

## The Shariah Advisory Council of Bank Negara Malaysia (SAC) Ruling on the New Islamic Reference Rate i.e Malaysia Islamic Overnight Rate (MYOR-i)

218<sup>th</sup> SAC Meeting dated 28 October 2021

### Part I: SAC Ruling, Its Effective Date and Applicability

Pursuant to section 52 of the Central Bank of Malaysia Act 2009, the SAC ruled that the new Islamic reference rate i.e. Malaysia Islamic Overnight Rate (MYOR-i) and its calculation methodology for both normal and contingency situations are Shariah-compliant as it includes only Shariah-compliant transactions.

- 1.1. This ruling is effective in accordance with the guidelines to be issued by the Bank and is applicable to the following IFIs:
  - (a) licensed Islamic financial institutions (IFIs) 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.
- 1.2. 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 the Shariah.

### Part II: Background

- 2.1. Financial benchmark reforms are underway in various jurisdictions to improve the integrity and reliability of interest rate benchmarks, in line with the Financial Stability Board's (FSB) recommendation. Among the key recommendations of the FSB are the development of a nearly risk-free Alternative Reference Rate (ARR) and strengthening of the existing Interbank Offered Rate (IBOR) in respective jurisdictions.
- 2.2. In line with the global financial benchmark reforms, BNM has appointed the Financial Markets Committee (FMC) to oversee the development of a transaction-based ARR.
- 2.3. Similar to other jurisdictions, the Malaysian ARR i.e. Malaysia Overnight Rate (MYOR) is to be based on a nearly risk-free rate and overnight transactions in the interbank money market and will exist in parallel with the existing Kuala Lumpur Interbank Offered Rate (KLIBOR).
- 2.4. As for the Islamic financial market, the existing Kuala Lumpur Islamic Reference Rate (KLIRR) will be abolished and replaced by a new Islamic benchmark rate i.e. Malaysia Islamic Overnight Rate (MYOR-i) due to its low usage and lack of compliance with global standards for financial benchmarks. Meanwhile, the MYOR-i is designed based on the Principles for Financial Benchmarks issued by the International Organisation of Securities Commissions

(IOSCO). It is developed in collaboration with the FMC and the AIBIM-FMAM<sup>1</sup> Islamic Market Technical and Development Committee (IMTDC).

- 2.5. MYOR-i is calculated based on the volume-weighted average rate of return on unsecured Shariah-compliant overnight MYR interbank placements, rounded to two decimal places.
- 2.6. The key features of MYOR-i are: (i) nearly risk-free rate; and (ii) represents actual and Shariah-compliant transactions in the interbank money market.
- 2.7. Eligible transactions comprise the following:
- i. Unsecured placements between interbank institutions (either brokered or direct/bilateral); and
  - ii. BNM's Islamic overnight monetary operations, which comprise tenders conducted through *Fully Automated System for Issuing/Tendering* (FAST) or manual operations, and direct overnight placements between BNM and interbank institutions, but excluding Standing Facilities.
- 2.8. For now, the eligible instrument which will be used in the computation methodology of MYOR-i is Commodity *Murabahah*-based instruments transacted in the Islamic interbank money market. New instruments may be added in the future to ensure MYOR-i is reflective of the latest conditions and developments in the Islamic financial market, subject to approval by BNM's SAC and meeting all requirements for eligible instruments as assessed by the Bank.
- 2.9. Meanwhile, *qard*-based instrument and its historical *hibah* rate will not be included in the MYOR-i calculation methodology as it may create perception that there is Shariah non-compliant element. The inclusion of the historical *hibah* rate on *qard* transactions may give the presumption that the *hibah* rate is an indicative rate for future *qard* transactions and may regularise the practice of granting *hibah* on *qard* as a business practice which are prohibited by the Shariah.
- 2.10. The calculation formula for MYOR-i is as follows:

$$\text{MYOR-i} = \frac{\sum \left( \text{Volume of Islamic interbank transactions (MYR)} \times \text{Profit rate for Islamic transactions} \right)}{\sum \text{Volume of Islamic interbank transactions (MYR)}}$$

- 2.11. Contingency situation may occur in the event of disruption to the normal production of MYOR-i (e.g. disruption to trade settlement, interbank trading or data collection).
- 2.12. Therefore, for contingency situation, the funding facility profit rate (FFPR)<sup>2</sup> will be used to replace the calculation methodology applied in normal situation. The calculation methodology in contingency situation is as follows:

<sup>1</sup> AIBIM = Association of Islamic Banking and Financial Institutions Malaysia

FMAM = Financial Markets Association Malaysia

<sup>2</sup> Funding facility provided by the Bank to meet temporary liquidity needs of interbank institutions at a profit rate as referenced in the Bank's Policy Document on Standing Facilities.

$$\text{MYOR-}i_t = \frac{1}{3} \sum_{n=1}^3 [\text{MYOR-}i_{t-n} + (\text{FFPR}_t - \text{FFPR}_{t-n})]$$

where  $t$  = day of disruption event (i.e. contingency calculation day); and  
FFPR = Funding Facility profit rate

### Shariah Issues

Based on the proposed calculation methodology, the potential Shariah issues identified are as follows:

- 2.13. Is the calculation methodology for MYOR-i in both normal and contingency situations Shariah-compliant?
- 2.14. Is the usage of conventional term reference rate permissible in absence of a reliable Islamic term reference rate?

