BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Shariah Contract Framework

Discussion Paper

Applicable to:
1. Licensed Islamic banks
2. Licensed banks and licensed investment banks approved to carry on Islamic banking business
3. Licensed takaful operators including professional retakaful operators
4. Prescribed development financial institutions approved to carry on Islamic financial business
5. Approved issuers of designated Islamic payment instrument

Issued on: 11 November 2024 BNM/RH/DP 028-21

This Discussion Paper (DP) outlines Bank Negara Malaysia's (the Bank) proposed approach for the review of 14 Shariah contract-based policy documents (PDs) in facilitating a diverse application of Shariah contracts by Islamic financial institutions (IFIs). This DP seeks feedback from IFIs and their respective Shariah committees on the following areas:

(a) Value proposition of Shariah contracts in supporting IFIs' business strategies and value-based reforms to support socio-economic development;
(b) Framework design for Shariah contract-based PDs where a single Shariah Contract Framework is explored, complemented with an Implementation Guide;
(c) Policy approach in the review of Shariah and operational requirements under the existing Shariah contract-based PDs; and
(d) Collaborative implementation strategy and timeline of policy review in phases.

Feedback received from this exercise will serve as input to the Bank's holistic review of the proposed Shariah contract-based PDs, to be conducted as early as 2025.

The Bank invites written feedback, including suggestions for further clarification on any particular issues or areas, or alternative proposals for the Bank to consider. The written feedback should–

(a) be prepared based on input from relevant parties within the organisation including, but not limited to, business unit and internal control functions such as risk management, compliance and internal audit functions given the cross-cutting implications of the proposals to the IFIs' business strategies, operations and offerings;
(b) be supported with clear rationale, evidence, or illustrations, as may be appropriate, to facilitate the Bank's assessment; and
(c) include responses to specific questions included in this DP.

The written feedback must be submitted electronically to the Bank by **10 February 2025** via email to shariahstandard@bnm.gov.my. In the course of preparing the feedback, specific queries can be directed to the same email address.

Issued on: 11 November 2024

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PART A OVERVIEW

1 Introduction

1.1 The Bank has issued a compendium of 14 Shariah contract-based PDs[1], with the inaugural *Murabahah* PD issued in 2013. The PDs contain two distinct components, namely (i) Shariah requirements; and (ii) operational requirements that aim to promote end-to-end Shariah compliance, provide clear guidance to IFIs in operationalising the Shariah contracts and enhance confidence in the Islamic financial system.

1.2 The compendium of Shariah contract-based PDs, in addition to Shariah rulings by Shariah Advisory Council (SAC) of Bank Negara Malaysia, has become the main source of reference for Shariah Committees (SC) and various functions in IFIs to ensure end-to-end Shariah compliance, including product development and internal control functions such as compliance, risk management and internal audit.

1.3 Whilst the Islamic financial industry continues to grow and align with value-based finance principles[2], the Bank envisages that the full potential and value proposition of Islamic finance can be further realised with the application of more diverse Shariah contracts aimed to better meet consumer and economic needs.

1.4 In this regard, this DP aims to explore potential approaches in recalibrating and enhancing the effectiveness of Shariah contract-based PDs to ensure a conducive regulatory environment for the application of diverse Shariah contracts. This DP also seeks to examine the corresponding challenges faced by the industry in applying the various Shariah contracts effectively. Specifically, this DP outlines strategies to support alignment of Shariah contract application with objectives of Shariah and Shariah contract, as well as promote the application of diverse Shariah contracts as follows:

(a) Unlock value proposition of Shariah contracts in supporting IFIs' business strategies and value-based reforms to support socio-economic development;
(b) Explore a framework design for Shariah contract-based PDs where a single Shariah Contract Framework is adopted, complemented with an Implementation Guide;
(c) Outline policy approach in the review of Shariah and operational requirements under the existing Shariah contract-based PDs; and
(d) Recommend, in phases, collaborative implementation strategy and timeline of policy review.

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[1] *Murabahah* (2013), *Mudarabah* (2015), *Musyarakah* (2015), *Istisna'* (2015), *Wakalah* (2016), *Wadiah* (2016), *Hibah* (2016), *Kafalah* (2017), *Wa'd* (2017), *Qard* (2018), *Ijarah* (2018), *Sarf* (2018), *Rahn* (2018) and *Tawarruq* (2018).
[2] Refer to Value-Based Intermediation (VBI) and Value-Based Intermediation for Takaful (VBIT).

The summary of proposed enhancements to Shariah contract-based PDs is provided in Appendix 1.

2 Interpretation

2.1 The terms and expressions used in this DP shall have the same meanings assigned to them in the Islamic Financial Services Act 2013 (IFSA), the Financial Services Act 2013 (FSA) and the Development Financial Institutions Act 2002 (DFIA), as the case may be, unless otherwise defined in this DP.

2.2 For the purposes of this DP–

"**Islamic financial institution"** means:

(a) a licensed Islamic bank;

(b) a licensed bank or a licensed investment bank approved under section 15(1)(a) of the FSA to carry on Islamic banking business;

(c) a prescribed development financial institution under the DFIA approved under section 33B(1) of the DFIA to carry on Islamic financial business;

(d) a licensed takaful operator including a professional retakaful operator; and

(e) an approved issuer of designated Islamic payment instrument under section 11 of the IFSA or approved issuer of a designated payment instrument approved under section 15(1)(e) of the FSA to issue a designated Islamic payment instrument.

2.3 A glossary of Arabic terms used in this DP is set out in Appendix 5.

PART B VALUE PROPOSITION OF SHARIAH CONTRACT

3 Wisdom and objectives of Shariah contracts

3.1 An IFI needs to ensure that at the transactional level, the Islamic financial products and services structured using various Shariah contracts comply with Shariah requirements[3]. These requirements are underpinned by fundamental Shariah principles including the prohibition of usury (*riba`*), excessive uncertainties (*gharar fahish*) and gambling (*maysir*).

3.2 In addition to this, an IFI shall also be guided by the objectives of Shariah (*maqasid Shariah*) in conducting its business and operations to ultimately prevent harm (*mafsadah*) and attain benefit (*maslahah*). This expectation is well embodied in the Value-Based Intermediation Strategy Paper[4], Value-Based Financing and Investment Impact Assessment Framework[5] (VBIAF) and Value-Based Intermediation for Takaful[6] (VBIT) documents (collectively referred to as VBI). This is also in line with global trends and developments that call for actions by financial institutions to adopt more sustainable and responsible practices[7], as well as the Bank's requirements for financial institutions to manage climate-related risks[8].

> *"The very objective of the Shariah (maqasid Shariah) is to promote the welfare of the people which lies in safeguarding their **faith**, their **life**, their **intellect**, their **posterity** and their **property**. Whatever ensures the safeguard of these five serves public interest and is desirable."*
> *– Al Ghazali*[9]

3.3 Current Islamic financial products and services can be designed to align with the objectives of Shariah, such as *tawarruq*-based sustainability financing that supports climate mitigation or climate adaptation in line with the objectives of Shariah to preserve property (*hifz mal*), protection of life (*hifz nafs*) and protection of posterity/ lineage (*hifz nasl*). However, the application of diverse Shariah

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[3] Including Shariah rulings made by the SAC of Bank Negara Malaysia and Shariah principles under the recognised sources of Islamic law, or any legal judgment deduced by a qualified jurist via the ijtihad process.
[4] Issued by the Bank on 12 March 2018.
[5] Issued by the Bank on 1 November 2019.
[6] Issued by the VBIT Task Force on 23 June 2021.
[7] For example, United Nation's Sustainable Development Goals and the Paris Agreement.
[8] For example, requirements specified under Climate Risk Management and Scenario Analysis PD and guidance under Climate Change Principle-Based Taxonomy document.
[9] Source: Abu Hamid Muhammad ibn Muhammad al-Ghazali, *Al-Mustasfā min `Ilm al-Usul* (On Legal Theory of Muslim Jurisprudence).

contracts could provide IFIs with a more unique value proposition and competitive advantage.

3.4 Given that each Shariah contract is intended to be applied for a specific purpose or objective (*maqasid `aqd*), an IFI has the opportunity to explore a wider scope of intermediation activities compared to conventional finance. For example, Shariah contracts with non-principal guaranteed features can be applied in structuring an investment account (IA) under the IFSA[10] e.g. *wakalah bi al-istithmar* and *mudarabah*. For an acquisition of property under construction, an IFI could adopt Shariah contracts that are suitable, whose wisdom (*hikmah*) and objectives are aligned with the purpose of the transaction such as *istisna`* or *ijarah mawsufah fi zimmah.* The wider offerings of Islamic financial products and services using diverse Shariah contracts can further support the IFI's business strategies in meeting the specific financial needs of consumers, including the unserved and underserved segments.

