



**NON-TRADEABLE ISLAMIC COMMERCIAL PAPERS:
A CASE STUDY OF AL RAJHI BANKING AND
INVESTMENT CORPORATION (MALAYSIA) BERHAD**

BY

NORLEZA BINTI ABU BAKAR

**A research paper submitted in fulfilment of the requirement
for the degree of Master of Science in Islamic Banking and
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International Islamic University Malaysia**

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ABSTRACT

The aim of this study is to examine the practicality of the issuance of Islamic Commercial Papers (ICPs) through evaluating the structure used by Al Rajhi Banking and Investment Corporation (Malaysia) Berhad (ARBM) pursuant to the Sukuk Programme of up to RM45.0 million in nominal value, issued by QL Resources Berhad (QL) in November 2011, which is referred to as the, “QL-ICPs Sukuk Programme”. The study is intended to highlight the main Shari’ah issues and challenges for ARBM to execute the QL-ICPs Sukuk Programme and how these Shari’ah issues are addressed or resolved by ARBM. In accordance with the aim of this study, a qualitative case study methodology is adopted to evaluate the QL-ICPs Sukuk Programme. The researcher finds several practical Shari’ah issues and then attempt to address the issues by providing a clear understanding on the Principal Terms and Conditions (PTCs) derived from the QL-ICPs Sukuk Programme. The PTCs are complied with the views and the rulings given by the ARBM’s Shari’ah Committee and approved by the Securities Commission of Malaysia. Several main Shari’ah issues to execute the QL-ICPs Sukuk Programme and the mechanisms to address such issues have been highlighted in the study. The study is an insight of the practical standing of the ICPs. It covers many perspectives to evaluate the instrument, while providing general framework and limitation of the ICPs. It also includes the main Shari’ah issues that need to be addressed for further development of the product. In addition to that, the researcher also discovered several general usage and benefits of the Conventional Commercial Papers. The study is significant as it will contribute to the scholarly literature on the Islamic Capital Market products, particularly on the ICPs since the researcher discovered that there is a lack of literature written on the ICPs. Hence, it is hoped that further study of the development of the ICPs can be conducted to narrow the gap between the theoretical understanding of the ICPs and the practical knowledge of the instrument in the context of the Malaysian Islamic Capital Market. The researcher also hoped that the industry practitioners as well as the academicians in the Islamic Capital Market can adopt the study to recognize any loopholes in the legal framework attached to the ICPs so as to develop the ICPs to be one of the Islamic Capital Market products which are competitive and globally accepted in the market.

خلاصة البحث

تهدف هذه الدراسة إلى فحص فعالية إصدار الأوراق التجارية الإسلامية بتقويم الهيكل الذي تستخدمه شركة الراجحي المصرفية للاستثمار (الماليزية) المحدودة في برنامج الصكوك بالقيمة الاسمية التي تقدر إلى 45 حد مليون رنجت الماليزي والذي أصدرته شركة كيوايل المحدودة في نوفمبر 2011 م. تلقي الدراسة الضوء على القضايا الشرعية والتحديات التي واجهته شركة الراجحي المصرفية والاستثمار في تحقيق برنامج الصكوك المذكور وكيفية معالجتها بها. وبناء على ما تهدف إليه الدراسة، يتم تقويم البرنامج بمنهج نوعي لدراسة الحالة حيث تحاول الباحثة الإشارة إلى بعض القضايا الشرعية ثم تقوم بعلاجتها ببيان الشروط الأساسية للبرنامج بيانا وافيا. وقد لوحظ أن هذه الشروط الأساسية تستوفي القوانين والآراء للمجلس الشرعي لشركة الراجحي المصرفية والاستثمار كما أنها قد حصلت على الموافقة من مجلس الأوراق المالية الماليزية. تركز الدراسة على عدد من القضايا المتعلقة بتحقيق برنامج الصكوك والآليات المستخدمة للتغلب على مشكلاتها لمعرفة مدى فعاليتها. وتغطي الدراسة وجهات النظر المختلفة عن هذه الأوراق من أجل تقويمها بوضعها في إطارها العام والإشارة إلى قصورها وقضاياها الشرعية من أجل تطوير الأوراق المالية الإسلامية من وضعها الراهن. وبالإضافة إلى ذلك تكتشف الباحثة بعض الفوائد والمنافع للأوراق التجارية التقليدية كما تعد الدراسة ذات أهمية نظرا لما ستساهمه إلى الدراسات العلمية الموجودة عن الأوراق التجارية الإسلامية لقلة المراجع والدراسات في هذا المجال، ويرجى في هذا الصدد إجراء المزيد من الدراسات في تطوير الأوراق التجارية الإسلامية لتقريب الفجوة بين المعرفة النظرية عنها وبين المعرفة التطبيقية لها في سياق سوق الرأسمالي الإسلامي الماليزي. تأمل الباحثة من اللاعبين في هذه الصناعة والأكاديميين في مجال الرأسمالي الإسلامي بأن يستفيدوا من هذه الدراسة للتعرف على الثغرات القانونية المرتبطة بالأوراق التجارية الإسلامية من أجل تطويرها لتكون على نفس المستوى من القبول والمنافسة مع غيرها من الأدوات المالية الإسلامية في العالم.

