

**The Shariah Advisory Council of Bank Negara Malaysia (SAC) Ruling
on the Execution of *Tawarruq* via Straight-Through Processing (STP)
SAC's 199th Meeting on 26 November 2019**

Part I: SAC Ruling, Its Effective Date and Applicability

Pursuant to section 52 of the Central Bank of Malaysia Act 2009, the SAC has made a ruling that the proposal to execute *tawarruq* via STP is permissible subject to the following conditions:

- i. The sale and purchase contracts in *tawarruq* must be executed in the correct sequence¹ and the transaction must be supported by clear evidence²;
- ii. The transacted asset must be identifiable and specifically determined (*mu`ayyan bi al-zat*) in terms of location, quantity and quality to fulfil the characteristics of a genuine transaction;
- iii. The execution of dual-agency shall observe the requirements as stipulated in the policy document on *Tawarruq* (*Tawarruq* PD) which include but are not limited to the following:
 - (a) the roles and responsibilities of the contracting parties, price determination, maturity date and asset specification shall be agreed upon by the contracting parties; and
 - (b) there must be clear segregation of roles and duties to be executed by the agent;
- iv. Ownership of the transacted asset from Shariah and legal perspectives as well as risks associated with the ownership shall be established and evidenced by appropriate documentation or record;³ and
- v. The purchaser shall have the right to take delivery of the transacted asset during each sale and purchase contract in *tawarruq*. In respect of the execution of *tawarruq* via STP, the option to take delivery shall be clearly disclosed to the customer prior to the *tawarruq* execution or following the sale transaction of the asset to the customer.⁴

This ruling comes into effect upon publication of this ruling on Bank Negara Malaysia's (the Bank) website⁵ dated XX May 2020 and is applicable to the following Islamic financial institutions (IFIs):

- (a) licensed persons under the Islamic Financial Services Act 2013 (IFSA);
- (b) licensed banks and licensed investment banks approved under section 15(1) of the Financial Services Act 2013 (FSA) to carry on Islamic banking business; and
- (c) prescribed institutions approved under section 33B(1) of the Development Financial Services Act 2002 (DFIA) to carry on Islamic financial business.

In line with sections 28(1) and (2) IFSA or sections 33D(1) and (2) DFIA, as the case may be, IFIs are required to comply with this ruling as a compliance with any ruling of the SAC in respect of any particular aim and operation, business, affair or activity of such IFIs shall be deemed to be a compliance with Shariah.

¹ Paragraph 12.3 of *Tawarruq* PD.

² Paragraph 15.3 of *Tawarruq* PD.

³ Paragraphs 13.7 to 13.10 of *Tawarruq* PD.

⁴ Such disclosure shall be made in a manner recognised by business practice (*`urf tijar*) and in accordance with Shariah.

⁵ The Bank has communicated this ruling to the relevant Islamic financial institutions on 28 November 2019 following the SAC's 199th meeting.

