

# Drafting Islamic Finance Documentation – BBA, Tawarruq & Diminishing Musharakah

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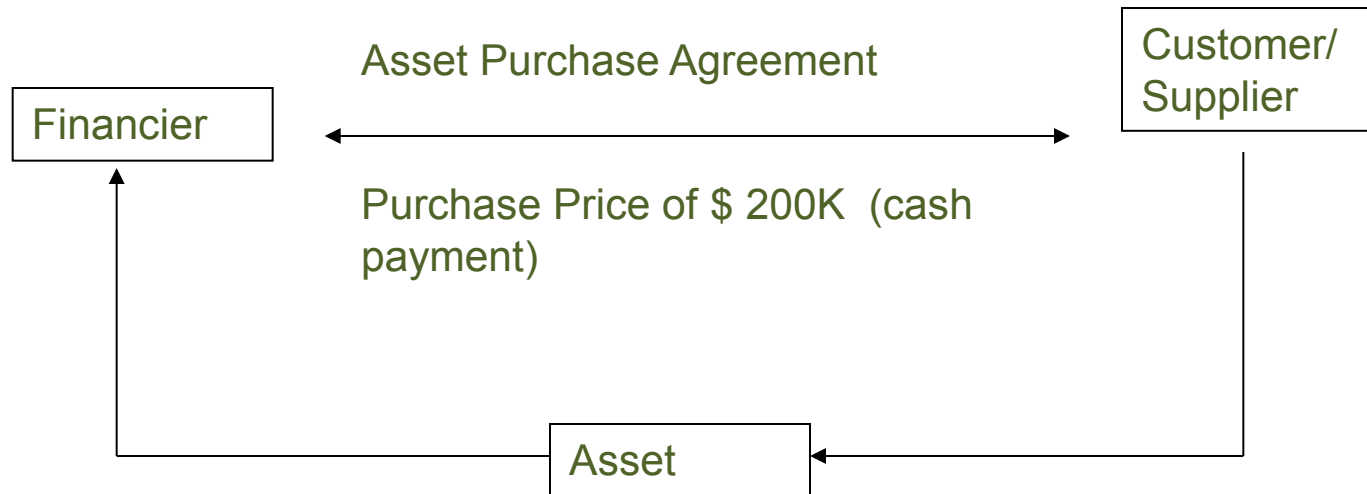
# Outline

- Financing Structures - BBA, Tawarruq, Commodity Murabahah, Diminishing Musharakah
- Documentation - BBA & Tawarruq / Commodity Murabahah
- Documentation - Diminishing Musharakah

# Sale Based Structures (BBA/Murabahah/ Tawarruq)

# BBA / Murabahah Financing Structure

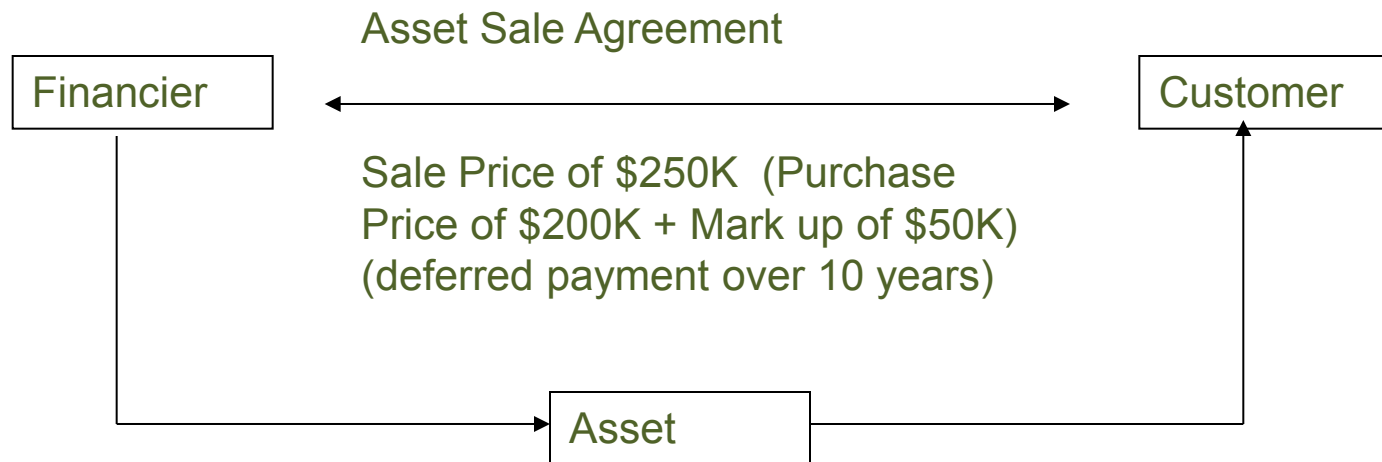
Bai' Bithaman Ajil (BBA) (Sale price with deferred payment) / Murabahah (Cost plus mark up profit)