ABSTRAK

Penulisan ilmiah ini bertujuan untuk mengkaji aspek praktikal penerbitan Kertas Komersial Islam (ICP) melalui kajian terperinci ke atas ICP yang distrukturkan oleh Al Rajhi Banking and Investment Corporation (Malaysia) Berhad (ARBM) dibawah Program Sukuk yang bernilai nominal RM45.0 juta terbitan QL Resources Berhad pada November 2011. Program Sukuk ini juga dikenali sebagai Program Sukuk QL-ICPs. Selain itu, kajian ini juga bertujuan untuk memberi pencerahan terhadap isu-isu utama Shari'ah dan cabaran yang dihadapi oleh ARBM di dalam menstruktur Program Sukuk QL-ICPs serta cara ARBM mengatasi dan menyelesaikan isu-isu Shari'ah yang timbul. Reka bentuk kajian ini ialah pendekatan kualitatif dengan menggunakan kaedah kajian kes. Melalui kajian ini, pengkaji telah menemui beberapa isu-isu praktikal Shari'ah dan telah cuba menjelaskan isu-isu tersebut dengan meneliti Terma dan Syarat (PTCs) bagi Program Sukuk QL-ICPs serta mengkaji mekanik ICP yang diterbitkan. PTCs yang digunakan bagi Program Sukuk QL-ICPs telah didapati mematuhi peraturan yang ditetapkan oleh Jawatankuasa Shari'ah ARBM dan diluluskan oleh Suruhanjaya Sekuriti Malaysia. Dapatan kajian ini memaparkan beberapa aspek praktikal penerbitan ICP iaitu mekanik ICP yang boleh diterima umum diikuti dengan kerangka kerja serta beberapa batasan terhadap penerbitan ICP. Ini juga termasuk isu-isu utama Shari'ah yang perlu ditangani untuk penambahbaikan produk. Pada masa sama, pengkaji juga telah menemui beberapa faedah dan manfaat penggunaan Kertas Komersial Konvensional secara umum. Kepentingan kajian ini adalah untuk menambah kepada kesusasteraan ilmiah produk Pasaran Modal Islam terutamanya bagi topik ICP yang pengkaji dapati agak terhad. Kajian ini juga diharapkan dapat digunakan untuk kajian yang lebih mendalam mengenai ICP bagi membolehkan jurang perbezaan antara fahaman konseptual dan penggunaan ICP dikurangkan di dalam konteks Pasaran Modal Islam di Malaysia. Akhir sekali, pengkaji juga berharap pihak pengguna dan ahli akademik di dalam Pasaran Modal Islam di Malaysia dapat mengenalpasti kelemahan kepada sistem perundangan yang berkaitan dengan ICP serta mampu menyumbang kepada perkembangan produk tersebut sebagai salah satu produk Pasaran Modal Islam yang berdaya saing dan diterima di peringkat global.

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a research paper for the degree of Master of Science in Islamic Banking and Finance.

.....
Rusni binti Hassan
Supervisor

This research paper was submitted to IIUM Institute of Islamic Banking and Finance and is accepted as a fulfilment of the requirement for the degree of Master of Science in Islamic Banking and Finance.

