

The 191st Meeting of the Shariah Advisory Council (SAC) of Bank Negara Malaysia

The SAC of Bank Negara Malaysia at its 191st meeting on 26 March 2019 ruled the following:

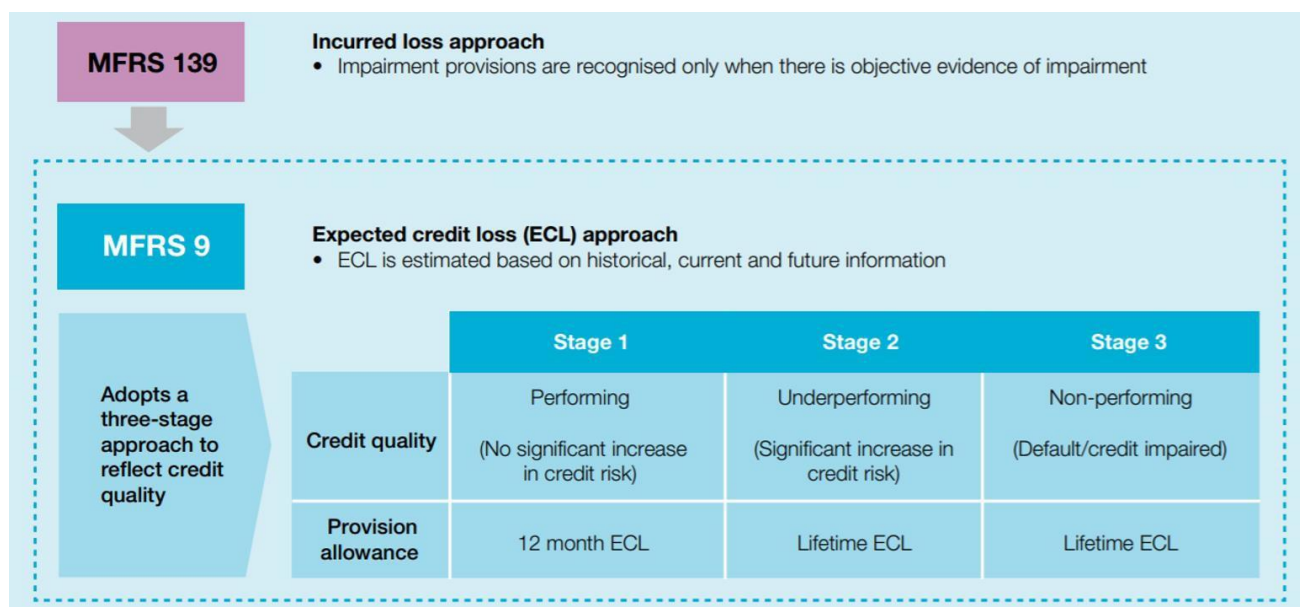
Rebate (*ibra'*) Reduction Mechanism to Partially Recover the Costs in Cashline Financing Product

SAC Ruling

The SAC has resolved that there is no objection in Shariah on the proposal to reduce the rebate (*ibra'*) on the unutilised amount for cashline-i facility based on *murabahah* / *tawarruq* concept to cover part of the costs incurred by the financier arising from compliance to the Malaysian Financial Reporting Standards 9: *Financial Instruments* (MFRS 9). However, to promote fair market practices, Bank Negara Malaysia as the authority may determine the appropriate regulatory policy or guideline on the implementation of such mechanism within the Islamic finance industry in Malaysia to ensure that the interest of all parties are considered.

Background

- In general, financial institutions bear certain costs in providing financing facilities to customers. These costs may increase with the implementation of the MFRS 9 (in replacement of MFRS 139) beginning the financial year 1 January 2018, in particular the new impairment provision requirements based on a forward-looking approach. The new impairment provision requirements require financial institutions to estimate expected credit loss either for the next 12 months or throughout the lifetime of a credit facility, having regard to historical, current and future micro and macroeconomic developments. This contrasts with MFRS 139, where impairment provision is only recognised when there is objective evidence of impairment i.e. incurred loss approach.