Diagram 1: Illustration of Shariah Contract Application Based on its Wisdom and Objectives to Meet Consumer's Financial Needs

	Consumer's financial needs	Challenge	*Diversification of Shariah contracts* — Current Offerings	+ Additional Offerings
Islamic banking	Micro, small and medium enterprises (MSMEs) requiring funding for business operation and expansion	Lack of credit history and collateral	**Credit-based financing** • E.g. *Tawarruq*-based working capital financing	**Blended Financing** * E.g. Financing based on philanthropic capital such as waqf, zakat and sadaqah **Equity-based financing** • E.g. *Mudarabah* or *musharakah* ventures funded by IA
Takaful	Underprivileged communities requiring takaful protection	Lack financial resources or competing financial priorities	**Mutual protection (*ta`awun*)** • Takaful participants mutually protect each other against pre-determined risks	**Broader application of *ta`awun*** • E.g. utilisation of distributable surplus to subsidise takaful contribution of others • E.g. waqf-takaful protection

Question 1

(a) Does your institution currently consider –

(i) objectives of Shariah (*maqasid Shariah*) in the formulation of your business plan, internal policies and procedures including risk appetite framework; and

(ii) objectives of Shariah contract (*maqasid `aqd*) in structuring Islamic financial products and services e.g. adoption of a suitable Shariah contract with

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[10] Under the IFSA, an investment account is distinguished from an Islamic deposit where the principal is not guaranteed by the IFI. Section 288 of the IFSA provides a savings provision where Islamic deposits accepted by an Islamic bank under the repealed Islamic Banking Act 1983 that do not fall within the definition of "Islamic deposits" under the IFSA are deemed to be "Islamic deposits" under the IFSA within the period as prescribed by the Minister (i.e. Islamic Financial Services (Prescribed Dates for Islamic Deposits) Order 2014 (P.U. (A) 149/2014). This is to ensure that an IFI would be able to make the appropriate classification of Islamic deposits and investment accounts based on the suitable Shariah contracts according to the definitions under the IFSA.

objectives aligned to the purpose of the Islamic financial products and services?

(b) Please describe or explain how the objectives of Shariah are embedded in your strategic, business and risk considerations, as well as in deliberations by your institution's SC. Please also describe or explain how the objectives of Shariah contract is considered in product development as well as in the SC's deliberations.

4 Values-based reforms to support socio-economic development

4.1 The IFSA provides clear definitions and scope of Islamic banking and takaful businesses that are underpinned by Shariah, distinguished from conventional finance. Islamic financial business is operationalised through the application of various Shariah contracts, for example, –

(a) in respect of Islamic banking business, an acceptance of money under an IA based on Shariah contracts with non-principal guaranteed features, which include *mudarabah*, *musyarakah* and *wakalah bi al-istithmar*. With regard to the provision of finance, an equity or partnership financing based on *musyarakah* or *mudarabah*, lease-based financing based on *ijarah*, sale-based financing based on *salam* or *murabahah*, as well as fee-based activity based on *wakalah*;

(b) for takaful, an arrangement based on *ta`awun* (mutual assistance) in which takaful participants contribute to a common fund in providing for mutual financial benefits payable to the takaful participants or their beneficiaries on the occurrence of pre-agreed events. The provision of takaful business is underpinned by Shariah contracts/ concepts governing the takaful operational model e.g. *tabarru`* for takaful participants' contribution into the takaful fund, *wakalah* for management of takaful fund by licensed takaful operators, *mudarabah* for management of participant individual investment fund as well as *qard* for rectification of deficit in takaful funds;

(c) For Islamic money market and Islamic foreign exchange market, Islamic financial instruments, transactions or operations that are not contrary to Shariah. The Islamic financial instrument applies various Shariah contracts such as *qard*, *murabahah* and *tawarruq*; and

(d) For Islamic payment instrument, any instrument that does not involve any element which is contrary to Shariah. The Islamic payment instrument applies various Shariah contracts, such as *wakalah* that governs the rights and obligations of contracting parties in an electronic money transaction.

4.2 The offering of Islamic financing by licensed Islamic banks in the past few decades is predominantly focused on credit/ debt-based financing where the Islamic financing products are structured using a combination of several Shariah contracts to achieve their intended economic/ financial outcome. For example, asset acquisition financing based on *ijarah muntahiyah bi tamlik* (lease contract that ends up with the transfer of ownership of a leased asset to the lessee) applies *ijarah* as the primary Shariah contract, supported with the application of ancillary contracts such as an undertaking (*wa`d*), gift (*hibah*) or sale (*bai`*) to effect the eventual transfer of asset ownership from a licensed Islamic bank to its customer upon maturity or in the event of default. The use of undertaking where the customer commits to ultimately purchase the asset effectively transforms the lease nature of *ijarah* into a credit/ debt-based financing[11].

4.3 As the Islamic banking industry has progressed and matured, a licensed Islamic bank has the avenue as provided under IFSA to offer a wider range of products and services as well as different modes of financing, tapping into new asset classes and markets, such as blended finance and partnership funding initiatives to complement the existing credit/ debt-based financing. This includes the application of equity-based Shariah contracts in line with their wisdom and objective such as *mudarabah* or *musyarakah* ventures. Essentially, these Shariah contracts enable customers' businesses to be funded by an investment to be made by licensed Islamic banks through a profit and loss sharing arrangement (*musyarakah*) or profit sharing and loss bearing arrangement (*mudarabah*). The profit and loss attributable to the customers and the licensed Islamic banks are determined based on the appropriate methodology to ensure that earnings are achieved in a fair, just and equitable manner[12]. These different modes of financing operationalised through various Shariah contracts place licensed Islamic banks in a fitting position to support national economic aspirations[13].

4.4 The diversified Islamic banking products and services based on various Shariah contracts in turn will also provide diversified underlying assets available for IA to cater wider segments of IA holders (IAH) with different risk appetite, making IA more appealing and competitive in the retail investment space such as equity crowdfunding and Peer-to-Peer (P2P) financing.

4.5 In addition, Shariah contracts that are benevolent in nature such as *waqf*, *hibah*, *qard* and *sadaqah* could harness and mobilise funding and capital for philanthropic purposes to promote greater social cohesion and financial resilience[14]. Such objectives are also in tune with the application of *ta`awun* (mutual assistance) concept in takaful where the consideration of wider application of Shariah contracts could further promote the application of *ta`awun* to provide wider protection of unserved and underserved segments in enhancing socioeconomic resilience[15]. This aligns with the Shariah concept of *rawaj* (circulation and distribution of wealth) in the protection of property (*hifz mal*).

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[11] Refer to Appendix 4 on illustration of variation in structures of Islamic financial products and services.

[12] Methodology and computation of profit rate attributable to an investment account holder and Islamic bank are subjected to the Rate of Return policy document issued on 17 January 2018.

[13] For example, in meeting new and more complex financing demands e.g. high-tech firms and other enterprises in highly innovative ventures.

[14] Refer to Appendix 3 for the illustration on characteristics of social finance offerings in Malaysia.

[15] Refer to Broader Application of *Ta`awun* in Takaful Exposure Draft issued on 28 June 2024.

> *"The principles of Islamic economics and finance hold the promise of driving **value-based** growth, beyond mere profit goals – one that is balanced, progressive, sustainable and inclusive. Aligned with the objectives of Shariah, we are called to foster **shared prosperity**."*
> *– Governor, Global Forum of Islamic Economics and Finance (GFIEF) 2024.*

Questions 2

(a) Please elaborate your institution's view on the values and roles of the diverse Shariah contracts (besides *tawarruq*) in–

- (i) supporting your institution's business strategies including diversification of Islamic financial products and services to serve wider and niche markets;
- (ii) facilitating the transformation of economy to a high-income nation; and
- (iii) enhancing the values of your institution in serving the wider community in addition to meeting the interests of your shareholders.

(b) In further enhancing the potential of Shariah contracts that support the value-based reforms, please elaborate on the following:

- (i) your institution's appetite and strategies for product innovations using diverse Shariah contracts;
- (ii) your institution's view on product innovations and Shariah contracts diversification that may necessitate greater adoption of financial technology (fintech) in your institution. For example, whether you envisage/ foresee the adoption of smart contracts[16] or blockchain technology in the near future to promote regulatory compliance/ governance, process automation and products development; and
- (iii) operational challenges in innovating Islamic financial products and services based on application of diverse Shariah contracts e.g. cost and staff competency to conduct research on product innovation.