**STEP ONE**

## BBA / Murabahah Financing Structure ...2

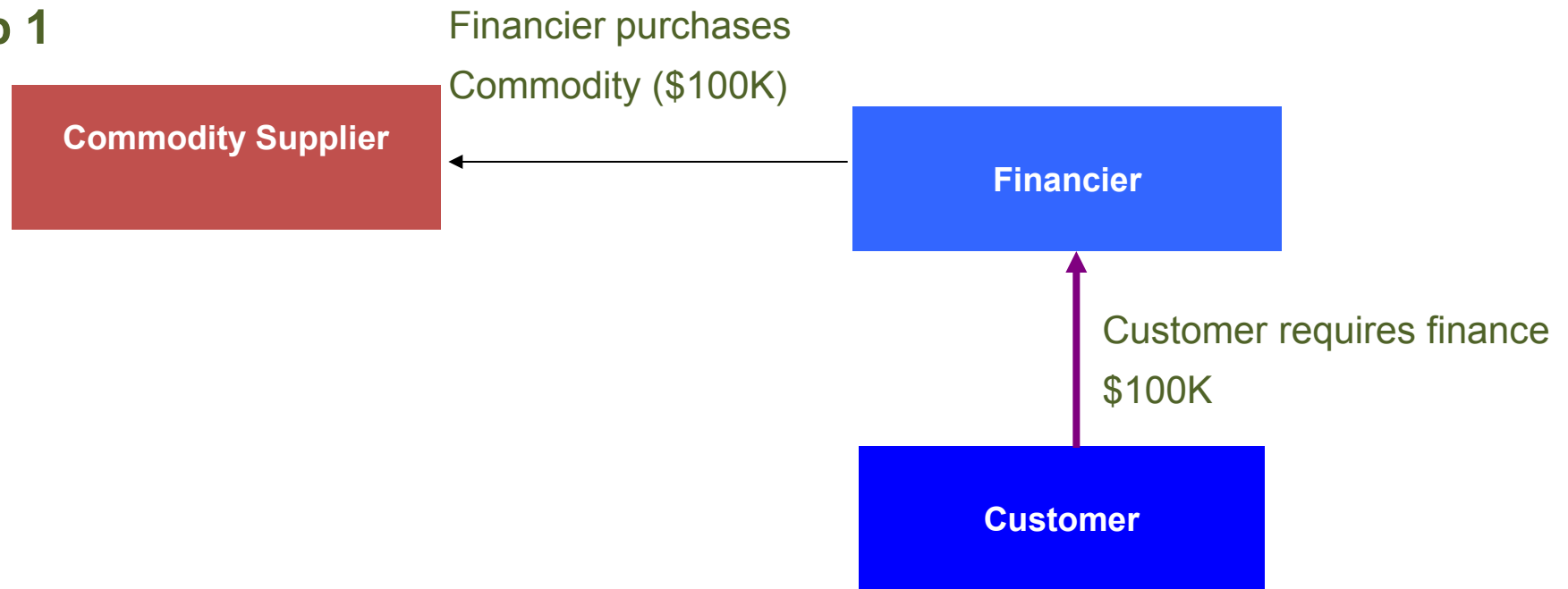
Bai' Bithaman Ajil (BBA) (Sale price with deferred payment) / Murabahah (Cost plus mark up profit)



