

The Shariah Advisory Council of Bank Negara Malaysia (SAC) Ruling on Restructuring and Rescheduling of Islamic Financing Facility during COVID-19 Crisis

30th SAC Special Meeting dated 14 July 2020
(revised on 16 October 2020)

Part I: SAC Ruling, Its Effective Date and Applicability

Pursuant to section 52 of the Central Bank of Malaysia Act 2009, the SAC made a ruling in respect of practices of restructuring and rescheduling of Islamic financing facility during the COVID-19 crisis.

1. Restructuring of an Islamic financing facility based on original Shariah contracts

Restructuring of an Islamic financing facility based on the original Shariah contract(s) may be undertaken using a supplementary agreement that is cross referred to the terms and conditions of the original agreement. No new agreement is required. This is intended to reduce the cost and challenges to customers, and operational burden on Islamic financial institutions (IFIs).

A new agreement is required where the restructuring involves -

- i. the application of a different Shariah contract – for example a house financing that is originally based on *musharakah mutanaqisah* (diminishing partnership) is being restructured using *ijarah*; or
- ii. a combination of multiple financing based on various Shariah contracts into a new single Shariah contract as part of a debt rationalisation exercise.

2. Restructuring of an Islamic financing facility into a conventional loan (or vice versa)

IFIs are allowed to restructure a conventional loan into an Islamic financing facility. However, restructuring of an Islamic financing facility to a conventional loan is not allowed. In cases where the customer chooses to restructure his existing Islamic financing facility to a conventional loan, it is the customer's prerogative and choice to do so. In such situation, the customer's choice is beyond the responsibility and control of the IFI.

3. Compounding profit on restructuring and rescheduling

IFIs are not allowed to include and account for any accrued profit on an original financing as the new principal amount for the restructured and rescheduled facility. Such practice aims to avoid amplification of profit on debts (compounded profit) that will worsen the financial position of customers who are already badly affected by the COVID-19 pandemic. Therefore, in implementing a restructuring and rescheduling:

- i. the new principal amount for the restructured and rescheduled facility shall be equivalent to the outstanding principal amount of the original facility, provided there is no additional financing;
- ii. IFIs are allowed to charge a new profit rate on the new principal amount; and
- iii. the amount of accrued profit and late payment charges (where applicable) on the existing financing can be added to the total new debt obligation, but this amount cannot be capitalised in the calculation of new profit.

This ruling comes into effect immediately upon publication of this ruling on Bank Negara Malaysia website dated 10 August 2020 and is applicable to the following 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 Institutions 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 compliance with any ruling of the SAC in respect of any particular aim and operation, business, affair or activity of IFIs shall be deemed to be in compliance with Shariah.

Part II: Background

- The COVID-19 pandemic and Movement Control Order (MCO) aimed at curbing the spread of the pandemic have had a devastating effect on the Malaysian economy. The spread of COVID-19 has also affected global supply and demand, which exacerbated the effects of the health crisis on the country's economy. For the first quarter of 2020, gross domestic product (GDP) grew at 0.7% and is expected to contract in the second quarter before gradually recovering.
- As a result, majority of the business sector is affected especially in terms of finance and cash flow, to the extent that many businesses cannot be sustained and are forced to take measures to reduce costs. These include, among others, by reducing the size of the workforce, shortening working hours and even closing down the operations. As a result, many have lost their jobs (the unemployment rate soared to 5.3% in May 2020 compared to 3.3% in May 2019) or faced declining monthly incomes. To ease the financial burden of individuals and small and medium enterprises (SME), various forms of assistance have been granted including providing a temporary deferment on the monthly payment of financing (moratorium).
- The challenges and problems confronting a majority of the population and businesses are expected to be temporary in nature due to the current situation. Financial performance and cash flows of individuals and businesses are expected to gradually recover in line with improvements in the economy. However, this issue needs to be addressed immediately to avoid a sudden and significant increase in impairment that can lead to bankruptcy and insolvency with longer term adverse implications on the people and economy. This can also have adverse effects on the strength of banking institutions.
- In the current environment, rescheduling and restructuring of original financing allow businesses and individuals to better manage their financial obligations to suit their prevailing financial situation. Therefore, the process involved in rescheduling and restructuring any facility has to be efficient, seamless and flexible in the current environment to enable those adversely affected to be able to accord attention towards finding new employment or additional income, or reinvigorate their businesses.
- Restructuring of an Islamic financing facility may be carried out in various ways such as using the same or different Shariah contract(s) or consolidating several financing based on a number of Shariah contracts into a single new financing contract. For example:

Customer	Restructuring mode	Original Shariah contract	New Shariah contract
A	Restructuring the existing financing using different Shariah contracts	<i>Musharakah Mutanaqisah</i>	<i>Ijarah</i>
B	Consolidating several financing based on various Shariah contracts	Personal financing (<i>tawarruq</i>), vehicle financing (<i>ijarah</i>) and credit card (<i>qard</i> and <i>ujrah</i>)	<i>Tawarruq</i>

- There is a possibility where a customer specifically chooses to restructure a conventional loan into an Islamic financing facility (or vice versa) or consolidate both Islamic financing facility and conventional loan into either a single Islamic financing facility or conventional loan.
- There are different practices currently adopted by IFIs in repricing of contracts in restructuring – some charge a new profit rate on the total outstanding financing debt being restructured (outstanding principal amount plus accrued profit); whilst there are others that charge a new profit rate on the outstanding principal amount only and segregating the accrued profit without any compounding element.

