.</p> <p>Neither the seller nor the purchaser can sell to another a thing sold by <i>bay' al-wafa'</i>.<sup>8</sup></p>	<p>In iSSB, the sale contract of Leg 1 is considered as an outright sale. iSSB allows the buyer to deal with the asset as a legitimate owner upon execution of the sale transaction, including selling it to a third party. Therefore, any encumbrances are not valid though it could be on the basis of mutual agreement.</p> <p>(Refer also to the above explanation of Criterion no. iv).</p>
<b>(b)</b>	<b>The asset of sale (<i>al-mabi'</i> or <i>al-ma'qud 'alaih</i>)</b>	
<b>(i)</b>	<p><i>Bay' al-wafa'</i> expects the same asset of sale to be returned to the seller in its absolute form.</p>	<p>Under iSSB, the securities as an asset of sale at Leg 2 could be different from the asset sold at Leg 1. In fact, both are considered different assets of sale. However, the two (2) assets are expected to come from the same counter and share the same stock code.</p>

<sup>6</sup> *Al-Mawsu'ah al-Fiqhiyyah*, Chapter 9, pg. 260

<sup>7</sup> <http://www.fiqhacademy.org.sa/qarat/7-4.htm> Resolution no. 66 (4/7) 9-14 May 1992, and ISRA Compendium for Islamic Financial Terms, pg. 24

<sup>8</sup> The Mejlle (Being an English Translation of *Majallah el-Ahkam-I-ADliya* and A Complete Code of Islamic Law), pg. 58

Item	Issues	Resolution
		Similarly, in conventional SBL-NT, the lender is expecting 'similar' or 'equivalent' securities to be returned upon recall and not absolutely the same set of securities. 'Similar' here means a set of securities that comes from the same counter and shares the same stock code with the one that was lent earlier.
<b>(c)</b>	<b>Initiating Party</b>	
	Normally in <i>bay' al-wafa'</i> , it is the seller who would initiate the return of the same asset by paying the buyer the purchase price.	As highlighted under the Criterion no. (ii) above that the document of undertaking ( <i>wa'd</i> ) to sell similar securities in iSSB will be executed by Party B (not Party A) and it is supported by a sale transaction.  This further strengthens the argument of that the Leg 1 transaction is an outright sale.
<b>(d)</b>	<b>Underlying Concept</b>	
	In <i>bay' al-wafa'</i> , the return of the purchased asset from buyer to seller is a mere fulfilment of condition prescribed in the earlier contract of sale.	iSSB is attributed by two (2) independent sale transactions. Condition (in <i>bay' al-wafa'</i> ) is an obligatory but sale (in iSSB) is optional. Buyer reserves the right not to proceed with Leg 2 sale transaction though it might be consider as breaking promise ( <i>wa'd</i> ).

**(iii) Resemblance to *al-Qard* (Loan)**

Item	Issues	Resolution
<b>(a)</b>	<b>Nature of asset (<i>al'mabi'/al-ma'qud 'alayh</i>)</b>	
	The set of securities traded in iSSB as asn asset ( <i>al-mabi'/al-ma'qud 'alayh</i> ) might be seen as ' <i>mithliyat</i> ' (homogenous) item. With <i>wa'd</i> to execute the Leg 2 of transaction in place, the whole exercise might be seen as merely a <i>qard</i> whereby the asset "borrowed" in Leg 1 of transaction is returned (through the Leg 2 transaction) with additional benefit. The issue of " <i>qard jarra naf'an</i> " may be an issue here.	Trading securities in iSSB is a true sale and not considered a <i>qard</i> . This can be clearly observed through the difference between the two ( <i>qard</i> and sale) in terms of their liability as explained below.

Item	Issues	Resolution
(b)	<b>Liability</b>	
	In <i>qard</i> , borrower remains liable to repay the loan so long there is an outstanding balance.	In iSSB, there is a possibility whereby Leg 2 shall not take place for any reason whatsoever.

(iv) **Application of the concept of *Wa'dan*<sup>9</sup>**

Item	Issues	Resolution
(a)	<b>Permissibility of <i>Wa'dan</i></b>	
		<p><i>Wa'dan</i> is a relatively new term introduced by modern scholars as a legal trick (<i>'illah</i>) to avoid two promises on the same subject matter becoming a binding <i>muwa'adah</i>, which is not allowed by most scholars. The legal trick works through having different conditions that will eventually lead to the exclusive execution of one binding <i>wa'd</i> in the future.<sup>10</sup></p> <p><i>Wa'dan</i> in the proposed iSSB-NT model involves two parties giving two promises that have different conditions on the same subject matter, but only one of either <i>Wa'd</i> 1 or <i>Wa'd</i> 2 will be executed in accordance to the relevant conditions.</p> <p><i>Wa'dan</i> as highlighted by some scholars in their research has been used in structured products such as Islamic forward FOREX, Islamic profit rate swaps and Islamic cross currency swaps for risk management and hedging purposes.<sup>11</sup></p>

<sup>9</sup> *Wa'dan* is two unilateral promises, given by one party to another, that are not interrelated, and their application depends on two different conditions. Ref: Aznan Hasan (Dr.), "*Pengertian Al-Wa'ad, Al-Wa'dan Dan Al'Muwa'adah*", *Muzakarah Cendekiawan Syariah Nusantara 2008*, p.1

<sup>10</sup> ISRA Research Paper 30/2011: The Bindingness and Enforceability of a Unilateral Promise (*Wa'd*): An Analysis from Islamic Law and Legal Perspectives, p.82

<sup>11</sup> ISRA Research Paper 20/2011: The Bindingness and Enforceability of a Unilateral Promise (*Wa'd*): An Analysis from Islamic Law and Legal Perspectives, p. 37



(v) Payment Term of the Sale Price of Leg 1

Item	Issues	Resolution
(a)	Permissibility of Deferred Lump Sum/Monthly Instalment	<p>In general, deferred payment of Sale Price in ‘<i>uqud mu’awadhat</i> (Contracts of Exchange) is permissible as discussed under the concept of <i>bay’ mua’ajjal</i> (Deferred Sale). ‘Deferred’ as proposed under iSSB-NT means payment of Sale Price of Leg 1 can be made on a lump sum basis of which the sale price is paid at a predetermined future date; or can be on a staggered basis of which the sale price is paid via monthly instalment.</p> <p>Such payment terms in iSSB-NT should not raise any concerns related to Shariah given the total amount due will be the same, irrespective whether paid in Lump Sum or by instalment over the same period, thus contains no element of <i>riba al-nasiah</i> (also known as <i>riba al-duyun</i> or <i>riba al-jali</i> or <i>riba al-jahiliyyah</i>).<sup>12</sup></p> <p>Mutually agreed payment structure such as monthly installment should be acceptable from Shari’ah perspective as it reflects and does not exceed the SP of Leg 1. Furthermore, there is neither issue of <i>Gharar</i> (ambiguity) nor <i>Riba</i> in the said arrangement.</p>

Should there be any changes in or additions to the process, structure, or mechanism as what has been presented; it must be submitted to the Shar’iah Committee for review and approval.

*And prayers and peace be upon the last Prophet Mohammad, and be upon his relatives and all his companions.*

<sup>12</sup> *Riba al-Nasiah* is the stipulation of a premium paid to the lender in return for his allowing a delay in repayment. During the pre-Islamic period, this type of *riba* was widespread; whenever it was time to repay and the debtor was unable to do so, the lender would increase the payment period in return for an increase in the amount of debt.