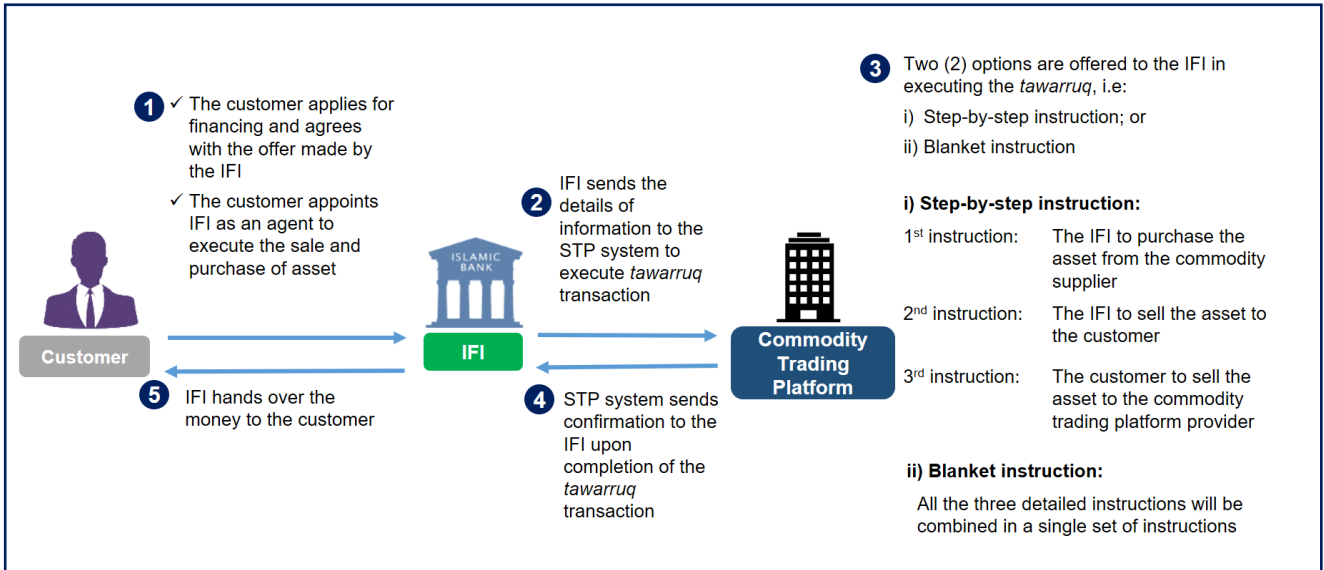
Part II: Background

- Several IFIs have submitted proposals to the Bank on the execution of *tawarruq* via STP for financing and deposits products. Through STP, the sale and purchase contracts in *tawarruq* will be executed automatically upon the sending out of a set of transactional data, containing all asset purchase information, to the server of the commodity trading platform provider.
- The execution of *tawarruq* through STP is an enhancement to the existing method of *tawarruq* execution. The STP system enhances the efficiency of *tawarruq* execution and is more practical in executing high volume transactions at a particular time. Therefore, STP is expected to mitigate operational issues that can potentially lead to incidents of Shariah non-compliance.
- There are two (2) proposed methods of STP execution:
 - (a) The execution of STP based on a step-by-step instruction:**
 - Each sale and purchase contract in *tawarruq* will be executed after the STP system receives instruction from the IFI to execute each sale and purchase contract step-by-step in accordance with the proper sequence as stipulated in the *Tawarruq* PD.
 - Similar to the existing *tawarruq* execution, IFI will act as an agent on behalf of the customer to execute the sale and purchase contracts.
 - For each sale and purchase contract, there is a time interval that allows the buyer to opt for taking delivery of the transacted asset.
 - (b) The execution of STP based on a blanket instruction:**
 - The instruction to execute all three sale and purchase contracts in *tawarruq* will be keyed-in by the IFI into the STP system at the inception prior to the execution of the sale and purchase contracts in the *tawarruq*.
 - The IFI will act as the agent to the customer to complete the second sale and purchase contract (representing the customer to accept the sale from IFI) and the third sale and purchase contract (representing the customer to sell the asset to the commodity trading platform provider).
 - The option for the customer to take delivery of the asset is only disclosed before the sale and purchase contracts in *tawarruq* are executed. The customer does not have the option to take delivery of the asset when the sale and purchase contracts are already being executed.
 - All the sale and purchase contracts in *tawarruq* will be concluded by the STP system with great efficiency (in several milliseconds or nanoseconds).

Shariah issue

Is the execution of *tawarruq* through STP is Shariah compliant?

Illustration of execution of *tawarruq* based financing through STP



Part III: Key Discussion

Whether the customer has the option to take delivery of the asset

- In the execution of *tawarruq* through STP, the disclosure to the customer on the option to take delivery of the asset will be made as follows:

Step-by-step instruction	Prior to entering into <i>tawarruq</i> or upon sale of the asset to the customer.
Blanket instruction	Prior to entering into <i>tawarruq</i> .