- In the context of cashline-i products, MFRS 9 requires financial institutions to establish impairment provisions on the entire credit facility including unutilised balance or undrawn cashline facility. This could be costly for Islamic financial institutions (IFIs), given that IFIs are not allowed to charge any fees over unutilised balance in their current practices.
- To address this issue, the Association of Islamic Banking and Financial Institutions Malaysia (AIBIM) representing the Islamic banking industry has proposed a rebate (*ibra'*) reduction mechanism for unutilised balance of credit facility to partially recover cost incurred arising from higher impairment provisions under MFRS 9.
- The details of the proposal are as follows;
 - i. AIBIM proposes to introduce another type of profit rate namely the floor profit rate that is charged on unutilised facility amount. As an addition to existing profit rates applied in current cashline-i products (i.e. ceiling profit rate and effective profit rate).
 - ii. Where a customer utilises the entire facility amount, the *ibra'* rate given to the customer is the difference between the ceiling profit rate and the effective profit rate.
 - iii. Where the customer does not utilise the entire facility amount, the *ibra'* rate given to the customer on the unutilised portion is reduced to the difference between the ceiling profit rate and the floor profit rate.
- Below is an illustration of the difference in current and proposed rebate rates:

Diagram of *ibra'* rates

Rate Type	Standard practice	Proposed practice
Ceiling profit rate	12%	12%
Profit (utilised)	8% (<i>ibra'</i> = 4%)	8% (<i>ibra'</i> = 4%)
Profit (unutilised balance) – For illustration, floor profit rate 1%.	0% (<i>ibra'</i> = 12%)	1% (<i>ibra'</i> = 11%)

Shariah Issue

- Is the proposed *ibra'* reducing mechanism for unutilised portion of cashline-i deemed as Shariah compliant?

Key Highlights of the SAC Discussion**Implication of MFRS 9 on IFIs**

- Based on MFRS 9 requirements, impairment provisions are expected to increase given changes in provisions for credit losses are calculated which also include undrawn facility. This will result in the manner:
 - Higher expenses recorded in the income statement and will reduce banks' profitability (i.e. net income margin).
 - Reduction in capital resulting from lower retained earnings and asset (i.e. outstanding amount for financing) recorded in the statement of financial position.
 - Higher taxation – For stage 1, tax deductions are not allowed where the full amount of impairment provisions will be subjected to tax while for Stage 2, only 50% of impairment provisions are allowed for tax deduction.

Shariah justification for the proposal

- The SAC in the previous ruling has generally allowed the use of *ibra'* concept in the product structure offered by the IFIs.¹
- Referring to the discussion among the scholars, closely resembling the aforesaid practices are *ibra' muqayyad*² and *ibra' mu'allaq*³. Some of the Hanafi and Shafi'i's scholars view that the aforesaid *ibra'* is not permissible if the condition in giving the *ibra'* becomes a norm whereas the school of Maliki and Hanbali allows such *ibra'* practices.⁴ Based on the discussion among scholars, it clearly indicates that the application of *ibra'* may be extended in accordance with current needs as long as it does not contradict with general principle of Shariah.
- In addition, offering of *ibra'* in this context is the financier's right as a seller in a deferred payment sale, in which the *ibra'* may be given in any form and condition based on the willingness and discretion of the financier. This also forms part of the structure of *ibra'* which has been agreed at the onset of the contract and this approach is not deemed as a penalty charge on unutilised balance of the facility.

Implication to the customer

- Customers and IFIs have agreed to the terms and conditions during the signing of the contract and the details do not contradict Shariah principles. This is based on the hadith:⁵

المسلمون على شروطهم إلا شرطاً أحل حراماً أو حرم حلالاً

"Muslims are bound by the conditions in which they agreed upon, except for the one that permits the haram (forbidden acts) and forbids the halal (permissible)."

Such approach is also consistent with the following fiqh maxim:⁶

الأصل رضی المتعاقدين ونتيجته هي ما التزمه بالتعاقد

"The original ruling for a contract is the consent of the contracting parties and its effect is based on what have become the rights and duties as agreed in the contract."