**STEP TWO**

# Commodity Murabahah Financing Structure ...1

## Step 1

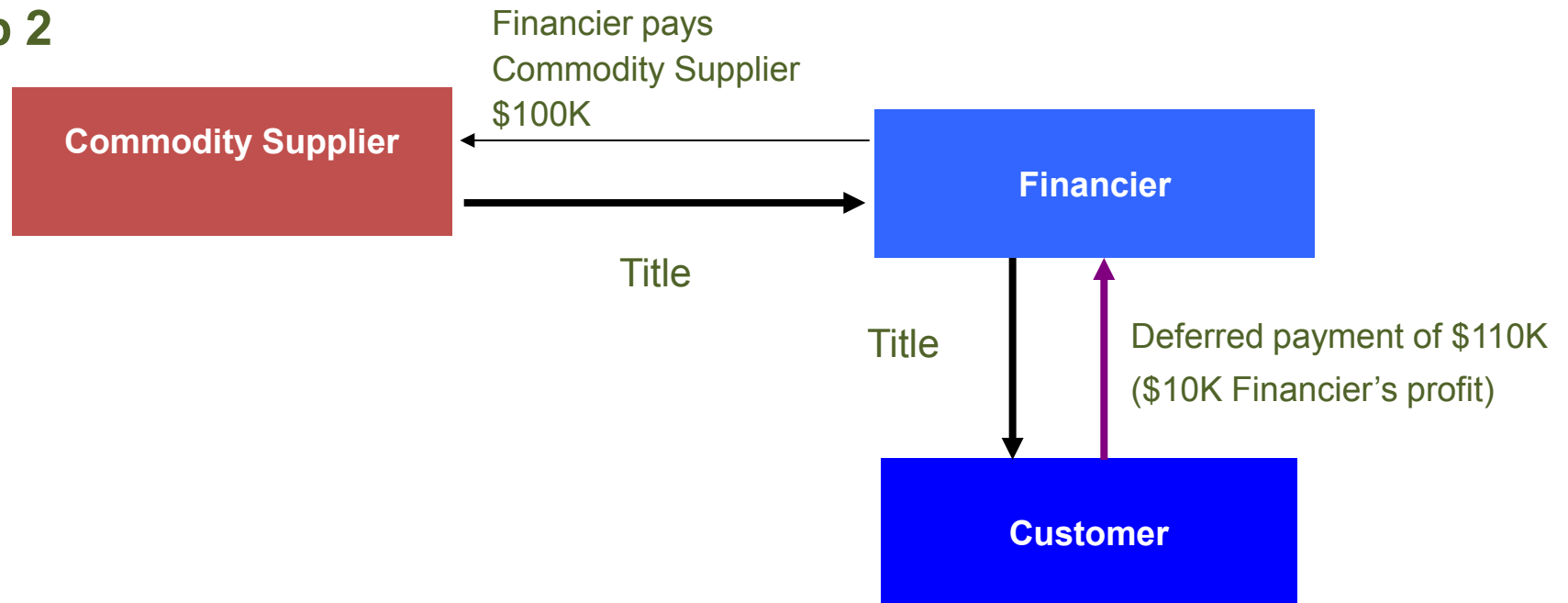


Customer requires finance from Financier (e.g. \$100K)