- The execution of *tawarruq* through STP with blanket instruction implicitly results in the customer not having the option to take delivery of the asset while the sale and purchase contracts in *tawarruq* are being executed. However, through a dual-agency arrangement, the IFI is appointed as an agent of the customer to execute all the sale and purchase contracts. In this regard, the customer has effectively agreed to waive his right to take delivery of the asset at the beginning of the contract.
- An electronic certificate issued by the commodity trading platform provides details on the asset and serves as an evidence for the sale and purchase contract and completion of ownership transfer.

Whether there is a clear segregation of roles and duties to be performed by agent under a dual-agency arrangement

- *Tawarruq* PD⁶ stipulates that the IFI must establish clear segregation of roles and duties to be performed under a dual-agency arrangement, for example, designating different personnel to perform each role or implementing an appropriate system that will independently execute the dual-agency roles; e.g. short messaging systems (SMS) or telephone calls.
- Among others, the purpose of this requirement is to ensure that the sale and purchase contract in *tawarruq* are executed in the correct sequence.
- The STP system is developed to enable the sale and purchase contract in *tawarruq* to be executed in the correct sequence. As such, the appointed agent will act in a proper sequence in executing

⁶ Paragraph 26.2(d)(ii) of *Tawarruq* PD.

the sale and purchase contracts, evidencing separate execution of the agent's role in the dual-agency arrangement during each sale and purchase process.

- Assigning different personnel to perform the agency roles and duties is one of the examples of operationalising a dual-agency arrangement which is in line with the Shariah requirements.

Part IV: Basis of Ruling

The execution of dual-agency complies with the requirements of Tawarruq PD

- *Tawarruq* PD⁷ stipulates that the execution of the sale and purchase contracts between the principal and agent in a dual-agency arrangement must be in compliance with the following conditions:
 - (a) essential criteria or specification of the authorised task, such as price, tenure and asset specification, shall be mutually agreed by the contracting parties; and
 - (b) the transaction shall be in a proper sequence as provided in *Tawarruq* PD⁸ and supported by proper evidence.
- The proposed execution of *tawarruq* via STP complies with the above requirements as the parties involved in the execution of *tawarruq* have agreed to the terms and conditions at the onset of the contract and the sale and purchase contracts are executed in the correct sequence.

Sale and purchase contract are executed in the correct sequence

- *Tawarruq* PD⁹ stipulates that the offer and acceptance in each sale and purchase contract in a *tawarruq* must be executed in the following sequence:
 - (a) the seller sells the asset to the purchaser by entering into a sale and purchase contract; and
 - (b) subsequently, the purchaser from the first sale and purchase contract enters into another sale and purchase contract to sell the same asset to a third party.
- The STP system has been set up to execute each sale and purchase contract in the correct sequence as required by *Tawarruq* PD. The STP system will not allow the second contract to take place before the first contract is completed. The execution of sale and purchase contracts in *tawarruq* is evidenced by the issuance of an auditable electronic certificate upon completion of each contract.

The customer has the option to take delivery of the transacted asset

- *Tawarruq* PD¹⁰ stipulates that the purchaser in each sale and purchase contract shall have the right to take delivery of the asset and prohibits stipulation of any terms and conditions preventing such action.
- For *tawarruq* execution via STP, a customer has the option to take delivery of the asset and this option must be disclosed to the customer upon entering into the *tawarruq*. For the execution of *tawarruq* via a blanket instruction, the customer's decision to waive his right to take delivery of the asset does not nullify the sale and purchase contract.

⁷ Paragraph 17.3 of *Tawarruq* PD.

⁸ Paragraph 17.2 of *Tawarruq* PD.

⁹ Paragraph 12.3 of *Tawarruq* PD.

¹⁰ Paragraph 15.4 and 15.5 of *Tawarruq* PD.

Part V: Implication of SAC Ruling

- *Tawarruq* can be executed in an orderly, swift and efficient manner as the sale and purchase of asset can be completed within a very short period of time through a controlled system.
- This ruling demonstrates that Shariah is not a hindrance towards embedding technological advancement in the offering of Islamic financial products. Instead, it serves as a catalyst for innovation in the products and services offered by IFIs.