Effect of the previous SAC ruling on the imposition of a commitment fee on unutilised balance of facility

- The SAC in its previous ruling⁷ disallows Islamic banks to impose a commitment fee on unutilised balance of Islamic overdraft facility or revolving credit on the basis that the facility amount allocated belongs fully to the customer and the usage of the facility amount is subject to the customer's discretion. Therefore the charges on the facility amount imposed to the customer is not justified.
- However, in the context of the proposed *ibra'* reduction mechanism by AIBIM, no additional charges are applied outside of the agreed selling price as per contracted between both parties. Instead, IFIs only reduce the rate of *ibra'* given to the customers, which is permissible given that *ibra'* is within an IFI's discretion.
- Therefore, there is a difference in underlying Shariah principles applied between the previous SAC ruling on the imposition of commitment fee and the proposal on *ibra'* reduction mechanism with regards to unutilised balance of cashline-i facility.

¹ 32nd SAC Meeting (27 February 2013) and 101st SAC Meeting (20 May 2010).

² *Ibra' muqayyad* : *ibra'* which is limited by certain condition.

³ *Ibra' mu'allaq* : *ibra'* which is subject to certain condition and if the condition is satisfied, the *ibra'* will be given.

⁴ Ibn Qudamah, *al-Mughni*, Maktabah al-Qaherah, Mesir, 1969, v.5, p.16-17; Abu Bakar Muhammad Syatha al-Dimyati, *I'nanah al-Thalibin*, Dar al-Ihya' al-Kutub al-Arabiyyah, Beirut, n.d, v.3, p.192; Ibn Al-Humam, *Fath al-Qadir Syarh al-Hidayah fi Syarh al-Bidayah*, Matba'ah al-Kubra al-Amiriyyah, 1317H, v.7, p. 44-45; al-Kasani, *Bada'i' al-Sana'i' fi Tartib al-Syara'i'*, Dar al-Kutub al-'Ilmiyyah, Beirut, n.d., v.6, p.45; al-Dusuqi, *Hashiyah al-Dusuqi 'ala al-Syarh al-Kabir*, Dar Ihya' al-Kutub al-Arabiyyah, n.d., v.4, p.99; Kuwait Ministry of Waqf and Islamic Affairs, *al-Mawsu'ah al-Fiqhiyyah al-Kuwaitiyyah*, 1993, v.1, p.165-166.

⁵ Abu Daud, *Sunan Abi Daud*, Bait al-Afkar al-Dawliyyah, 1999, p. 398, hadis no. 3594

⁶ Ahmad al-Zarqa', *Syarh al-Qawa'id al-Fiqhiyyah*, Dar al-Qalam, 1989, p. 482

⁷ 12th SAC Meeting (24 February 2000).

The rates of ibra' reduction allowed by Bank Negara Malaysia

- For the purpose of ensuring the consistent and fair market practices in the industry, Bank Negara Malaysia (BNM) as the regulator can determine the appropriate *ibra'* reduction rate for unutilised balance of cashline-i facility that applicable for the industry.

Basis of Ruling

- The proposed *ibra'* reduction mechanism has no Shariah concern. This is based on the opinion of some school of thoughts that allows the concept of *ibra' muqayyad* and *ibra' mu'allaq* to be applied in muamalat transactions.
- *Ibra'* is one of the form of rebate where contracting parties can waive his/her rights to the other party who has an obligation to pay a certain amount contracted. Hence, in principle, the *ibra'* can be given in any form based on the willingness and discretion of the entitled party (i.e. the financier).
- MFRS 9 requirements, in which additional provisions are made for the remaining unutilised amount can cause additional cost to be incurred, that may entail a negative impact to the growth of IFIs.

Implication of SAC Ruling

- The ruling of the SAC provides an avenue for IFIs to cover some of the operating costs incurred arising from compliance with MFRS 9. This ruling is only applicable to cashline-i financing products based on the *murabahah / tawarruq* concepts.
- For the purpose of standardisation in industry practices, the *ibra'* reduction rate may be subjected to the policies and guidelines issued by BNM.

This ruling is effective immediately upon the decision made by the SAC on 26 March 2019. The implementation will be based on the policies and guidelines issued by BNM in the future or approval given by BNM on a case- by-case basis through product application.

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 Institution Act 2002, as the case may be.