Financier purchases commodity from Commodity Supplier

# Commodity Murabahah Financing Structure ...2

## Step 2

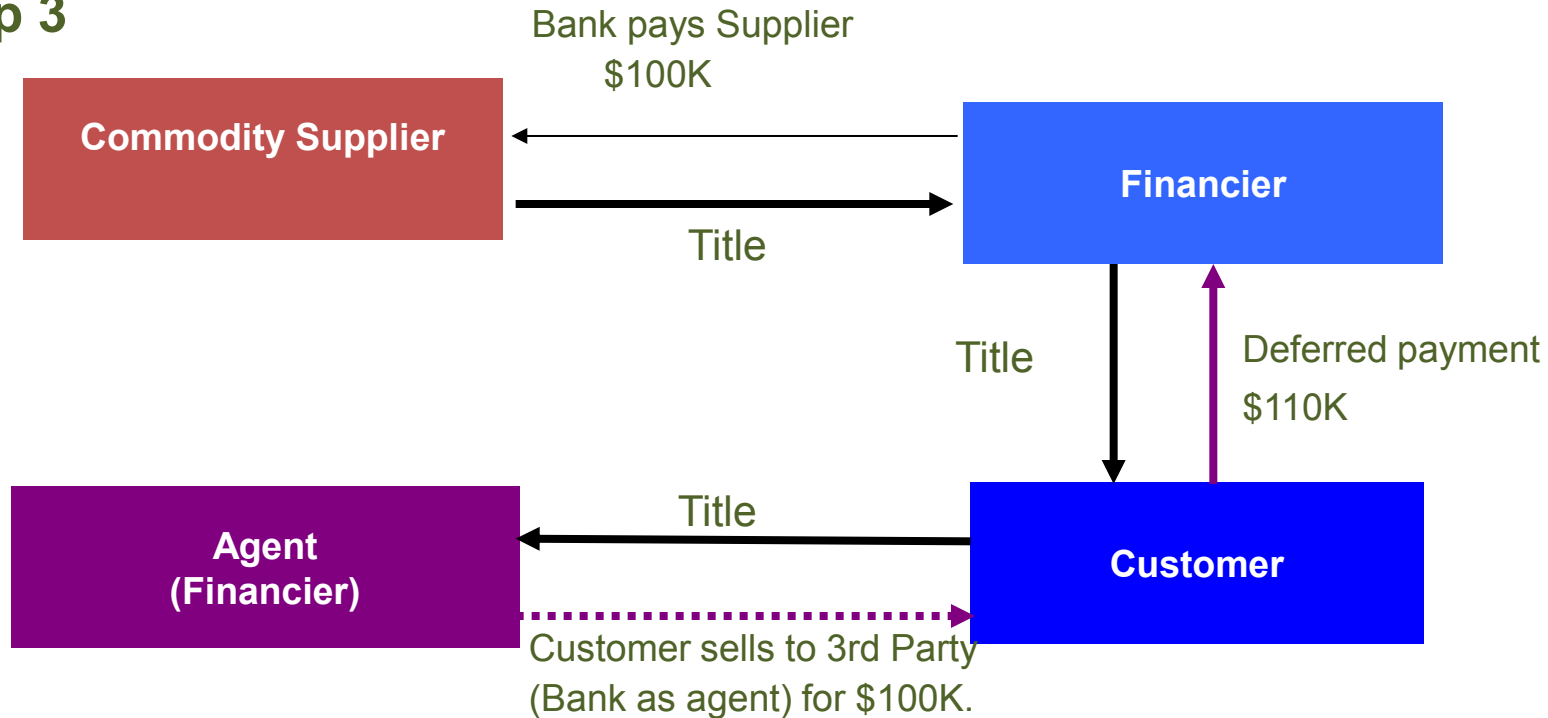


Supplier sells commodity and transfers title to Financier.

Financier sells purchased commodity to Customer on deferred payment basis at a pre-agreed fixed price.

# Commodity Murabahah Financing Structure ...3

## Step 3



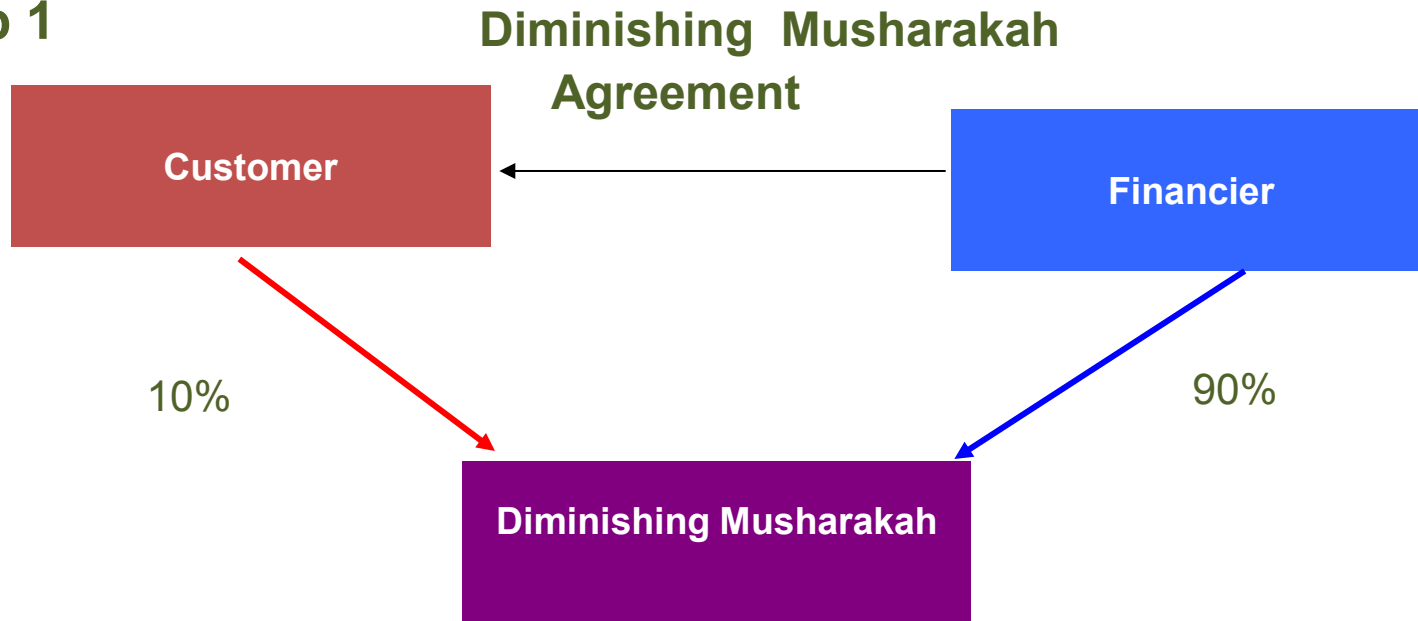
Customer sells commodity to third party via agent (Financier acts as agent for customer). Agent finds third party for Customer.



