194th Meeting of the Shariah Advisory Council (SAC) of Bank Negara Malaysia

The SAC of Bank Negara Malaysia at its 194th meeting on 25 June 2019 ruled the following:

Import Financing Product Based on *Bai` Istijrar* for Islamic Letter of Credit

SAC Ruling

The SAC approved the proposed structure of import financing based on *bai` istijrar* (sale of supplies with deferred price) for Islamic Letter of Credit (Letter of Credit-i) subject to the following conditions:

i. The Facility Agreement must clearly specify the following:
   a. Responsibility of the importer (customer) as an agent to execute the purchase of goods on behalf of the Islamic financial institution (IFI);
   b. Responsibility of the importer to purchase goods from the IFI upon receiving the imported goods and/or documents; and
   c. Risks and liabilities of the contracting parties with regards to ownership of the goods at each stage of the sale transaction.

ii. The IFI must ensure that the transactions above are executed in a proper sequence where the responsibility of the importer as the purchasing agent must be fulfilled prior to the purchase of goods by the importer from the IFI.

The SAC's approval on the above application of *bai` istijrar* contract is confined to the proposed structure due to the specific needs for such financing product under trade finance facility.

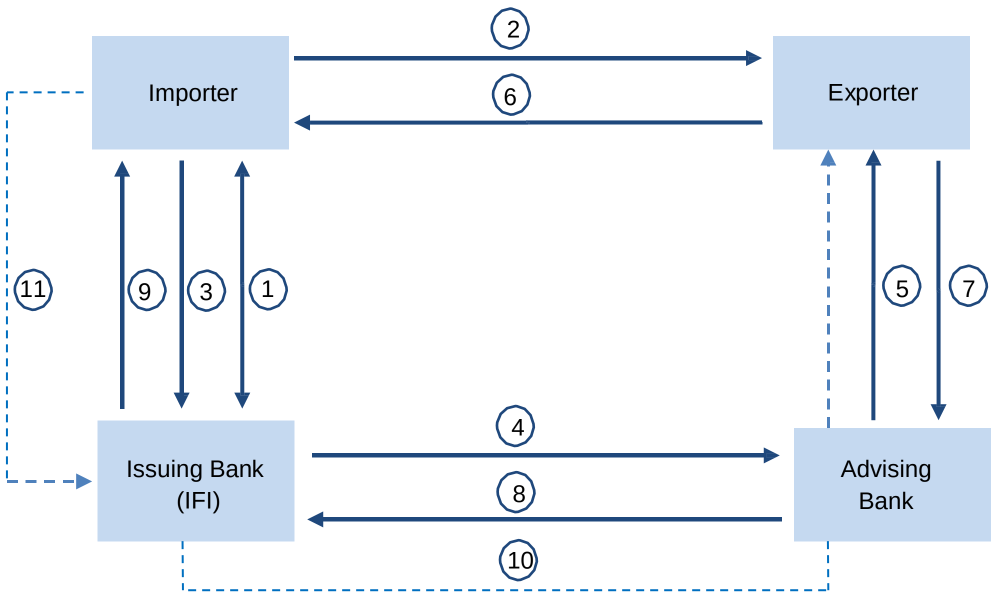
Background

- An IFI has proposed to offer an import financing product based on *bai` istijrar* for Letter of Credit-i that allows the importer to obtain financing facility to purchase goods from the exporter against Letter of Credit-i issued by the IFI. The product is proposed as an alternative to the current market practice that offers such financing based on *murabahah* and/or *tawarruq* contracts.

Shariah Issue

- Is the proposed structure of import financing based on *bai` istijrar* for Letter of Credit-i Shariah compliant?

Illustration of the proposed import financing for Letter of Credit-i structure



1. Facility offering:
   - Contracting parties sign the Facility Agreement;
   - Appointment of agent – appointment of IFI as agent to issue Letter of Credit-i, inspect the documents and make payment to exporter. Appointment of importer as puchasing agent on behalf of IFI; and
   - Promise from importer to purchase the goods upon receiving the goods/ documents;
2. Importer orders the goods on behalf of IFI;
3. Importer requests for Letter of Credit-i issuance;
4. IFI issues Letter of Credit-i;
5. Advising bank informs exporter on the Letter of Credit-i;
6. Exporter delivers the goods to importer;
7. Exporter presents the documents to advising bank;
8. Advising bank forwards the documents to IFI;
9. IFI releases the documents to importer; *
10. IFI makes payment of the purchase price based on invoice to the exporter through the advising bank; and
11. Importer settles the sales price at maturity.