[16] For example, self-executing applications that can trigger an action when pre-specified conditions are met.

PART C REVIEW OF FRAMEWORK DESIGN

5 Proposed new Shariah contract framework design

5.1 To date, the Bank has issued 14 individual Shariah contract-based PDs which were developed through a robust development process, including deliberations of Shariah requirements at the SAC's level as well as the operational requirements to support Shariah compliance and ensure a prudent application of Shariah contracts. The current individual Shariah contract-based PDs consider the iterative strategy of the Bank in developing a comprehensive framework for Shariah contracts in phases, resource requirements as well as to ensure the requirements are reflective of the nature and specificities of each Shariah contract.

Diagram 2: Overview of Shariah Contract-based PDs

Shariah Contract-based Policy Documents

	Exchange-based	Equity-based	Trust-based	Others
14 PDs issued since 2013	• *Murabahah* *(sale with mark-up)* • *Istisna`* *(Construction/ manufacturing)* • *Ijarah* *(Lease)* • *Sarf* *(Currency exchange)* • *Tawarruq* *(Tripartite sale arrangement)*	• *Mudarabah* *(Profit sharing and loss bearing)* • *Musyarakah* *(Profit and loss sharing)*	• *Wakalah* *(Agency)* • *Wadi`ah* *(Safekeeping)* • *Kafalah* *(Guarantee)* • *Rahn* *(Collateral)*	• *Hibah* *(Gift)* • *Wa`d* *(Promise)* • *Qard* *(Interest free loan)*

	Shariah Requirements	Operational Requirements
Components of PDs	• Nature and salient features of Shariah contract • Components in a contract e.g. contracting parties • Application/ arrangement with other contracts • Dissolution/ completion of contract	• Governance & oversight • Product structuring & documentation • Risk management throughout the cycle of contract • Disclosure to promote informed decision making • Business and market conduct

5.2 Over the years since the issuance of the Shariah contract-based PDs, there have been various regulatory developments[17], rapid advancement in technology[18] as well as progress in industry practices that necessitate for the current framework design of the Shariah contract-based PDs to be adaptable, relevant, and effective in supporting regulatory objectives whilst facilitating innovations within the Islamic finance industry.

5.3 In this regard, the Bank plans to modernise the framework design of Shariah contract-based PDs to make it clearer, simpler and more practical through a proportionate approach, whilst continue to uphold Shariah compliance and ensure safety and soundness of the IFIs. The review of the framework design is envisaged to–

(a) **Enhance ease of use and navigation**
Improving IFIs' user experience in navigating the various interlinkages of requirements across Shariah contracts, such as in products structuring and development involving multiple Shariah contracts[19], as well as in compliance testing and internal audit. Towards this objective, a comprehensive single document instead of separate Shariah contract-based PDs and potential adoption of technology solutions in the long run could enhance IFIs' user experience;

(b) **Ensure greater alignment between Shariah and regulatory requirements**
Ensuring greater alignment by streamlining common Shariah and operational requirements which can be universally applied across all Shariah contracts-based PDs or those with similar nature (e.g. sale-based and equity-based Shariah contracts). This is to facilitate regulatory compliance and improve operational efficiency, whilst ensuring the requirements are proportionate to the risk profile and varying degrees of complexity in the application of different Shariah contracts, as well as remain consistent with other interrelated requirements issued by the Bank (e.g. Shariah Governance and Product and Transparency PDs); and

(c) **Support practical applications**
Facilitating practical applications of diverse Shariah contracts and implementation/ operationalisation of Shariah and operational requirements that could harness full potential of Shariah contracts. This could be achieved through the development of an Implementation Guide

[17] For example, proposed enhancements to Product Transparency and Disclosure requirements via issuance of the Exposure Draft, and issuance of PD on Fair Treatment of Financial Consumers.
[18] This includes potential application of innovative technology in the financial industry (fintech), as well as in regulatory architecture such as artificial intelligence, machine learning and blockchain technology.
[19] For instance, the structuring of *musyarakah mutanaqisah* products which involves three Shariah contract-based PDs, namely *Musyarakah*, *Ijarah*, and *Wa'd*.

(IG) to complement the Shariah contract framework, as guidance references on practical contracts applications (refer to paragraph 5.5).

Proposed new framework design: Single Shariah contract framework complemented with an implementation guide

5.4 Considering the everchanging environment in the Islamic financial industry and the intended outcomes under paragraph 5.3, as a start, the Bank is exploring to adopt a new framework design that consolidates the 14 Shariah contract-based PDs into a single document (hereinafter referred to as the "Framework"). The Framework will contain two distinct parts, namely–

(a) Part A: Overarching Shariah principles, universal Shariah requirements and specific Shariah requirements

Common Shariah principles that can be universally applied to all Shariah contracts, as well as unique Shariah requirements based on types of Shariah contract i.e. (i) equity-based; (ii) exchange-based; (iii) trust-based; and (iv) others/ ancillary contracts; and

(b) Part B: Universal operational requirements and specific operational requirements

Principle-based operational requirements that can be universally applied to all Shariah contracts, as well as specific operational requirements to address specific risk profile, nature and characteristic of each Shariah contract.

Diagram 3: Illustration of New Shariah Contract Framework Design

Part A: Shariah requirement

- **Overarching Shariah Principles**
  - Objective of Shariah *(refer to paragraph 6.3 of this DP)*
  - Objective of Shariah contract *(refer to paragraphs 6.5 – 6.8 of this DP)*
- **Universal Shariah requirements** *(refer to paragraphs 8.2 – 8.3 of this DP)*

  E.g. Exchange-based contracts
  - Contracting party
  - Subject matter
  - Offer and acceptance

  E.g. Equity-based contracts
  - Contracting party
  - Subject matter
  - Offer and acceptance
  - Capital
  - Profit
  - Loss
- **Specific Shariah Requirements** *(refer to paragraph 8.4 – 8.5 of this DP)*

  E.g. Exchange-based contracts
  - *Murabahah*: Shariah requirements on mark-up price and determination of cost
  - *Istisna`*: Shariah requirements on asset specification and ownership

  E.g. Equity-based contracts
  - *Musyarakah*: Shariah requirements on capital, profit, loss & application of musyarakah mutanaqisah

Part B: Operational requirement

- **Universal operational requirements** *(refer to paragraphs 10.2 – 10.3 of this DP)*
  - Governance and oversight
  - Structuring
  - Risk management
  - Financial disclosure
  - Business and market conduct
- **Specific operational requirements** *(refer to paragraphs 10.4 – 10.6 of this DP)*

  E.g. Exchange-based contracts
  - *Murabahah*: Operational requirements on acquisition of asset and inventory management
  - *Istisna`*: Operational requirements on *istisna`* asset and project

  E.g. Equity-based contracts
  - *Musyarakah*: Operational requirements on oversight of *musyarakah* venture

The new framework design is envisaged to achieve the intended outcomes under paragraph 5.3 including promoting effective implementation of Shariah contracts as well as supporting effective regulatory compliance to the requirements. The new framework design also aims to enhance the agility to cater for innovation and new Shariah contracts[20] in the future.

5.5 Whilst the Framework will contain paragraphs that are labelled as "G" to support IFIs' compliance to requirements in paragraphs that are labelled as "S", the Framework will be also complemented with an IG which intends to provide best practice and guidance on potential applications of diverse Shariah contracts. The IG aims to outline practical aspects (both on Shariah and operational requirements implementation) that can be considered by IFIs, for example in the structuring of Islamic financial products and services. For the initial stage, the IG will cover fundamental aspects in basic Islamic financial products and services and will gradually expand to cater for various innovations of product offerings and evolving industry practices over time.

Diagram 4: Illustration of Implementation Guide

Overview

- Introduction

Sample practical applications of Shariah contracts by product/ model

Islamic Banking

(1) Deposit:

Tawarruq deposit
- Structuring
- Documentations

Qard deposit
- Structuring
- Documentations

(2) Investment accounts:

Mudarabah IA
- Structuring
- Documentations

Wakalah bi al-istithmar IA
- Structuring
- Documentations

(3) Financing model:

Musyarakah mutanaqisah house financing
- Structuring
- Documentations

Tawarruq working capital
- Structuring
- Documentations

(4) Primary model:

Mudarabah venture
- Structuring
- Documentations

Operating *ijarah*
- Structuring
- Documentations

Takaful

(1) *Mudarabah* and *wakalah* takaful operational model:
- Structuring
- Documentations

(2) *Waqf* takaful operational model:
- Structuring
- Documentations

Payment system

(1) *Wakalah* e-money:
- Structuring
- Documentations

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[20] For example, principle-based Shariah requirements under Part A for exchange-based Shariah contract can also be applied for *istijrar* and *salam* contracts.