# Diminishing Musharakah Structure

# Diminishing Musharakah Financing Structure

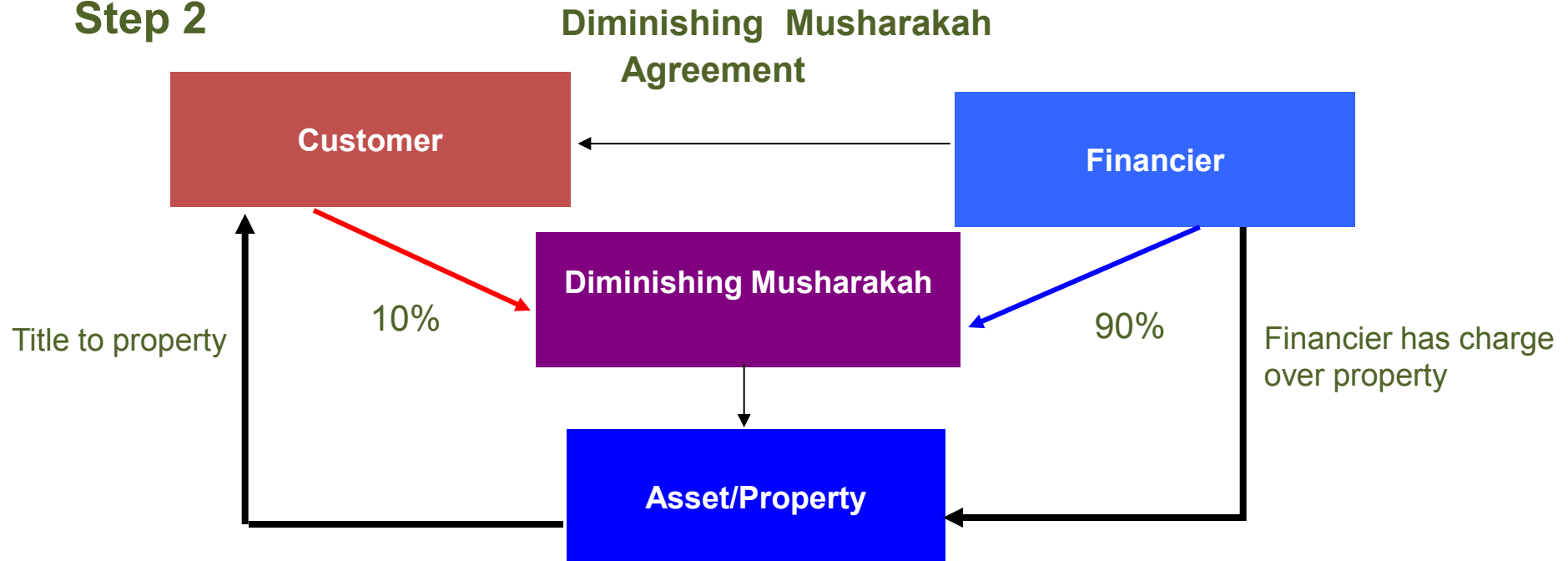
## Step 1



Financier enters into a Musharakah Agreement with the Customer, Both of them pay their respective shares to seller of the asset/property. For example, 90% of the property is owned by Financier and 10% of the asset/property is owned by the Customer