.....
Khaliq Ahmad
Dean, IIUM Institute of Islamic
Banking and Finance

DECLARATION

I hereby declare that this research paper is the result of my own investigation, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

Norleza binti Abu Bakar

Signature.....

Date

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*This research is dedicated to my beloved late parents, my husband and children who
are my source of inspiration ever.....*

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LIST OF ABBREVIATIONS

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
ABCP	Asset Backed Commercial Paper
ABS	Asset Backed Securities
ARB-KSA	Al Rajhi Bank, Kingdom of Saudi Arabia
ARBM	Al Rajhi Banking & Investment Corporation (Malaysian) Berhad
BBA	Bai Bithaman Ajil
BIMB	Bank Islam Malaysia Berhad
BNM	Bank Negara Malaysia or Central Bank of Malaysia
BSAS	Bursa Suq Al Sila
CFA	Capital Adequacy Framework
CIFP	Chartered Islamic Finance Professional
CM	Commodity Murabahah
CMSA	Capital Market and Services Act 2007
CP	Conventional Commercial Papers
CPO	Crude Palm Oil
CSP	Commodities-Supplying Participants
GCC	Gulf Cooperation Councils
GIC	Government Investment Certificates
GII	Government Investment Issues
HTM	Hold to maturity
IB	Investment Bank
ICM	Islamic Capital Market
ICP	Islamic Commercial Paper
IDB	Islamic Development Bank
IFI	Islamic Financial Institution
IFS	Islamic Financial System
IFSA	Islamic Financial Services Act 2013
IFSB	Islamic Financial Service Board
IiBF	IUM Institute of Islamic Banking and Finance
IUM	International Islamic University Malaysia
IMF	International Monetary Fund
IMTN	Islamic Medium Term Note
INCEIF	International Center for Education in Islamic Finance
IPO	Initial Public Offering
IRTI	Islamic Research and Training Institute
LIBOR	London Interbank Offered Rate
LME	London Metal Exchange
LOLA	The Lodge and Launch Framework
MIFC	The Malaysian International Islamic Financial Centre
MyClear	Malaysian Electronic Clearing Sdn Bhd
PLC	Public-listed Companies
PTC	Principle Terms and Conditions
PORPSS	Participation and Operation Rules for Payment and Securities Services
RWA	Risk Weighted Average

SAC	Shariah Advisory Council
SC	Securities Commission of Malaysia
SPV	Special Purpose Vehicle
SR	Saudi Riyal
S&P	Standard and Poor
QL	QL Resources Berhad

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Islamic Capital Market (ICM) is one of the fastest growing components in global capital market (IMF, 2010), particularly in Malaysia. It works similarly to the conventional capital market but it has been “carried out in ways that do not conflict with the conscience of Muslims and the religion of Islam”. The capital market refers to a channel, which helps in mobilizing funds from non-productive to productive channel, which facilitates in the promotion of economic growth in a country¹. The Malaysian International Islamic Financial Centre (MIFC) recorded that the size of the country’s ICM has tripled during its first phase of development at the rate of 13.6% annually since 2000 to 2010. By 2012, the growth size reached 16.3% per annum and worth RM1.42 trillion by December that year. MIFC (2015) also recorded that the market capitalization of Shari’ah-compliant companies and value of sukuk outstanding in Malaysia have increased at average rate of 11.5% and 22.2% per annum respectively.

One of the most important tools in ICM is the securities instrument. “Securities” means debentures, stocks or bonds issues which represent the indebtedness of the Issuer for the borrowed monies. It includes Islamic Commercial Papers (ICPs), and Islamic Medium Term Notes (IMTNs). The difference between ICPs and IMTNs are that they are named in accordance to its maturity period. The ICPs refer to the short-term papers issued by corporations with original tenor of one (1) year or less whilst IMTNs refer to securities issued by corporations with a tenor exceeding one (1)

¹ http://www.sc.com.my/general_section/islamic-capital-market/, retrieved on 8 March 2015.

year². Technically, all of the mentioned features of the securities are stipulated in the Principle Terms and Conditions (PTC) of the respective securities. ³Sukuk means “certificates of equal value, which evidence undivided ownership or investment in the assets using Shari’ah principles and concepts endorsed by the Shariah Advisory Council (SAC) of the Securities Commission Malaysia. For avoidance of doubt, sukuk as approved by the Securities Commission of Malaysia do not include sukuk issued by:-

- i) The Federal Government;
- ii) Any State Government; or
- iii) Bank Negara Malaysia (BNM); where any issuance of sukuk from either of the above entity will be exempted from approval from the Securities Commission Malaysia.