Question 3

(a) What are the pain points in the current Shariah contract-based PDs design (i.e. individual 14 PDs outlining both Shariah and operational requirements) in terms of facilitating your understanding, fostering product innovation and ensuring regulatory compliance? Are there any gaps or specific areas for improvement that could be pursued to achieve these objectives?

(b) In your view, will the proposed new framework design be more feasible and practical from implementation perspectives (for both Shariah and operational parts), and what are the anticipated challenges?

(c) Based on the intended outcomes of the new framework design under paragraphs 5.3 and 5.4, would you prefer for an alternative option that retains the existing individual 14 Shariah contracts (modular design approach), complemented with one overarching PD that outlines universal overarching principles applicable for all 14 contracts? If yes, please state your rationale on this.

(d) Are there any other framework design recommendations deemed suitable as alternative? Please support your response with justifications.

(e) What is your view on the approach to introduce an Implementation Guide (IG) to complement the Shariah contract framework? Please indicate any suggestions to ensure the practicality of the IG from the industry's perspective.

PART D REVIEW OF SHARIAH REQUIREMENTS

6 Alignment with the objectives of Shariah and Shariah contract

6.1 In line with the growing importance of entrenching intrinsic values of Shariah in Islamic finance (refer to paragraph 3), the Bank is exploring to enhance the Shariah contract-based PDs by incorporating principles on the objectives of Shariah principles in the Framework aimed to ensure that the application of Shariah contract aligns with these principles.

> *"The objective of the Lawgiver (Shariah) for the responsible Muslim is that his intention in action* ***aligns with the objective of Islamic legislation*** *(Maqasid al-Shariah)"*
> *– Al-Shatibi*[21]

6.2 Whilst the overarching principles on objectives of Shariah encompass various objectives and wider wisdoms of Islamic legislation *(tasyri' islami)* aimed at preventing harm and promoting the well-being of human life, the Bank places greater emphasis on the relevant principles on objectives of Shariah in the context of contemporary application in Islamic finance as follows:

(a) overarching principles on objectives of Shariah (*maqasid 'ammah*) in respect of wealth protection (*hifz mal*); and

(b) specific objectives (*maqasid khassah*) intended by each Shariah contract (*maqasid `aqd*).

Overarching principles on objectives of Shariah

6.3 Guided by the key fundamental Shariah principles in Islamic finance (refer to Appendix 3), the Bank's review of the Shariah contract-based PDs includes the outlining of principles on the objectives of Shariah to facilitate the IFIs in ensuring the alignment of Shariah contract applications with the objectives of Shariah in the structuring of Islamic financial products and services. These principles will be incorporated in Part A of the Framework as follows:

(a) Principle 1: Profits to be earned through the application of Shariah contracts in Islamic financial products and services must be justified and derived from IFIs' acceptance or sharing of risk associated with an asset or capital investment, or a service;

(b) Principle 2: Wealth creation through the application of Shariah contracts must be balanced with wealth transfer and circulation[22];

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[21] Source: Ibrahim ibn Musa Abu Ishaq al-Shatibi, Kitab *al-Muwafaqat fi Usul al-Shariah.*

[22] For example, Broader Application of *Ta`awun* in Takaful Exposure Draft aims to promote equitable wealth circulation by encouraging effective resource distribution to preserve protection needs among takaful participants, as well as support protection needs of unserved and underserved segments.

(c) Principle 3: Application of Shariah contracts in Islamic financial products and services must be supported with adequate disclosure to the contracting parties to promote transparency and traceability of fund movements; and

(d) Principle 4: Fairness and excellence (*ihsan*) should be embodied in the application of Shariah contract products and services.

6.4 Whilst the Bank observes that the current practices of IFIs already embedded the consideration of the objectives of Shariah to a certain extent[23] as these are ingrained as part of the Bank's regulatory requirements[24] and universal values that are also subscribed by conventional financial institutions, they may not be prominently, consistently or consciously applied as part of the IFIs' business strategy and day-to-day operations[25]. In this regard, the Bank will clarify the expectations and provide guidance to operationalise/ implement the principles on the objectives of Shariah, such as embedding considerations of the Shariah objectives in the operational aspects including on principles of governance, product structuring, disclosure and market conduct.

Diagram 5: Illustration on Consideration of Shariah Objectives in Operational Aspects

Area	Principle	Guidance
Governance	The IFI shall ensure the application of Shariah contract is adequately supported with the risk appetite framework and in line with the **objectives of Shariah**	Integrate objective of Shariah consideration within IFI's strategic planning process e.g. mission, vision and corporate values to reflect broader objectives of Shariah including economic justice, fairness and transparent conduct
Structuring	The IFI shall ensure the structuring of Islamic financial products and services using Shariah contracts is in line with the risk appetite and **objectives of Shariah**, supported with adequate policies and procedures, infrastructure and documentation	Shariah Committee to consider meeting objective of Shariah in endorsing Islamic financial products and services
Disclosure and Market Conduct	The IFI shall ensure application and implementation of Shariah contracts are undertaken in a fair and transparent manner in line with **objectives of Shariah** to protect customers' interests.	Solicit and value customer feedback regarding ethical and transparent market conduct based on objective of Shariah

[23] For example, in the structuring of Islamic financial products and services and deliberation of the Shariah committee which include a consideration of the objective of Shariah.

[24] For example, Responsible Financing and Fair Treatment of Financial Consumers PDs issued on 6 May 2019 and 27 March 2024 respectively.

[25] For example, implicit consideration of Shariah objectives in internal policies and procedures result in varying and inconsistent practices.

Specific objectives of Shariah contracts

6.5 In addition to the proposed inclusion of overarching principles on the objective of Shariah in the Framework, the Bank will also outline specific objectives of each individual Shariah contract (*maqasid `aqd*) as guidance (labelled as “G” in part A of the Framework) to facilitate the IFIs in adopting the suitable Shariah contract with objectives aligned with the purpose of each Islamic financial product and service towards achievement of the objectives of Shariah.

6.6 For example, the majority of Shariah scholars and Shariah standard setting bodies associate the use of *tawarruq* with obtaining cash as its primary objective[26]. In the context of Islamic banking practice, the use of *tawarruq* is aligned with financing designed to generate cash where the specific use of the cash is not specified, such as personal financing and credit card.

6.7 Islamic financial products and services should not only be Shariah compliant at the transactional level, but also support the ultimate objectives of Shariah in preventing harm and attaining benefits which include promoting socioeconomic resilience and human well-being through the application of suitable Shariah contracts in line with their objectives and wisdom. For example, an application of *ijarah* contract in a house financing in the form of a lease structure (e.g. finance or operating *ijarah*) can be an alternative financial solution to the existing credit/ debt-based financing in supporting house ownership among the unserved and underserved segments, in line with the objective of Shariah to preserve life (*hifz nafs*). The application of credit/ debt-based financing for these segments of consumers, including those who are vulnerable may arguably further amplify the adverse impacts of excessive accumulation of debt[27], and therefore may be a detriment to the objectives of Shariah. In addition, equity-based financing or blended finance can also be an alternative financial solution for MSMEs[28], in which it will not create further indebtedness and thus will strengthen the MSMEs financial resilience and capacity building during crisis.

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[26] Mansur ibn Yunus Al-Buhuti, *Al-Raudhul Murbi’ Syarh Zad al-Mustaqni’*, (Riyadh: Dar al-Watn), vol.6, p. 88; Muhammad ibn Soleh al-Uthaimeen, *Al-Syarhul Mumti’ ‘ala Zad al-Mustaqni’*, (Dar Ibn al-Jauzi), vol.8, p.219-221; AAOIFI Shariah Standards, *Tawarruq*, paragraph 5.1.

[27] For example, “too much finance” may diminish benefits to economic growth with potentially detrimental effects such as more frequent booms and busts of an economy, diverting human capital away from productive sectors (Arcand, Berkes and Panizza (2012), “Too Much Finance?”, IMF Working Paper 12/61).

[28] For example, introduction of iTEKAD programme since 2020 which combines the provision of business assets funded by social finance instruments (e.g. donations, social impact investment, zakat and cash waqf) with microfinance, supplemented with structured financial and business training.

6.8 In this regard, the Bank considers outlining the intended objective and wisdom of each Shariah contract in Part A of the Framework as a guidance to facilitate IFIs' structuring of Islamic financial products and services.