# Diminishing Musharakah Financing Structure ...2

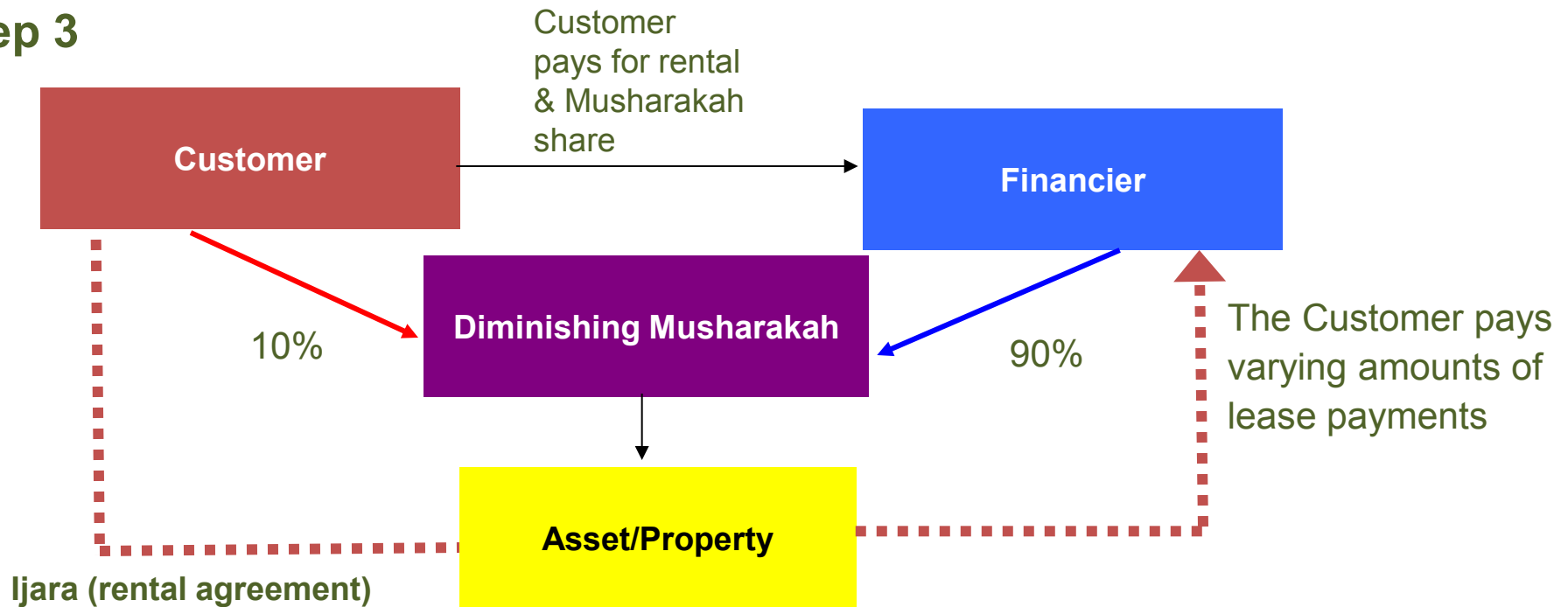
## Step 2



The Diminishing Musharakah purchases the asset property  
The property will be registered in the name of the Customer  
Financier has a legal charge and other security over the asset/property

# Diminishing Musharakah Financing Structure ...3

## Step 3



Diminishing Musharakah – Customer makes payments to Financier for purchase of Musharakah unit owned by Financier.

Ijarah Agreement – Customer makes lease payments to Financier for the use of the Financier's share in the asset/property

# Financing Structures – Relevant BNM Requirements

## BBA / Murabahah

- BNM Circular on Implementation of Shariah Advisory Council of Bank Negara Malaysia's Resolution on Bai' 'Inah (2012)
- BNM Policy Document on Murabahah (2013)
- BNM Policy Document on Wakalah\* (2016)
- BNM Policy Document on Wa'd\* (2017)

## Commodity Murabahah / Tawarruq

- BNM Policy Document on Tawarruq (2015)
- BNM Policy Document on Wakalah\* (2016)
- BNM Policy Document on Wa'd\* (2017)

## Diminishing Musharakah

- BNM Policy Document on Musyarakah (2015)
- BNM Policy Document on Ijarah\* (2016)
- BNM Policy Document on Wakalah\* (2016)
- BNM Policy Document on Wa'd\* (2017)

# Legal Documentation – Master Facility Agreement

# Master Facility Agreement

## Purpose

- provides an overview of the arrangements between the financier and the customer pursuant to the facility
- in essence an expansion of the terms of the letter of offer
- is used as the principal agreement for the facility

# Master Facility Agreement – Main Provisions

## Definitions:

- sets out the definitions used in the Master Facility Agreement;
- such definitions will also apply in the other documentation to the facility
- some important definitions would be:
  - ✓ Asset
  - ✓ Facility
  - ✓ Financier
  - ✓ Customer
  - ✓ Facility Amount
  - ✓ Definitions related to the financing structure,  
e.g. for a Murabahah or Tawarruq structure – “Asset Purchase Agreement” , “Asset Sale Agreement”, “Asset Purchase Price”, “Asset Sale Price”



# Master Facility Agreement – Main Provisions ...2

Conditions precedent for the facility, which include among others:

- execution and stamping of the documentation for the facility,
- insolvency/liquidation search on the customer,
- search on the customer on applicable company register,
- internal company approval/board of directors resolution authorising the facility,
- approval/consent of relevant authority or creditor obtained,
- presentation of documents relating to collateral for registration with the relevant authority,
- valuation report in respect of the asset,
- payment of all fees and expenses in relation to the facility,
- solicitors' confirmation on fulfilment of conditions precedent

# Master Facility Agreement – Main Provisions ...3

## Representations and warranties of customer:

- similar as in other financing documents, e.g.
  - status of customer
  - customer is authorised and permitted to accept and carry out its obligations under facility and documentation
  - execution of facility documents would not contravene law or any previous agreements entered into by customer
  - no other consent or authorisation or approval (otherwise than that already obtained) is necessary to ensure that customer can accept and carry out its obligations under facility and documentation