Sukuk can be categorized into many of its features that have many different opinions in accordance to Islamic schools. First, sukuk can either be asset backed or asset based. Asset backed sukuk refers to sukuk that the originator sells an on-going project that generate revenue used to pay for dividend. On the other hand, asset based sukuk refers to sukuk where the dividend is paid from originator and not from the revenue of asset. This type of asset can be further divided into unsecured, secured and covered sukuk. Second, the sukuk can also be recognized through its underlying contracts. It can either be a sale-based contracts (Murabahah, Salam and Istisna),

² As stipulated in the ‘Participation and Operation Rules For Payments and Securities Services’ issued by Malaysian Electronic Clearing Corporation Sdn. Bhd. (MyClear) on behalf of BNM. Released Date: 17 February 2011, p.51 and 59.

³ The definition of Sukuk is as per the Guidelines on Unlisted Capital Market Products under the Lodge and Launch Framework SC-GL/4-2015, 1st. Issued: 9 March 2015 by the Securities Commission Malaysia hereinafter referred to as the “Guidelines on the UCMP under the LOLA Framework”, pursuant to Section 377 of the CMSA 2007 and is effective from 15 June 2015, p. 12.

lease-based contract (Ijarah) or partnership-based contracts (Musharakah and Mudarabah). (Securities Commission, Malaysia)

The Islamic securities instruments are highly recognized during the recent financial crisis, as studies proved that Islamic finance had shown strong growth (MK Hassan, 2010). This rapid expansion of the component of capital market has led to various researches in many segments of the ICM, highlighting its sustainability in the long run. Before dwelling into the operation of ICP, it is crucial to understand the core elements of Islamic finance. The basis of Islamic finance is the prohibition of lending money for interest (riba), which is the main difference between Islamic finance and conventional finance. The rulings against riba came from the following verse from the Quran:-

“O you who believe! Be afraid of Allah and give up what remains (due to you) from RIBA (usury) (from now onward), if you are (really) believers. And if you do not do it, then take a notice of WAR from Allah and His Messenger but if you repent, you shall have your capital sums. Deal not unjustly (by asking more than your capital sums), and you shall not be dealt with unjustly (by receiving less than your capital sums). (Al Baqarah 2:278-279)”.

It is clear from the verse above that Allah S.W.T. has declared war against those who deals with *riba*. Hence, in the Islamic banking and finance industry, the lending or borrowing of money should not include payment of interest. Since issuance of bond involve payment of interest, it is considered to be non-Shari’ah compliant.

Apart from the fact that bond includes payment of interest, it is also considered as non-compliant due to its nature as a debt instrument. The word debt (Dayn) in the Arabic language refers to submission and humiliation.⁴ Bensaïd (2013) quote a Prophetic tradition that refers debtor as being detained. Muslim jurist also stated that debt is a financial obligation that must be discharged (Bensaïd, 2013). Apart from that,

⁴ Abadi, F. (2005) Al Qamus al-Muhit, Beirut: Mu’assasat al Risalah.

a debtor is also entitled to zakat fund for he is considered as poor (Ibn ‘Abidin, 1984). Therefore, Shari’ah scholars disagree on the usage of debt as an instrument for further development of an economy.

With the prohibition on usage of bond, Islamic financial engineers created sukuk that has similar function to bond, which is a fixed-income instrument. It is not meant to become a copy of conventional bond that portrays a contractual debt obligation, but a Shari’ah compliant asset management tool. The industry’s major struggle is to stay true to its principle while having to provide equal banking services, expand scope of financial activities and provide growth to the economy (Al-Salem, 2009). In simplicity, the industry has to achieve competitive advantage when compared to conventional financial industry.