> ***Example***
>
> ***(a) Tawarruq***
> *Execution of sale and purchase transaction to obtain cash* where the specific use of the cash is not specified
>
> ***(b) Wakalah***
> *Authorising or appointing another person to perform a specific task on behalf of the principal*

Question 4

(a) For licensed Islamic bank, please provide your SC's view on whether there is a need to align the current application of Shariah contracts with their specific objective (*maqasid `aqd*) and objectives of Shariah (*maqasid Shariah*). If the application of Shariah contracts is not fully aligned with the objectives of the Shariah contract and objectives of Shariah, what would be the potential implications from the Shariah perspectives to the Islamic banking products and services and what are the potential alternative Shariah contracts?

(b) Please elaborate your institution's view on potential–
   (i) implementation challenges should the Bank impose both objectives of contract and objectives of Shariah to be embedded in your institution's internal policies and procedures as well as product development and approval process (at both SC and management levels); and
   (ii) any impact arising from more conscious consideration on the objective of Shariah as well as the objectives of Shariah contract to your institution's business strategies.

7 Objective of review

7.1 The existing Shariah contract-based PDs outline the basic and fundamental Shariah requirements on five key aspects to ensure the implementation of Shariah contract complies with Shariah principles, namely (i) inherent nature; (ii) components; (iii) salient features; (iv) application with other contracts; and (v) dissolution and completion. The provision of these Shariah requirements that are endorsed by the SAC aims to promote greater legal and Shariah certainty in Islamic finance.

7.2 Over the years since the issuance of Shariah contract-based PDs with growing implementation and application of various Shariah contracts, the Bank recognises the need to ensure the coherence of Shariah requirements across the 14 Shariah contract-based PDs, as well as the importance of these Shariah requirements in facilitating IFIs to ensure their compliance with Shariah. In this regard, the Bank will review the current Shariah requirements to provide greater clarity on the expectation of Shariah compliance with fundamental requirements that need to be observed by IFIs. In particular, the Bank will–

(a) streamline the Shariah requirements across 14 Shariah contract-based PDs in achieving greater alignment and consistency, thereby minimising redundancies[29] and conflicting requirements, if any (refer to universal Shariah requirements under paragraphs 8.2 and 8.3); and

(b) recalibrate the current Shariah requirements to differentiate fundamental Shariah requirements with requirements that are operational in nature (refer to specific Shariah requirements under paragraphs 8.4 and 8.5).

8 Approach of review

8.1 Shariah requirements are firstly differentiated according to their nature and level of compliance to provide clear expectation for their implementation. Specifically, these Shariah requirements will be reviewed and grouped into three distinct categories namely (i) universal Shariah requirements that are applicable to all Shariah contracts; (ii) specific Shariah requirements to the respective Shariah contracts; and (iii) Shariah guidances to support IFIs' compliance to the universal and specific Shariah requirements.

Universal Shariah requirements

8.2 The universal Shariah requirements are principle-based in nature that can be universally applied to all Shariah contracts, and are not to cater for the specificities and nature of any particular Shariah contract. Generally, these are requirements that relate to the fundamental concept and method of Shariah contract execution such as offer and acceptance, contracting parties and subject matter.

8.3 As the 14 Shariah contracts are with varying nature and characteristics, such as exchange-based and equity-based, the Bank will further differentiate the universal Shariah requirements based on the type of Shariah contracts. For example, one of the principles that must be adhered to for exchange-based Shariah contracts is relating to the determination of price which must be determined and mutually agreed at the time of entering into the contract. Meanwhile, for equity-based contracts, one of the principles that must be adhered to is the requirement relating to the determination of profit-sharing ratio which must be determined and mutually agreed at the time of entering into the contract. These Shariah requirements on the determination of price or profit-sharing ratio are universal to all exchange-based and equity-based Shariah contracts respectively, and will be incorporated under Part A of the Framework.

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[29] For example, similar Shariah requirements relating to contracting parties as well as offer and acceptance.

Specific Shariah requirements

8.4 Where the universal Shariah requirements are not adequate to cater for the feature and nature of specific Shariah contracts, the Bank will provide the specific Shariah requirements under Part A of the Framework to ensure that the inherent nature of these Shariah contracts are adhered to by IFIs in line with Shariah principles that underlie the contracts. For example, Shariah prohibits the guarantee of return or principal by any partner in equity-based contracts including *mudarabah*[30] and *musyarakah*[31] to preserve the risk sharing nature of the contracts. This requirement is unique and specific to *mudarabah* and *musyarakah* contracts, and therefore will be provided in the Part A of the Framework.

8.5 In addition, it is observed that certain existing specific Shariah requirements are generally more operational in nature where the non-compliance with these requirements will not lead to a Shariah non-compliance (SNC) event, for example, a non-compliance with paragraph 14.2[32] of *Wakalah* PD. In this regard, the Bank may consider providing these as operational requirements instead of Shariah requirements.

Shariah guidances

8.6 The Bank will retain the current label "G" in the Framework for paragraphs that provide further clarifications, guidance or information to support compliance of the IFIs with the relevant Shariah requirements (paragraphs labelled as "S"). However, the Bank will take a different approach as compared to the existing Shariah contract-based PDs, whereby the guidance that is operational in nature (i.e. not in relation to Shariah requirements), which outlines potential industry practices that can be adopted by the IFIs, will be repositioned under the IG.

Question 5

(a) Please elaborate your institution's view on how the proposed review approach of Shariah requirements–

(i) provides greater clarity on the fundamental Shariah requirements that need to be complied with;

(ii) supports wider application of Shariah contracts including providing guidance on consideration of novel Shariah contracts in the domestic market; and

(iii) presents challenges to the relevant functions within your institution that relies on the Shariah contract-based PD in discharging their duties e.g.

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[30] Paragraph 15.10 of *Mudarabah* PD.

[31] Paragraph 15.14 of *Musyarakah* PD.

[32] Whereby an agent enters into a transaction with a third party and does not disclose that he is acting on behalf of principal, the rights and responsibilities arising from the transaction must be assumed by the agent.

Shariah advisory/ research, compliance, risk management and internal audit functions.

(b) In respect of paragraph 8.5, please elaborate the–

(i) extent that Shariah contract-based PDs are used as a benchmark or reference point within your institution's internal SNC framework, and other areas that can be considered/ included in this review exercise; and

(ii) your institution's practice in differentiating SNC events with operational lapses (to also provide examples of past cases, if any).

(c) Please highlight other suggestions or alternative approaches that the Bank can consider in the review of Shariah requirements e.g. potential reclassification of Shariah requirement (paragraph labelled as "S") as guidance (paragraph labelled as "G").

PART E REVIEW OF OPERATIONAL REQUIREMENTS

9 Objective of review

9.1 The Islamic financial business is operationalised through the application of various Shariah contracts, supported by robust governance arrangements, risk management practices and internal controls to manage the associated risks arising from Islamic financial transactions. Operational requirements are formulated to complement Shariah requirements aimed to promote compliance with Shariah as well as sound application and operationalisation of respective Shariah contracts. In the current Shariah contracts-based PDs, operational requirements cover five key aspects namely (i) governance and oversight; (ii) structuring; (iii) risk management; (iv) business and market conduct; and (v) financial disclosure.

9.2 In order for the regulatory framework to remain accommodative to the Islamic financial industry's development and progress, the Bank recognises the importance of maintaining regulatory coherence with other PDs covering similar areas[33] as well as ensuring the operational requirements to remain proportionate to the risk profile of each Shariah contract. The application of proportionality principles in the requirements of Shariah contract-based PDs must be done in a manner that does not undermine compliance to Shariah as well as safety and soundness of the IFIs. Therefore, the Bank will review the current operational requirements to–

(a) streamline the common operational requirements that can be applied across all Shariah contract-based PDs, whilst remain consistent with other interrelated PDs. This is to facilitate IFIs' regulatory compliance and improve operational efficiency by ensuring greater alignment and consistency, thereby minimising redundancies and conflicting requirements, if any (refer to universal operational requirements under paragraphs 10.2 and 10.3); and

(b) recalibrate the extent/complexity of operational requirements to be commensurable with the risk profile, nature and characteristic of each Shariah contract, size of exposures as well as complexity of Islamic financial products and services (refer to specific operational requirements and operational guidances under paragraphs 10.4 to 10.7).

9.3 This review exercise aims to promote clearer and more effective regulations that will facilitate application of diverse Shariah contracts and regulatory compliance of IFIs.

[33] For example, PDs on Shariah Governance, Corporate Governance, Risk Governance and Fair Treatment of Financial Consumers as well as Guidelines on Product Transparency and Disclosure.

10 Approach of review

10.1 Operational requirements are firstly differentiated according to its nature and level of compliance to provide clear expectations for their implementation. Specifically, these operational requirements will be reviewed and grouped into three distinct categories namely (i) universal operational requirements; (ii) specific operational requirements; and (iii) operational guidances.