## Affirmative and negative covenants of customer:

- similar; examples of affirmative covenants:
  - notification by customer of any material adverse changes or any litigation or breach of its contractual obligation
  - making payments under the facility
  - disclosure of information

# Master Facility Agreement – Main Provisions ...4

Affirmative and negative covenants of customer (cont'd):

- example of negative covenants:
  - customer will not provide financing/loan to any other party,
  - will not dispose or part with the asset financed,
  - will not vary or amend its constituent documents or change its financial year

Events of default/dissolution:

- circumstances would be similar as in other financing documents
- examples:
  - non-payment under facility
  - breach of obligations under the facility
  - litigation adversely affecting the customer

# Master Facility Agreement – Main Provisions ...5

Upon event of default/dissolution:

- financier shall be entitled to enforce its rights under the facility
- enforcing transaction documents for any outstanding payments

Other provisions:

- right of set off,
- fees and expenses,
- application of proceeds upon realisation of security,
- advance payment,
- miscellaneous/further provisions (notices, variation of terms, governing law etc)

# Legal Documentation – Sale Based Structures

# Documentation for Bai' Bithaman Ajil Facility – Asset Purchase Agreement

## Recitals:

- stating that the Asset Purchase Agreement is entered into pursuant to the Master Facility Agreement
- providing an overview of the purchase arrangement that is expanded under this agreement

## Agreement to purchase:

- sets out the agreement of the financier to purchase the asset and the customer/third party to sell the asset
- details of asset purchased to be included in the agreement
- purchase price as set out in the Asset Purchase Agreement, to be paid by financier to customer or third party

# Documentation for Bai' Bithaman Ajil Facility – Asset Purchase Agreement ...2

## Agreement to purchase (cont'd):

- beneficial ownership of asset to be transferred to financier immediately upon execution of the Asset Purchase Agreement
- purchase price to be paid by financier to customer upon compliance of conditions precedents of facility
- provision for purchase price to be paid to another party being deemed as payment to seller (who is either the customer/third party)

# Documentation for Murabahah/ Bai' Bithaman Ajil Facility – Asset Sale Agreement

## Recitals:

- stating that the Asset Sale Agreement is entered into pursuant to the Master Facility Agreement
- providing an overview of the sale arrangement that is expanded under this agreement

## Salient Terms:

- sets out the agreement whereby the financier sells the asset and the customer buys the asset
- details of asset sold to be included in the agreement
- beneficial ownership of asset transferred to customer immediately upon execution of the Asset Sale Agreement



# Documentation for Murabahah/ Bai' Bithaman Ajil Facility – Asset Sale Agreement ...2

## Salient Terms (continued):

- sale price as set out in the Asset Sale Agreement to be paid by customer to financier
- payment of sale price by customer to financier on deferred payment terms, either in lump sum or instalments
- provisions on accelerated payment of sale price upon early redemption, in event of default/ dissolution
- provisions on rebate (ibra') on sale price for early redemption
- provisions on compensation (ta'widh)/late payment charge for any late payment

# Documentation for Murabahah / Tawarruq Facility – Purchase Request/Undertaking

## Purpose:

- to commence the purchase of the asset by the financier for the purpose of the Murabahah
- usually by way of a letter

## Salient Terms (continued):

- made pursuant to Master Facility Agreement, terms in MFA incorporated in letter
- request by customer for financier to acquire asset
- sets out the proposed cost of asset to be purchased (corresponding to funding required)
- also include undertaking of customer to purchase the asset from financier upon asset acquisition

# Documentation for Murabahah / Tawarruq Facility – Agency Arrangement

## Purpose:

- to facilitate the dealings by financier in relation to asset acquisition (for Murabahah) or asset disposal (for Commodity Murabahah/Tawarruq)
- may be by way of an agreement or a letter
- such agency may also be incorporated in the Purchase Request/Undertaking
- agency based on the Shariah concept of Wakalah

## Salient Terms (continued):

- made pursuant to Master Facility Agreement, terms in MFA incorporated in agreement/letter
- appointment by financier of customer to acquire asset (e.g. Murabahah) or by customer of financier to dispose of asset (e.g. Commodity Murabahah)
- sets out the proposed cost of asset to be purchased (corresponding to funding required)
- sets out the particular scope of agency, agency fee and duration of agency

# Legal Documentation - Diminishing Musharakah Structure

# Documentation for Diminishing Musharakah Facility – Musharakah Agreement

## **Purpose**

- executed pursuant to the grant of the facility, also usually pursuant to the Master Facility Agreement
- sets out the terms of the Musharakah between the parties
- expands the Musharakah arrangement that has been generally stated in the Master Facility Agreement