Shariah Issues

Does Shariah allow -

- restructuring of an Islamic financing facility using the original agreement?
- restructuring of an Islamic financing facility into a conventional loan (or vice versa)?
- compounding profit for restructuring and rescheduling?

Part III: Key Discussion

Variation of price requires a new `aqad

- In restructuring an Islamic financing facility that involves variation to the original price as well as the relevant terms and conditions, a new *`aqad* between the contracting parties is required. This is to ensure that the contract is valid based on mutual consent of the contracting parties.
- Based on the current situation and the expected large number of individuals and businesses in need of restructuring, the signing of a new contract will be burdensome to both the customer and IFI in terms of the costs to be incurred, the process and time involved. To ease the burden, the contracting parties can enter into a supplementary agreement to restructure the financing. Terms and conditions of an original agreement may be varied in a supplementary agreement without entering into a new legal agreement and may be cross-referred to the original agreement in restructuring of an Islamic financing facility.
- A new *`aqad* that meets the requirement of a valid contract from Shariah point of view is required for restructuring of an Islamic financing facility, and it can be documented in the supplementary agreement. Mutual consent from the contracting parties on the modified terms and conditions in the supplementary agreement must be obtained to avoid misunderstanding and potential dispute.

The principles of ta`awun (mutual assistance) is key towards ensuring Shariah compliance

- As an Islamic financial intermediary, IFIs must take necessary measures to ensure Shariah compliance is observed at all times. This includes assisting customers to transition from non-Shariah compliant financial transactions into Shariah compliant transactions. In this case, IFIs should facilitate requests from customers to restructure their conventional loan facilities into Islamic financing facilities.
- Meanwhile, restructuring of an Islamic financing facility to a conventional loan is in principle not allowed in Shariah. However, the customer has the right and freedom to choose. If the customer decides to restructure their Islamic financing facility to a conventional financing, it is considered beyond the responsibility and control of the IFI.

Compounding profit in Islamic financing facility

- In the case of compounding profit on a restructured and rescheduled Islamic financing facility, the SAC ruled that IFIs are not allowed to impose compounding profit in order to ease the burden of customers who are impacted by COVID-19 which have a huge impact on society. This ruling is premised on the principle of *ihsan* (beneficence).
- However, IFIs and their customers may agree to new terms and conditions including the method of calculating new profit rate that is more reflective of the risk borne by the IFIs.
- A simplified illustration of the calculation of total debt being restructured (one which involves only a revision to the monthly instalment and tenure of the debt payment):

Existing financing amount (before restructuring/rescheduling)	
Principal outstanding (a)	RM50,000
Non-accrued profit (<i>outstanding principal (a) x profit rate 3% p.a x remaining tenure</i>)	RM6,665
Accrued profit	RM380
Outstanding debt	RM57,045

Financing amount (after restructuring/rescheduling)	
Previous principal outstanding (a)	RM50,000
New profit (<i>outstanding principal (a) x profit rate 3% p.a x new tenure</i>)	RM7,936
Accrued profit	RM380
New outstanding debt (<i>outstanding principal (a) + new profit + accrued profit</i>)	RM58,316

Part IV: Basis of Ruling

Restructuring based on original Shariah contracts

- Variation to the terms and conditions of the original agreement via a supplementary agreement is allowed provided it has been agreed and clearly communicated to the contracting parties. This is in line with the following *fiqh* maxim:

الأصل في العقود رضا المتعاقدين وموجبها هو ما أوجباه على نفسيهما بالتعاقد¹

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

- Cross-referencing of the modified terms and conditions in a supplementary agreement to the original agreement is allowed based on *maslahah* to ensure an efficient and cost effective restructuring process is in place especially in the current challenging circumstances caused by COVID-19. This is in line with the following hadith and *fiqh* maxim:

المشقة تجلب التيسير²

“Hardship begets facility.”

- Shariah has no objection for the restructuring of a financing using a Shariah contract that is different from the original contract, and consolidation of financing based on various Shariah contract into a single Shariah contract. This is in line with the following hadith:

المسلمون على شروطهم إلا شرطا أحل حراما أو حرم حلالا³

“(Dealing of) Muslims is based on conditions (as agreed) amongst them, except conditions that permit a forbidden matter or forbid a permissible matter.”

- Nevertheless, a new legal agreement is required for restructuring of an Islamic financing facility involving the application of a different Shariah contract from the original contract and involving consolidation of several Shariah contracts into a single new Shariah contract. This is to ensure proper application of different Shariah contracts in line with the requirements and objectives as each Shariah contract has different and specific salient features and requirements.