* Note: For the delivery of goods via ship which involves Bill of Lading, the sale of goods from IFI to the importer will be executed upon the delivery of the documents. Meanwhile, for delivery of goods via other modes of transportation (e.g. train, airplane or Delivery Order), the importer may acquire or receive the goods earlier than the documents that will be released by IFI. In this case, the sale of goods by IFI to importer will take place when the importer takes the goods. The calculation of the sales price will be finalised when the IFI delivers the documents to the importer at a later date.

Key Highlights of the SAC Discussion

Application of bai` istijrar contract in the product structure

- The *bai` istijrar* contract may be applied in the following modes of delivery/ delivery documents:
  i. Delivery of goods via ship (Bill of Lading) under Usance terms:
  Through the issuance of invoice and Bill of Lading document, IFI will have constructive ownership over the goods purchased. The IFI will then sell the goods to the importer upon delivery of the documents where the importer will then take physical possession of the goods at the port. The final selling price will be calculated at the maturity of the Letter of Credit-i i.e. upon the expiry of the credit term as agreed by the importer and exporter.

  ii. Delivery of goods via train and airplane (Railway Bill and Airway Bill), or any other methods that result in the IFI not having any control over the goods:
  The importer will receive from the exporter a copy of the delivery documents i.e. Railway Bill or Airway Bill that is sent separately from the goods delivered. The importer may use these documents to acquire the goods from the port.

  iii. Delivery Order:
  The Delivery Order document is typically used for delivery of goods via land transportation e.g. using lorry. The importer (on behalf of IFI) will receive the goods by providing a confirmation of acceptance through the document.

- In the case of (ii) and (iii) above, the sale and transfer of ownership will take effect upon acceptance of the goods by the importer. The final selling price will be calculated upon delivery of the documents for financing of Sight Letter of Credit whereas the final selling price for financing of Usance Letter of Credit will be calculated at the maturity date of the Letter of Credit-i.

Application of supporting contracts/ concepts i.e. agency (wakalah) and promise (wa`d) in the product structure

Upon signing of the Facility Agreement, the contracting parties will agree to enter into the following arrangement:

a) Agency *(wakalah)*

- The importer will appoint the IFI as an agent to issue the Letter of Credit-i, inspect the documents, and make payment to exporter. Meanwhile, IFI will appoint the importer as an agent to purchase the goods on behalf of the IFI and to take delivery of the goods. The transfer of ownership of the goods will take effect immediately after the importer has signed the documents of acceptance and takes possession of the goods.

b) Promise *(wa'd)*

- The importer will promise to purchase the goods from the IFI immediately after the acceptance of the documents or acquisition of the goods.

Suitability of the application of the contract of bai` istijrar for the proposed product structure

- *Bai` istijrar* is a sale contract whereby the buyer acquires the goods from the seller from time to time with neither offer (*ijab*) and acceptance (*qabul*), nor determination of the price each time the acquisition/ purchase takes place. The price may be determined by the contracting parties or be based on a benchmark even after consumption of the goods.[1]

- The classical discussion on the contract of *bai` istijrar* involves the acquisition of goods on ongoing or staggered basis. However, based on current practice, the Letter of Credit-i may be issued to represent a single sale contract only or multiple sales contracts.

[1] Kuwait Ministry of Waqf and Islamic Affairs, *al-Mawsu`ah al-Fiqhiyyah al-Kuwaitiyyah*, v.9, p. 43; Muhammad Taqi al-Uthmani, *Buhuth fi Qadaya Fiqhiyyah Mu`asirah,* p. 58; AAOIFI, *al-Ma`ayir al-Shar`iyyah*, 2015, Dhabit al-Gharar al-Mufsid lil Mu`amalat al-Maaliah, no. 31, item 5/2/2.

Uncertainty (gharar) in the determination of the sales price in the bai` istijrar contract

- The interpretation of *gharar* element is one of the main reasons scholars have different views on the permissibility of *bai` istijrar*. The *gharar* element here is on the absence of a clear determination of price in the *bai` istijrar* contract which may result in the contract being void.