In order to do that, Islamic financial product innovation has become sophisticated in the past few years. Product innovation refers to the process of utilizing Islamic legal contracts in new ways to develop financial products that are in compliance with Shari’ah principles and have ability to replicate the economic effects of conventional financial products (Humayon Dar, 2003). Apart from replication, the industry also operate towards the realization of Maqasid al Shari’ah, which involves obligations of organization and individual in fostering justice and social welfare based on sources of Shari’ah, which are Al Quran and As Sunnah (Vejzagic and Smolo, 2011). In its essentials, it involves the protection of the religion, protection of life, protection of mind, protection of wealth and protection of lineage.

The replication of financial product from conventional financial system is even more active in Malaysia, as its Islamic Financial System (IFS) operates in parallel with conventional financial system. In order to compete with the conventional financial system, the IFS have to present itself as a viable alternative, from financial

products variety to attractive returns on investment. From the legal perspective, the Securities Commission of Malaysia monitors the issuance of sukuk. Before any issuance of sukuk takes place, the Issuer must obtained the regulatory approval from the Securities Commission Malaysia. The registered Shariah Adviser⁵ will have to ensure that the structure of the instrument is complied with the Shari'ah principles. It is important to note that every financial institution has different opinion or requirement on each transaction of a product.

A commonly known bank which has one of the stringent Shari'ah requirements in the world is Al Rajhi Bank, Kingdom of Saudi Arabia (ARB-KSA), (previously known as Al Rajhi Banking and Investment, Kingdom of Saudi Arabia). The bank is a leading international banking group founded in 1957 in the Kingdom of Saudi Arabia (KSA). ARB-KSA is one of the biggest Islamic banks in the world. It is also a major investor in the KSA's business and is one of the largest joint stock companies in KSA with a paid up capital of Saudi Riyal (SR) 16.25 billion as at 31 December 2014⁶

⁷Backed by the full force of its established operations in the Middle East, ARB-KSA made its maiden foray into the international banking market by setting up its first overseas operations in Malaysia that is, Al Rajhi Banking and Investment Corporation (Malaysia) Berhad (ARBM or the Bank) in October 2006. ARBM was incorporated as a wholly-owned subsidiary of ARB-KSA and was being one of the first foreign banks to be awarded a full banking license by BNM or Central Bank of Malaysia. As of 30 June 2015, the bank has 24 branches all over Malaysia. Starting

⁵ The registered Shariah Adviser means an individual, corporation or a foreign Shariah Adviser who is registered with the Securities Commission Malaysia under the "Registration of Shariah Advisers Guidelines", Issued /Effective: 10 August 2009.

⁶ Taken from the website: <http://alrajhibank.com.sa>, retrieved on 30 June 2015.

⁷ Taken from the website: http://alrajhibank.com.my/corporate_about_al_rajhi.shtml, retrieved on 30 June 2015.

with its first and main branch at Jalan Ampang, Kuala Lumpur on 16 October 2006, ARBM now has twenty-four (24) branches nationwide. Fifteen (15) in the Klang Valley, one each in Johor Bahru, Melaka, Penang, Ipoh, Kota Bharu, Kuantan, Kuching, Sg. Petani, and Kota Kinabalu. (ARBM, Website)

As a matter of fact, the Bank in Malaysia is required to align with its parent Bank in Saudi, causing it to embrace and strictly adhered to the principles of partnership and fairness outlined by the Saudi's Shari'ah principles. It differs tremendously due to difference in views from different school or mazhabs between the two (2) countries. Hence the bank's participation in the Malaysian capital market is limited to its parent's Shari'ah principles. Even so, in November 2011, ARBM, managed to successfully execute the first ICPs, which were issued pursuant to the Sukuk Programme that was solely advised and arranged by the Bank for its corporate client in Malaysia. The issuance was an inaugural issuance, a breakthrough and historic transaction for ARBM because the Bank became the Sole Principal Adviser and Arranger for the Transaction. The Issuer is QL Resources Berhad (QL), which is listed on the Main Market of Bursa Malaysia Berhad (Bursa). QL is a scalable and sustainable multinational agro-food corporation with a market capitalization of over RM4.929.72 billion based on the closing share price of RM3.95 per ordinary share as at 30 June 2015⁸. The company is one of Asia's leading marine product players which is also the largest egg producers and surimi⁹ manufacturers. Currently, QL is building a presence in the sustainable palm oil sector with activities including milling,

⁸ Taken from <https://www.bloomberg.com/quote/QLG:MK>, retrieved on 30 June 2015.

