



The Islamic Development Bank

ISTISNA'A MODE OF FINANCING

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Definition

A. Istisna'a is a contract whereby a party undertakes to produce a specific thing which is possible to be made according to certain agreed-upon specifications at a determined price and for a fixed date of delivery. This undertaking of production includes any process of manufacturing, construction, assembling or packaging.

In Istisna'a, the work is not conditioned to be accomplished by the undertaking party and this work or part of it can be done by others under his control and responsibility.

Istisna'a, an instrument of pre-shipment financing and it is a contract where the deal can be referred to something not in existence at the time of concluding the contract, while Murabaha is an order to buy goods or commodities which are in existence in hand or possible to be found in the market.

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Objectives

B. The main objective of the Istisna'a mode of financing is to promote manufacturing capability in the IDB member countries. This may relate to manufacturing of complete assets in the form of capital goods. These goods may benefit the industrial, agricultural or infrastructure sector. This mode of financing can also be applied to

Long Term Trade Financing (LTTF) to enhance intra-trade among IDB member countries.



Scope and Eligibility

C. Istisna'a provides medium term financing to meet financing requirement for manufacturing/supplying/sale of identified goods, such as industrial/construction equipment, machinery, cargo vessels, oil tankers, trawlers, dredgers, locomotives, etc., transport equipment, pipelines for water and oil distribution, gas and electricity and their transmission/ distribution lines, electric generators and transformers, telecommunication equipment, oil rigs, hospital equipment, etc.

Under this mode of financing, it is possible to finance intangible assets like gas, electricity, etc. It is also possible, unlike under leasing and installment sale, to finance working capital. Istisna'a financing period is determined by the time required for procurement of necessary materials and manufacturing of the goods according to the agreed contract.



Terms and Conditions

- D. The following terms and conditions, subject to change, may apply:
- i. The financing of capital goods shall be for a period not exceeding 12 years including a gestation period co-extensive with the period needed to manufacture and /or deliver the goods contracted, but not exceeding 3 years from the date of contract.
 - ii. The mark-up currently applicable on IDB's project financing shall be either fixed at 5.5% per annum on Islamic Dinar, or floating at six months LABOR plus 170 basis points spread. However in case of Export Financing the terms are: The rate of return will be valid for a period of 6 months from the date of approval of a project by the Board of Executive Directors. IDB reserves the right to apply a different rate if the Lease Agreement has not been signed within these 6 months.
 - iii. The manufacturer/contractor will provide a performance and refundment bond guarantees issued by a commercial bank acceptable to IDB, ensuring that the goods to be delivered conformed to specifications incorporated in the contract and to guarantee refundment of the progress payments made by the IDB, should the manufacturer/contractor fail to deliver the goods or if he delivers non-conforming goods.

- iv. The beneficiary (buyer) shall also furnish a guarantee to **IDB** from the Government, a first class commercial bank or any other type of guarantee acceptable to **IDB** to secure the repayment of installments on due dates.
- v. The manufacturer will insure the assets under construction/ manufacturing and **IDB** shall be named as the loss payee.
- vi. The beneficiary (buyer), in consultation with, and on behalf of the **IDB**, shall negotiate and conclude a contract and appoint a consultant to supervise the execution of the work of the manufacturer/ contractor. Cost of such a consultant will be included under **IDB** financing.
- vii. Repayment installments to be made on due dates by the beneficiary will be denominated in Islamic Dinar (ID), and can be paid in a freely convertible currency acceptable to **IDB**. Fifteen percent rebate in the applicable mark-up will be applied annually on the installments repaid on or before the due dates.
- viii. It is permissible to include a penalty clause in an Istisna'a contract, if the parties so agree, save for cases of force majeure.



Payment Modalities

E. The price of the goods in a contract of Istisna'a could be paid either in advance or in arrears, and could be paid in one payment or by installments during the manufacturing of the goods or at future dates. The manufacturer is bound and obliged to deliver the goods within the agreed time. Failure to deliver within the agreed time will make the manufacturer liable to pay the buyer liquidated damages in accordance with the contract unless such delay is due to force majeure.



Procurement

F. The selection of manufacturer/contractor of assets will be limited to contractors/ manufacturers from **IDB** member countries in conformity with **IDB** Procurement Guidelines.



Disbursement

G. Disbursement will follow procedures as adopted by **IDB** and contained in the relevant guidelines. An advance payment of up to

20%, against acceptable Bank Guarantee, is permissible. After the finalization of the contract and award of bids, the Bank would ask the manufacturer or contractor to open a letter of credit in favor of the supplier of materials or reimburse the expenses already incurred upon submitting the required supporting documents and verified by the relevant departments of IDB. Reimbursable expenses should not be occurred before signing of the Istisna'a agreement.



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Application Procedure

H. Request for financing by a Government agency or a private entrepreneur under this mode may be made to IDB through the office of the IDB Governor in the country concerned. The official request should accompany a feasibility study or an appropriate project document establishing financial and technical feasibility of the project.



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Advantages of Istisna'a

I. Financing under this mode will encourage and facilitate the full use of the talent and technical capability in the IDB member countries in the area of capital goods production. It will enhance intra-trade in goods and transfer of technology among the IDB member countries. Lack of financial capital, thus, may not be an impediment for production of capital goods.

This mode will allow financing of intangible assets like gas, electricity, etc. It could also finance infrastructure projects like roads, buildings, etc. This mode would allow financing of trade and projects, thereby establishing linkage between the two in the framework of pre-shipment financing which would include financing of working capital, which is not otherwise possible under leasing and installment sale financing



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