Universal operational requirements

10.2 The Bank will adopt principle-based operational requirements under Part B of the Framework, to complement the current operational requirements which can be broadly addressed in other related PDs covering similar aspects, such as governance and disclosure-related operational requirements. The principle-based requirements will be universally applicable to all Shariah contracts and primarily outcome-focused with the aim to establish high-level objectives and outline clear regulatory expectations without being highly prescriptive and allow for flexibility in the implementation. This enables IFIs to tailor practices to their specific circumstances while still meeting the overall regulatory objectives.

10.3 For example, Diagram 6 illustrates how the current operational requirements regarding the Board's roles and responsibilities in the *Wakalah* PD are recalibrated into a principle-based operational requirement for adoption under Part B of the Framework. This principle-based operational requirement will also make reference to the relevant requirements in Corporate Governance PD to ensure consistent regulatory expectations. In tandem with this review approach, the Bank may also conduct the consequential review of the related PDs to ensure that the expectations of the current operational requirements are well integrated into these PDs, or consider removing certain operational requirements that are well-captured in other related PDs such as Shariah Governance PD.

Diagram 6: Illustration on Universal Operational Requirements

Recalibration

Current Operational Requirement	Universal Operational Requirement
Wakalah PD Paragraph 23.4: The Board has overall responsibility for corporate governance, Shariah governance and Shariah compliance of an IFI. As such, the Board must – (a) approve the business and risk strategies of the IFI with regard to the application of wakalah; (b) approve and oversee the implementation of policies and procedures governing the application of wakalah, which must include the following aspects: (i) purpose, roles, duties and responsibilities of the IFI;….(vii) information disclosure; (c) ensure appropriate internal controls, systems and infrastructure are in place to implement wakalah in accordance with Shariah requirements; (d) ensure that sufficient resources are in place and that the IFI has adequate and qualified senior management with sufficient knowledge and competency on the concept, application and risks associated with the wakalah arrangement; and (e) ensure independent reviews are conducted regularly to assess compliance with the policy documents issued by the Bank and internal policies established by the IFI	**Wakalah PD** The Board of Directors of an IFI (the Board) must establish a sound governance structure, supported by appropriate internal policies and procedures, sufficient resources and internal controls to facilitate effective oversight on the implementation of Shariah contracts. The adequacy of the governance structure must be commensurate with the nature, complexity and risk profile of the Shariah contracts.

Specific operational requirements

10.4 Where the universal operational requirements cannot adequately cater or address the specific risk profile, nature and characteristic of each Shariah contract, the Bank will provide the specific operational requirements under Part B of the Framework to ensure that these Shariah contracts are executed in a manner that is both compliant with Shariah and sound from operational, conduct and risk management perspectives.

10.5 The provision of specific operational requirements will also take into consideration the various practices and potential variations in the structuring of Islamic financial products and services. In the context of Islamic banking, the current financing products are structured with the combination of various Shariah contracts to achieve the desired credit risk profile and economic/ financial outcome i.e. credit/ debt-based financing. For example, the application of an undertaking (*wa`d*) by a customer in a *musyarakah mutanaqisah* contract (diminishing *musyarakah*) for a house financing effectively mitigates and transforms equity risk into credit risk[34].

For such structures, the requirements imposed by the Bank in respect of the governance, operational and risk management for credit risk are provided for under other PDs issued by the Bank such as Credit Risk PD, and therefore will not be reiterated in the Framework.

10.6 The Bank will retain the operational requirements that address the specific risk profile, nature and characteristics of the respective Shariah contracts. For example, the Bank will retain existing operational requirements relating to effective maintenance, monitoring and valuation of inventory under *Murabahah* PD to ensure a licensed Islamic bank effectively manage the inventory risk arising from its asset ownership (such risk does not arise under *murabahah* to the purchase orderer as it is effectively mitigated by the application of an undertaking (*wa`d*) by a customer to purchase the asset). In the case of equity-based Shariah contracts such as *musyarakah* and *mudarabah*, the Bank will retain requirements for IFIs to establish effective mechanisms to manage equity risks arising from the investment, such as adequate due diligence assessment and ongoing monitoring of investment.

Operational guidances

10.7 The Bank will retain the current label "G" in the Framework for paragraphs that provide further clarifications, guidance or information to support compliance of the IFIs with the relevant operational requirements (paragraphs labelled as "S"). Taking into consideration aspects of proportionality, parity, and neutrality to ensure that the critical requirements are effectively tailored to the varying risk

[34] Refer to Appendix 4 on illustration of variation in structures of Islamic financial products and services.

profile and contexts across IFIs, the Bank will reclassify certain operational requirements in the current Shariah contract-based PDs as practical operational guidances under the IG document that will be co-developed with industry (refer to paragraph 12). These guidances are aimed at promoting common understanding and sound industry practices.

Diagram 7: Illustration of Reclassification of Operational Requirements as Operational Guidance

CURRENT SHARIAH CONTRACT-BASED PD

Operational Requirement

***Musyarakah* PD**
- Paragraph 26.23 (S): IFI shall have effective monitoring and assessment mechanism
- Paragraph 26.24 (S): IFI shall establish appropriate safeguard measures to ensure effective governance and oversight at venture level
- Paragraph 26.25 (G): Safeguard may include appointment of representative at venture level
- Paragraph 26.26 (S): Where a representative is appointed, such appointment must be made at entity conducting the actual business.
- Paragraph 26.27 (S): IFI shall establish policies and procedures on appointment of representatives…
- Paragraph 26.28 (S): The appointed representatives shall possess the necessary skill, knowledge, qualifications and experience
- Paragraph 26.29 (G): The appointed representative may be an employee of IFI, an entity within the group or external party…
- Paragraph 26.30 (S): Appointment of representative shall subject to conditions including no conflict of interest, clear roles and responsibilities as well as written undertaking…
- Paragraph 26.31 (S): The roles and responsibilities of representative shall include reporting of progress and performance of venture…
- Paragraph 26.32 (S): IFI shall have policy in place to ensure effectiveness of representative functions…

Reclassification Considerations

Proportionality

Rigour of regulation calibrated to level of risk

Parity

Same type of risk, same type of regulation

Neutrality

Agnostic to different technologies, system and approaches

THE FRAMEWORK

Operational Requirement

Part B
- Paragraph XX (S): An IFI shall establish effective monitoring as well as adequate governance and oversights over the *musyarakah* venture to safeguard interest of IFI and ensure conduct of business is in line with the stipulated and agreed terms and conditions

Operational Guidance

Implementation Guide
- In safeguarding the interest of IFI as the capital provider, an IFI may consider the following approaches:
  - Appointing an IFI's representative at the venture level…
  - Instituting robust reporting mechanisms…
  - Periodical review on performance of the venture…

Question 6

(a) In view of the intended practical and proportionate Framework, please highlight your institution's view on how the proposed review exercise–

(i) facilitates diversification and innovation of Islamic financial products and services using various types of Shariah contracts;

(ii) adds value or impacts the current structuring and development process of Islamic financial products and services; and

(iii) presents a challenge to the relevant functions within your institution that relies on the Shariah contract-based PDs in ensuring Shariah contracts are implemented with prudence e.g. compliance, risk management and internal audit functions.

(b) Please highlight other suggestions or alternative approaches that the Bank can consider in the review of operational requirements.

PART G REVIEW STRATEGY AND TIMELINE

11 Collaborative approach in the review of Shariah contract-based PDs

11.1 The Bank aims to adopt a collaborative approach in the review of Shariah contract-based PDs in ensuring the review considers practical aspects on the adoption of diverse Shariah contracts in Islamic financial products and services as well as implementation of the requirements. For this purpose, the Bank is proposing for the establishment of a Shariah Contract Task Force (SCTF) consisting of representatives from the Islamic banking and takaful/ retakaful industry with the following key roles in the review:

(a) Provide input on challenges faced by IFIs such as from the perspectives of regulatory treatment[35], legal infrastructure[36] and institutional-specific operational considerations[37] in adopting diverse Shariah contracts for Islamic financial products and services, as well as impact arising from the review of framework design, Shariah and operational requirements under Parts D, E and F of this DP;

(b) Formulate proposed solutions to address the identified challenges, which can be adopted by IFIs in diversifying potential Islamic financial products and services using various Shariah contracts; and

(c) Co-develop the IG which includes the reclassified requirements as guidance under Parts E and F of this DP, as well as practical guidance as best practice that IFIs can consider in adopting diverse Shariah contracts for Islamic financial products and services.