⁹ Surimi is fish that is minced to make a gelatinous paste that is then flavoured, reformed into flakes, sticks or other shapes (Wikipedia).

plantations and biomass clean energy. QL has operation centers in Malaysia, Indonesia, Vietnam and China (QL, Website)¹⁰.

The ICPs issued by QL were structured as the Non-Tradable / Non-Transferable / Non-Rated Sukuk Programme of up to RM45.0 million in nominal value, hereinafter referred to as “QL-ICPs Sukuk Programme”. The Sukuk Programme¹¹ means a facility which allows multiple issues, offers or invitations to subscribe or purchase IMTNs, ICPs or a combination of ICPs and IMTNs, within an availability period which is disclosed to the Securities Commission Malaysia and the sukuk holders. ¹²“The tenure of a debt or Sukuk Programme involving an issuance of CPs or combination of both CPs and MTNs, whether conventional or Islamic, must not exceeds seven (7) years”. The QL-ICPs Sukuk Programme has tenure of three and a half year (3 ½ years) and they were issued on six (6) months interval basis. The first issuance of the ICPs pursuant to the QL-ICPs Sukuk Programme was successfully issued on 22 November 2011 whilst the final issuance was concluded on 22 August 2014. The entire ICPs pursuant to the QL-ICPs Sukuk Programme were solely subscribed by ARBM via a private placement basis.

Private Placement refers to a type of primary Debt Securities issue in which the securities are placed with a small number of large, “sophisticated”, typically institutional investors and does not involve any Tender¹³. Thus, the Debt Securities

¹⁰ Taken from <http://www.ql.com.my/>, retrieved on 30 June 2015.

¹¹ The definition of Sukuk Programme is as per the Guidelines on Unlisted Capital Market Products under the Lodge and Launch Framework SC-GL/4-2015, 1st. Issued: 9 March 2015 by the Securities Commission Malaysia hereinafter referred to as the “Guidelines on UCMP under the LOLA Framework”, pursuant to Section 377 of the CMSA 2007 and is effective from 15 June 2015, p. 13.

¹² As stipulated in the “Guidelines on UCMP under the LOLA Framework”, pursuant to Section 377 of the CMSA 2007 and is effective from 15 June 2015, p. 52.

¹³ Definition of Private Placement is as stipulated in, Participation and Operation Rules For Payments and Securities Services, issued by Malaysian Electronic Clearing Corporation Sdn. Bhd. (My Clear), on behalf of BNM, Released Date: 17 February 2011, p. 62.

could be issued under ¹⁴“Bought Deal” basis to the primary subscriber, direct placement to several investors, book building by the appointed agent or any other method as agreed by the parties involved.”

1.2 STATEMENT OF THE PROBLEM

ICPs are very important securities instrument to meet short-term financing and liquidity requirements of the Issuer. It is especially important in the Malaysian ICM, where financial institutions as well as corporations utilized it for movement of fund. However, despite its importance, the instrument has only been discussed in theory, without evaluation of the current practice of the instrument executed by Islamic financial institutions. Without an evaluation of current practice, it is difficult for the instrument to be utilized towards its potential.

Hence, this paper is intended to evaluate the first non-tradable / non-transferable / non-rated ICPs which were executed by ARBM. A qualitative case study is used to evaluate the ICPs issued pursuant to the QL-ICPs Sukuk Programme, which was principally and solely advised and arranged by ARBM in November 2011. The researcher is using the PTC which was retrieved from the official website of the Securities Commission Malaysia as the documentation and material for the case study. The study will then attempt at listing the general benefits, the main Shari’ah issues and challenges faced by ARBM on executing the issuance of the ICPs and the mechanisms to address such issues.

¹⁴ Definition of “Bought Deal” refers to a new issuance that has been bought entirely by the arranger or the group of arrangers, to resell to investors as stipulated in the Participation and Operation Rules For Payments and Securities Services, issued by Malaysian Electronic Clearing Corporation Sdn. Bhd. (My Clear), on behalf of BNM, Released Date: 17 February 2011, p. 48.