# Documentation for Diminishing Musharakah Facility – Musharakah Agreement ...2

## Recitals:

- stating that the Musharakah Agreement is entered into pursuant to the Master Facility Agreement
- providing an overview of the Musharakah arrangement that is expanded under this agreement

## Musharakah arrangement:

- sets out the agreement to participate in the Musharakah,
- amount/type of contribution provided by both the customer and the financier in respect of the Musharakah
- beneficial interest in the asset which will be vested in the customer and the financier pursuant to the Musharakah,
- ownership units in the asset which will be divided between the customer and the financier in the proportion initially set out in the Musharakah Agreement,
- agreement of the parties that the customer will gradually purchase the financier's ownership units in the asset until the expiry of the Musharakah

# Documentation for Diminishing Musharakah Facility – Musharakah Agreement ...3

## Offer of ownership units:

- financier to offer its ownership units for purchase by customer by way of advance notice
- customer may accept by making payment for the ownership unit

## Expiry of Musharakah arrangement:

- may occur upon customer purchasing all of the financier's ownership units in the asset
- or at option of the financier upon occurrence of event of default/dissolution under the facility

## Musharakah not a partnership:

- provision stating that the Musharakah is not a partnership under the relevant law and that local law relating to partnerships do not apply

# Documentation for Diminishing Musharakah Facility – Ijarah Agreement

## **Purpose**

- executed pursuant to the grant of facility and subsequent to the Master Facility Agreement and the Musharakah Agreement
- sets out the terms of the Ijarah between the parties
- expands the Ijarah arrangements set out in the Master Facility Agreement



# Documentation for Diminishing Musharakah Facility – Ijarah Agreement ...2

## Recitals:

- stating that the Ijarah Agreement is entered into pursuant to the Master Facility Agreement and the Musharakah Agreement
- providing an overview of the Ijarah arrangement that is further expanded under this agreement

## Ijarah arrangements:

- sets out the renting out of the financier's ownership unit in the asset to the customer based on the principles of Ijarah,
- the rental is to commence on a date specified in the Ijarah Agreement and will continue until the expiry of Ijarah,
- rental payment to be made on monthly basis, rental amount to be determined by financier and subject to review and may be based on a particular formula for calculating the rental payment (based on financier's remaining ownership unit and the financing rate)

# Documentation for Diminishing Musharakah Facility – Ijarah Agreement ...3

## Ijarah arrangements (cont'd)

- notice of rental payment to be issued by financier,
- rental payment may be adjusted upon any expense incurred by customer under agency/maintenance agreement,
- any late payment of rental will be subject to compensation rate (ta'widh),
- duties in relation to maintenance of the asset to be divided between financier (major maintenance) and customer (ordinary maintenance)

## Expiry of Ijarah:

- upon the customer purchasing all of the financier's ownership units in the asset,
- upon event of dissolution/default, the financier continues to be entitled to receive rental payments until the Ijarah arrangement is terminated by the financier

## Reimbursement:

- the customer agrees to reimburse and compensate for the financier in the event of any claims arising or made by third parties in relation to the asset

# Documentation for Diminishing Musharakah Facility – Purchase Undertaking

## Purpose of document:

- executed pursuant to Musharakah Agreement and Master Facility Agreement
- serves as a means to ensure payment of funding amount by customer to financier
- expands details on the undertaking as set out in Musharakah Agreement and Master Facility Agreement
- may be subsumed as part of Musharakah Agreement

## Recitals:

- stating that the Purchase Undertaking is entered into pursuant to the Master Facility Agreement and the Musharakah Agreement
- providing an overview of the purchase undertaking arrangement that is further expanded under this document

# Documentation for Diminishing Musharakah Facility – Purchase Undertaking ...2

## Undertaking provision:

- customer undertakes to purchase the financier's ownership units in asset
- in accordance with offer for purchase as may be provided in the undertaking

## Expiry of undertaking:

- upon the customer purchasing all of the ownership units of the financier in asset

## Event of dissolution/default under the Master Facility Agreement:

- customer will be under obligation to purchase all remaining financier's ownership units in asset within a certain period

# Documentation for Diminishing Musharakah Facility – Purchase Undertaking ...3

Compensation / late payment charge for late payment:

- in the event customer is obliged to make payment under purchase undertaking and fails to make payment as specified by financier
- compensation (ta'widh) / late payment charge may be imposed on such late payment

Execution page:

- only customer to execute purchase undertaking
- both parties cannot execute as otherwise it would be an agreement
- If this document is in the form of an agreement then this may trigger a Shariah issue

# Questions? Thank you

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