11.2 The Bank will outline further details on the SCTF at a later stage e.g. composition of members, terms of reference and conduct of meetings. The SCTF serves as a collaborative platform between the Bank and industry in promoting diversification of Islamic financial products and services using various Shariah contracts, and this approach does not replace nor override the current formal consultation process e.g. via the issuance of discussion papers or exposure drafts by the Bank.

11.3 Guided by the industry readiness and progress of the review exercise, the Bank will play a facilitative role in IFIs' exploration of various approaches such as via pilot projects or Financial Technology Regulatory Sandbox in adopting viable and suitable Shariah contracts for innovative solutions to meet the financial needs of consumers as well as to finance economic transformation (see Part B). The IFIs may also consider the application of *Hajah* and *Darurah* PD[38], where applicable, in the application of Shariah contracts in Islamic financial products and services.

[35] For example, capital requirements under Capital Adequacy Framework for Islamic Banks PD.
[36] For example, clarity on the applicability of the Hire-Purchase Act 1967.
[37] For example, availability of talent and expertise, as well as IFI's risk appetite.
[38] Issued by the Bank on 3 January 2024.

Question 7

Please indicate your institution's–

(a) interest to participate in the proposed SCTF;

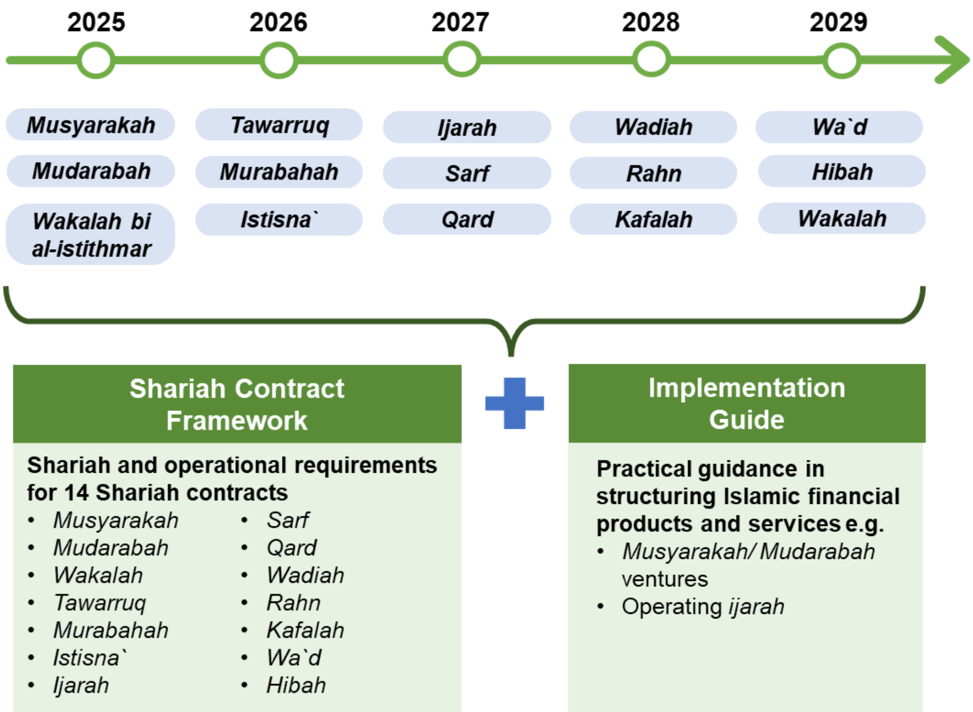
(b) identified challenges or enablers for the diversification of Islamic financial products and services using diverse Shariah contracts; and

(c) plan to explore the possibility of leveraging on the Financial Technology Regulatory Sandbox (either Standard sandbox or Green Lane route).

12 Iterative review approach of Shariah contract-based PDs

12.1 In operationalising the proposed review of the 14 Shariah contract-based PDs, the Bank will adopt an iterative approach where the PDs will be reviewed in phases, complemented with the final framework and IG, commencing in 2025. The timeline and sequencing of the Shariah contract-based PDs review consider and balance the potential broader application of Shariah contracts in supporting value-based finance and economic transformation, with the resource requirement of the industry.

Diagram 8: Timeline of the Shariah Contract-based PDs Review



Question 8

Please highlight –

(a) whether you have any comments and/ or suggestions on the proposed sequencing of the Shariah contracts for review, taking into account institution/ industry initiatives or needs; and

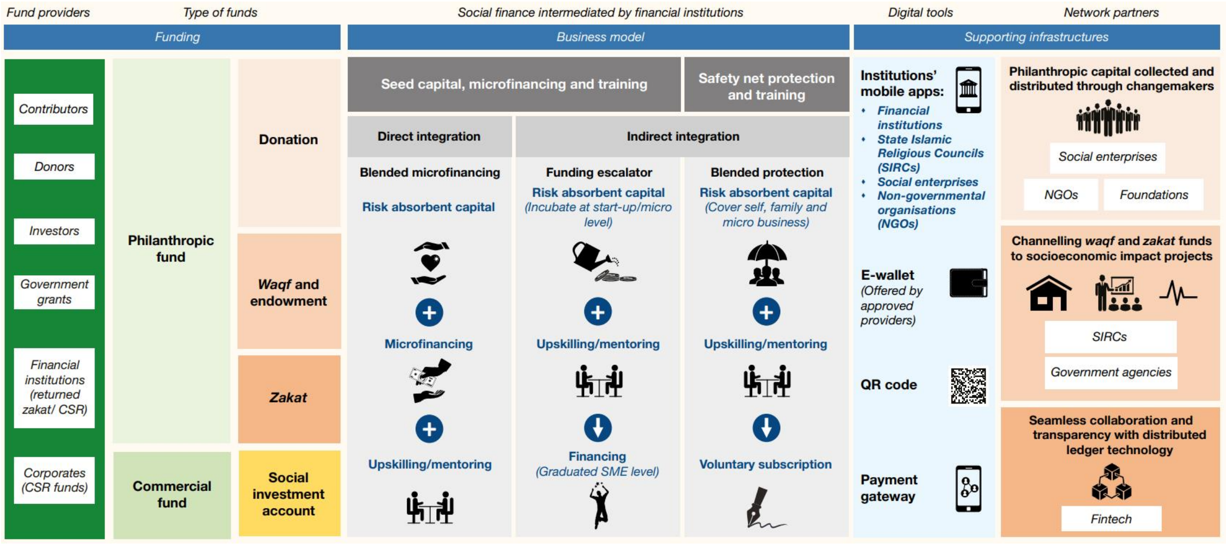
(b) your institution or industry-specific factors that the Bank need to consider in finalising the timeline of review e.g. institution/ industry focus in the next five years.

APPENDICES

Appendix 1 Summary of proposed enhancements to Shariah contract-based PDs

Area	Proposed Enhancement	Reference DP Paragraph
1. Framework Design	(a) Adopt a simplified and more practical framework design by- (i) Consolidating the existing 14 Shariah contract-based PDs into a single document (“Framework”) (ii) Outlining universal and specific Shariah and operational requirements based on type/ nature of Shariah contracts	Paragraphs 5.1 – 5.5
	(b) Complement the Framework with an Implementation Guide (“IG”) that outlines practical guidance in structuring various Islamic financial products and services using various Shariah contracts	
2. Shariah Requirements	(a) Outline overarching principles on objectives of Shariah as guidance	Paragraphs 6.1 – 6.8
	(b) Outline specific objectives of Shariah contracts as guidance	
	(c) Review existing Shariah requirements by– (i) streamlining Shariah requirements across 14 Shariah contract-based PDs; and (ii) recalibrating the Shariah requirements to differentiate fundamental requirements with the requirements that are operational in nature	Paragraphs 7.1 – 8.6
3. Operational Requirements	(a) Review existing operational requirements by– (i) Streamlining operational requirements with other related PDs issued by the Bank; and (ii) Recalibrating the extent/ complexity of operational requirements commensurable with risk profile, nature and characteristics of each Shariah contract	Paragraphs 9.1 – 10.7

Appendix 2 Illustration on characteristics of social finance offerings[39]