- In the proposed product structure, the price in the sale contract between IFI and the importer is determined based on a formula agreed by the contracting parties. Nevertheless, there is a component in the agreed formula that is still uncertain i.e. the benchmark rate of KLIBOR/ LIBOR that is not determined at the origination. The calculation of the final price will only be made at a future date i.e. at the point of delivery of the document or at maturity date of the Letter of Credit-i (according to the maturity of the credit term).

- The formula to calculate the final selling price at the maturity of the Letter of Credit-i is as follows:

$$\text{Selling price} = \text{invoice value} + \left(\text{invoice value} \times \text{profit rate*} \times \frac{\text{number of days**}}{360/365}\right)$$

Note:
* Component of profit rate includes cost of fund of IFI i.e. 3-month KLIBOR/LIBOR and profit margin of X%. The profit margin will be agreed by both parties at the inception of contract whereas KLIBOR/LIBOR rate will be determined at the maturity date of Letter of Credit-i.

** Financing period (number of days) will be calculated starting from the maturity date of the Letter of Credit-i until the maturity date of financing (based on the agreed period)

Basis of Ruling

- Some scholars of Hanafi, Shafi`i and Hanbali view that sales without determining the price upfront is permissible on the basis of *istihsan*, permissibility of sale by conduct (*bai` mu`atah*), and the permissibility of sale without fixing the price at the inception of contract (*bai` bima yanqati` bihi al-si`ri*).[2]

- There is a contemporary scholar who views that it is permissible for the buyer to acquire goods without determining the price upfront as the price will be calculated based on the prevailing market price (*bai` bi si`ri al-suq*). However, the permissibility of this practice is subject to the price that will be determined based on an established pricing benchmark, and there is no possibility for error and will not lead to any potential dispute between the contracting parties.[3]

- There are also contemporary scholars who view that the uncertainty (*gharar*) in price is permitted in certain situations. These include the sale that is transacted at the prevailing market price (*bai` bi si`ri al-suq*) or at the customary price or sale transaction based on *bai` istijrar*. The permissibility of such practices will allow the buyer to obtain the goods regularly from the seller at a price to be determined at a later date (even after consumption of the goods) based on customary price or subject to a specific benchmark.[4]

- Eventhough the final price is not concluded at the inception of sale contract, it may be considered as a minor *gharar* as the contracting parties are already aware/ made known of the actual price of the imported goods and have agreed on the price calculation formula.

- The sale transaction between the IFI and the customer is concluded in accordance with current market practice (`*urf*) that is supported by documentations that are legally enforceable which could provide clarity to the contracting parties and may avoid potential dispute between them.

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[2] Al-Haskafi, *al-Dur al-Mukhtar fi Syarh Tanwir al-Absar*, v. 4, p. 516; Ibn Nujaym, *al-Bahr Ra'iq Syarh Kanz Daqa'iq*, v. 5, p. 279; Ibn Hajar al-Haytami, *Tuhfah al-Muhtaj fi Syarh al-Minhaj*, v. 4, p. 217; Ibn Qayyim, *I`lam al-Muwaqi`in `an Rabbul `Alamin, v.4, p.5.*

[3] Muhammad Taqi Uthmani, *Buhuth fi Qadaya Fiqhiyyah Mu`asirah*, p. 63-64.

[4] AAOIFI, *al-Ma`ayir al-Shar`iyyah*, 2015, Dhabit al-Gharar al-Mufsid lil Mu`amalat al-Maaliah, no. 31, item 5/2/2.

Implication of SAC Ruling

- The proposed structure of import financing based on *bai` istijrar* for Letter of Credit-i is an alternative to the *murabahah* and *tawarruq* contracts that are currently applied in the market for such financing product.

- The proposed structure could provide solution to the potential issue of buying and selling the non-existent goods (*bai` ma`dum*) in *murabahah* structure and may reduce operating cost in the application of *tawarruq*.

This ruling is effective upon publication of this statement on Bank Negara Malaysia's website dated 13 December 2019.

An IFI shall comply with this ruling pursuant to section 28(1) of the Islamic Financial Services Act 2013 or section 33D(1) of the Development Financial Insitutition Act 2002, as the case may be.