Restructuring of Islamic financing facility to conventional loan (or vice versa)

- Shariah allows the restructuring of a conventional loan facility into an Islamic financing facility on the basis of helping the community/customer to get out of matters that are forbidden by Shariah. This is in line with the concept of *ta`awun* (mutual assistance) for goodness. However, an IFI shall not encourage/facilitate the restructuring of an Islamic financing into a conventional loan. Customer’s preference to restructure an Islamic financing into a conventional loan is beyond the responsibility and authority of the IFI. This is in line with the following Quranic verse:

وَتَعَاوَنُوا عَلَى الْبِرِّ وَالتَّقْوَىٰ ۖ وَلَا تَعَاوَنُوا عَلَى الْإِثْمِ وَالْعُدْوَانِ ۗ

“...help one another in furthering virtue and God consciousness, and not in what is wicked and sinful...”⁴

¹ Muhammad Mustafa Al-Zuhayli (2006), *Al-Qawa'id al-Fiqhiyyah wa Tatbiqatuha fi al-Mazahib al-'Arba'ah*. Damsyik: Dar al-Fikr, v. 2, p. 818.

² Al-Suyuti, (1403), *Al-Asybah wa al-Naza'ir*, Beirut: Dar al-Kutub al-'Ilmiyyah, p. 76-77.

³ Abu Daud (1999), *Sunan Abi Daud*, Bait al-Afkar al-Dawliyyah, p. 398, hadith no. 3594.

⁴ *Surah al-Ma'idah*, verse 2.

Prohibition of compounding profit on the basis of *ihsan*⁵

- Islam encourages the principle of *ihsan* in all matters including *muamalah* (transaction). This is as stated in the following verse of Qur'an:

إِنَّ اللَّهَ يَأْمُرُ بِالْعَدْلِ وَالْإِحْسَانِ

"Indeed, Allah commands justice and good conduct."⁶

- The application of the principle of *ihsan* is appropriate in providing assistance to those experiencing difficulties by alleviating their burden. Rasulullah SAW also encourages to apply *ihsan* in all matters, as evidenced in the following hadith:

عن أبي يعلى شداد بن أوس رضي الله عنه عن رسول الله صلى الله عليه وسلم قال : إن الله كتب الإحسان على كل شيء⁷

Reported by Abu Ya'la Shaddad bin Aws RA, that Rasulullah SAW said: "Verily Allah has prescribed *ihsan* (proficiency, perfection) in all things".

- In the current environment, IFIs should apply *ihsan* and help individuals and businesses affected by the COVID-19 pandemic, which is beyond their control, by alleviating their financial burden. As such, compounding of profit should not be imposed when customers experience hardships and difficulties. This is in line with the following hadith and *fiqh* maxim:

عن أبي هريرة، قال : قال رسول الله صلى الله عليه وسلم : من نفس عن مؤمن كربة من كرب الدنيا، نفس الله عنه كربة من كرب يوم القيامة، ومن يسر على معسر، يسر الله عليه في الدنيا والآخرة⁸

Reported by Abu Hurairah, he said: that Rasulullah SAW said: "Whoever removes a worldly grief from a believer, Allah will remove from him one of the griefs of the day of resurrection. And whoever alleviates the need of a needy person, Allah will alleviate his needs in this world and the hereafter."

- The prohibition of compounding profit also takes into account the considerations of *siyasah syar'iyah* and the concept of *al-jawa'ih* (disaster situation) where the regulator can set any relevant policy to safeguard the welfare of the contracting parties, especially in an unforeseeable difficulties or *force majeure* situations. This is also in line with the following *fiqh* maxim:

تصرف الإمام على الرعية منوط بالمصلحة⁹

"The affairs of the leaders over the people are based on *maslahah*."

⁵ SAC at its 206th meeting (19 August 2020) ruled that the basis for the ruling on prohibition of compounding of profit on restructuring and rescheduling (R&R) which resembles *riba jahiliyyah* requires additional analysis and research, as well as further discussion and deliberation by the SAC. The basis of the ruling emphasises the principle of *ihsan* in alleviating difficulties and financial hardships faced following the COVID-19 pandemic is applicable.

⁶ Surah al-Nahl, verse 90.

⁷ Muslim, *Sahih Muslim*. Dar al-Ihya' al-Turath al-Arabi, Beirut. v.3, p. 1548, hadith no. 1955.

⁸ Muslim, *Sahih Muslim*. Dar al-Ihya' al-Turath al-Arabi, Beirut. v.4, p. 2074, hadith no. 2699.

⁹ Al-Suyuti (1403H), *Al-Asybah wa al-Naza'ir*, Dar al-Kutub al-'Ilmiyyah, p. 121.

Part V: Implication of the SAC Ruling

- The SAC rulings aim to ensure an efficient, seamless and flexible restructuring and rescheduling process to cater for the different needs and circumstances of vulnerable groups such as lower-income individuals and small businesses in the current situation.
- The ruling regarding compounding of profit is not applied retrospectively considering that previous restructuring and rescheduling practices may have imputed such application of compounding profit. This is based on the consideration of *maslahah* and worsening of difficulties (*raf' al-haraj*), particularly in the current outbreak of COVID-19 and the impact of MCO.