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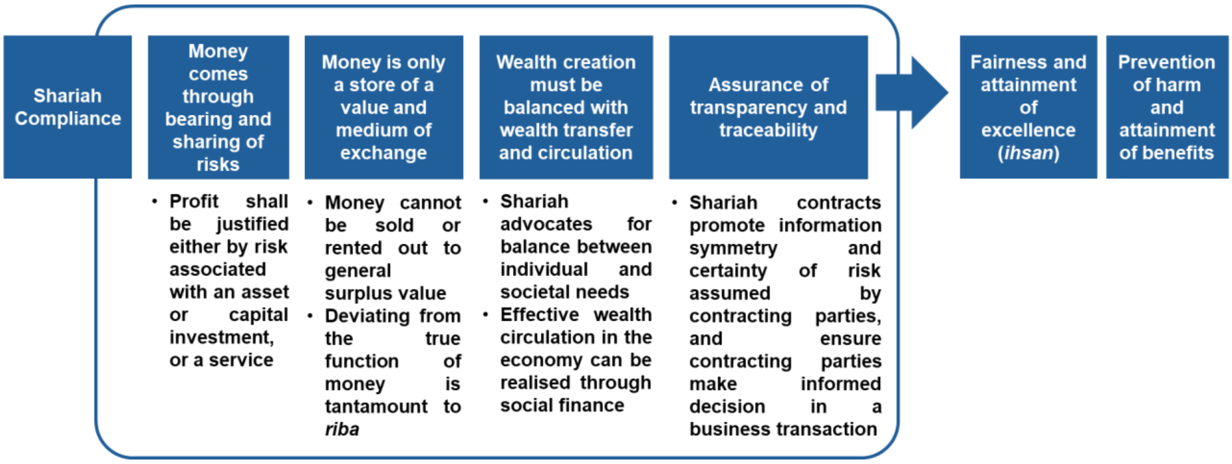
[39] Source: BNM's Financial Sector Blueprint 2022 – 2026.

Appendix 3 Intrinsic values in Islamic finance[40]

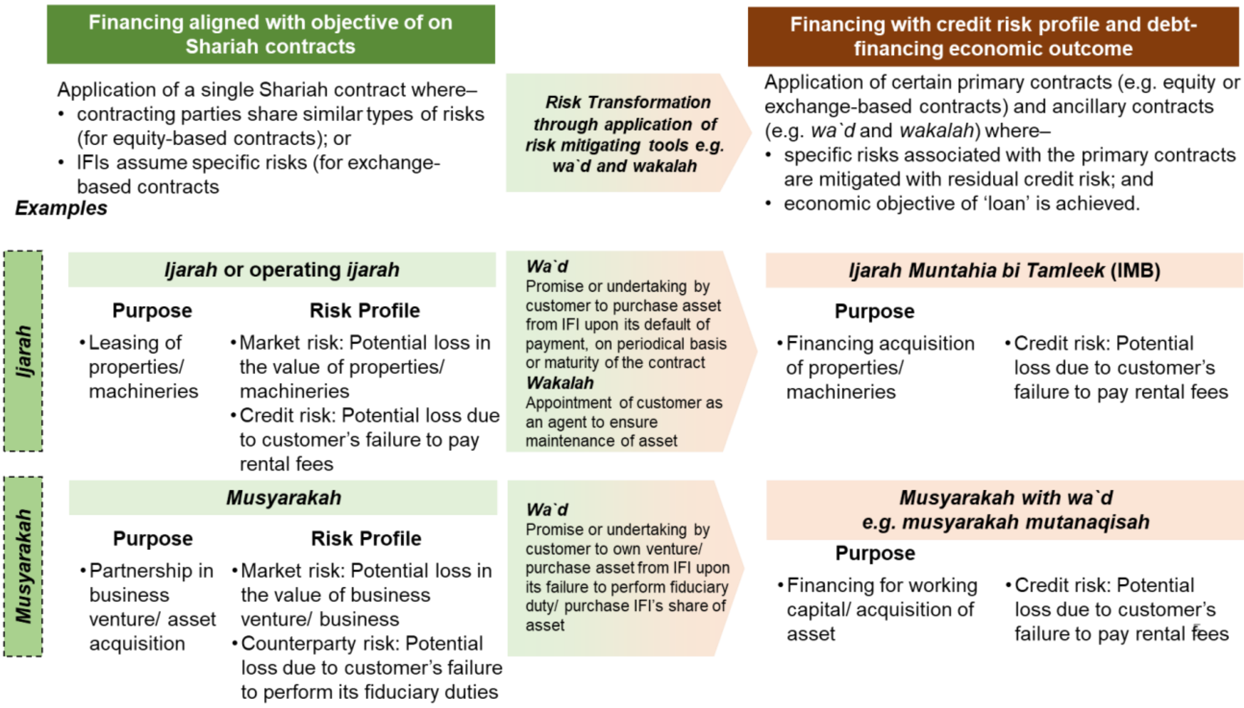
The SAC plays an instrumental role in clarifying the seven (7) fundamental value propositions in Islamic finance which are not only unique to Islamic finance but are also intended for universal application across the entire financial system.



[40] Source: Bank Negara Malaysia's Annual Report 2019.

Appendix 4 Illustration on variation of structure in Islamic banking products and services[41]

An IFI may structure the Islamic financial products and services through application of various Shariah contracts to achieve the desired risk profile and economic/ financial outcome. In particular, the specific risk profile and nature of respective Shariah contracts can be mitigated/ transformed with the application of other Shariah contracts:



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[41] Adapted from Box Article "Diversification of Islamic Banking Business and Products Driven by Shariah Contracts", Financial Stability and Payment System Report 2013.

Appendix 5 Glossary

Term	Definition
Hibah	*Hibah* refers to transfer of ownership of an asset from a donor (*wahib*) to a recipient (*mawhub lahu*) without any consideration.
Ijarah	*Ijarah* refers to– (a) a lease contract that transfers the ownership of a usufruct of an asset to another person for a specified period in exchange for a specified consideration; or (b) A contract for hiring of services of a person for a specified period in exchange for a specified consideration.
Ijarah Mawsufah fi Zimmah	*Ijarah Mawsufah fi Zimmah* refers to an *ijarah* contract that transfers ownership of a usufruct for a specified duration in the future based on an agreed specification by the contracting parties at the inception of the *ijarah* contract.
Ijarah Muntahiyah Bitamlik	*Ijarah Muntahiyah Bitamlik* refers to an ijarah contract which ends with the lessee owning the leased asset through mechanisms that transfer the asset ownership during or at the end of the lease period.
Istisna`	*Istisna`* refers to a contract in which a seller sells to a purchaser an asset which is yet to be constructed, built or manufactured according to agreed specifications and delivered on an agreed specified future date at an agreed pre-determined price.
Kafalah	*Kafalah* refers to a contract where a guarantor conjoins the guaranteed party in assuming the obligation of the guaranteed party.
Mudarabah	*Mudarabah* is a contract between a capital provider (*rabbul mal*) and an entrepreneur (*mudarib*) under which the *rabbul mal* provides capital to be managed by the *mudarib* and any profit generated from the capital is shared between the *rabbul* mal and the *mudarib* according to a mutually agreed profit sharing ratio (PSR) whilst financial losses are borne by the *rabbul mal* provided that such losses are not due to the *mudarib*'s misconduct (*ta`addi*), negligence (*taqsir*) or breach of specified terms (*mukhalafah al-shurut*).
Murabahah	*Murabahah* refers to a sale and purchase of an asset where the acquisition cost and/ or the mark-up are disclosed to the purchaser.
Musyarakah	*Musyarakah* refers to a partnership between two or more parties, whereby all parties will share the profit and bear the loss from the partnership.
Qard	*Qard* refers to a contract of lending money by a lender to a borrower where the latter is bound to repay an equivalent replacement amount to the lender.
Rahn	Rahn refers to a contract where a party, as pledgor (*rahin*) pledges an asset as collateral (*marhun*) to another party, a pledgee (*murtahin*) to fulfil an obligor's liability or obligation (*marhun bih*) owing to the pledgee in the event of default of such obligor.

Term	Definition
Sadaqah	*Sadaqah* is a donation of something to the people in need for the purpose of seeking closeness to Allah.
Sarf	*Bai` al-sarf* refers to a contract of exchange of money for money of the same or different type.
Tabarru`	*Tabarru`* is a gratuity or charity concept of donation.
Tawarruq	*Tawarruq* refers to two sale and purchase contracts where the first involves the sale of an asset to a purchaser on a deferred basis and the subsequent sale involves sale of the asset to a third party on a cash basis.
Wadi'ah	*Wadi`ah* refers to a contract where an asset is placed with another party for safekeeping.
Wa`d	*Wa`d* is a unilateral promise which refers to an expression of commitment given by one party to another to perform certain action(s) in the future.
Wakalah	*Wakalah* refers to an agency contract where a party, as principal (*muwakkil*) authorises another party as his agent (*wakil*) to perform a particular task on matters that may be delegated, with or without imposition of a fee.
Wakalah bi al-istithmar	*Wakalah bi al-istithmar* refers to an agency contract for the purpose of investment.
Waqf	Endowment.