### Part III: Key Discussion

***The exclusion of qard from the calculation methodology for MYOR-i in normal situation and the use of funding facility profit rate in contingency situation are crucial in ensuring end-to-end Shariah compliance***

- 3.1. BNM and the industry proposed for the exclusion of *qard*-based overnight interbank money market transaction and its *hibah* rates from the MYOR-i calculation methodology. The inclusion of *qard*-based transaction and its *hibah* rates into the calculation methodology may create presumption that the *hibah* rate is an indicative rate for future *qard* transactions, thus creating a customary business practice of granting *hibah* on *qard* which is prohibited by the Shariah.
- 3.2. Based on the data simulation<sup>3</sup> presented to the SAC, the exclusion of *qard* and its *hibah* rates from the calculation methodology has a very minimal impact to the MYOR-i i.e. less than 0.01% influence on the final benchmark rate.
- 3.3. Based on the above, SAC agreed to the exclusion of *qard*-based overnight interbank money market transaction and its *hibah* rates from the MYOR-i calculation methodology. This is consistent with existing SAC ruling and Shariah requirements in the Policy Document on *Qard* that prohibit disclosure, promotion or marketing of the indicative rate or prospective granting of *hibah* for *qard* transaction.<sup>4</sup>
- 3.4. Meanwhile, under contingency situation, the Bank will calculate and publish MYOR-i based on the average MYOR-i, adjusted for any changes in the FFPR, over the preceding three publication days. The proposed use of FFPR in contingency situation is intended to ensure MYOR-i only comprises Shariah-compliant elements and to avoid using interest rate such as OPR as per conventional MYOR. Therefore, the SAC agreed with the usage of FFPR during contingency situation as it is the alternative to OPR.

<sup>3</sup> Simulation presented to the SAC included data on past volume of *qard*-based transactions in the overnight interbank market, historical *hibah* rate on overnight *qard* transactions and impact analysis to the MYOR-i.

<sup>4</sup> Refer paragraph 14.7 of *Qard* Policy Document issued on 26 February 2018.

**Referencing to conventional term reference rate in the absence of Shariah-compliant term reference rate is allowed**

- 3.5. At present, a reliable Shariah-compliant term reference rate is not available globally and domestically to be used as pricing benchmark for Islamic financial instruments. Therefore, the SAC has agreed to allow temporary referencing to conventional term reference rate such as KLIBOR or other conventional term reference rates on *hajah* basis, until a reliable Islamic term reference rate is available. This is to prevent any disruption to the market given the relatively lower liquidity in the Islamic market.

**Part IV: Basis of Ruling**

**The calculation methodology of MYOR-i in both normal and contingency situations is Shariah-compliant and free from any prohibited elements**

- 4.1. Subject to observing certain Shariah principles such as prohibition of fraud and price manipulation, Shariah does not determine a specific calculation methodology for any Shariah-compliant transactions. As such, any calculation methodology is deemed permissible unless there is a violation of Shariah requirements based on the following *fiqh* maxim:

الأصل في العقود والشروط الجواز والصحة

*“The basic principle with regard to contracts and conditions is permissibility and validity.”<sup>5</sup>*

- 4.2. The move towards the adoption of MYOR-i is partly due to its feature that is based on actual transactions, and hence, is reflective of market conditions and not easily manipulated. This is in line with the Shariah principle of *siyasa shar’iyyah*<sup>6</sup> in Islamic finance to ensure fairness in pricing as promoted by the following *hadith*:

عن أنس بن مالك رضي الله عنه: قال الناس: يا رسول الله، غلا السعر فسر لنا. فقال رسول الله صلى الله عليه وسلم: إن الله هو المسعر القابض الباسط الرازق وإني لأرجو أن ألقى ربي وليس أحد يظالمني بمظلمة في دم ولا مال

*“It was narrated from Anas Bin Malik RA that: The people said to the Prophet PBUH (Peace be upon him): O Messenger of Allah, prices have risen, so fix the prices for us. The Prophet said: Indeed Allah is the One who fixes the prices, who withholds, who gives lavishly and who provides. And I hope that when I meet Allah none of you will have any claim on me for an injustice regarding blood or property.” (Tirmizi: Hasan Sahih)<sup>7</sup>*

- 4.3. The above *hadith* implicitly indicates that price movements in the market at that time were driven by market forces. Therefore, any indicator that is reflective of the prevailing market conditions is appropriate to be the benchmark rate for transactions within the given market.

<sup>5</sup> 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. 815.

<sup>6</sup> Basis and approach taken by the ruler for the interest of the nation and the people which is in line with Shariah principles.

<sup>7</sup> Tirmizi (1996), *Sunan Tirmizi*, Beirut: Dar Al-Gharb Al-Islami, v. 2, p. 582, *hadith* no. 1314; Abu Daud (2009), *Sunan Abi Daud*, Beirut: Dar Al-Risalah Al-'Alamiyyah, v. 5, p. 322, *hadith* no. 3451.

- 4.4. Although MYOR-i exists only in the form of an overnight rate and does not have a term rate, efforts to implement a dedicated Islamic reference rate to the extent possible are strongly encouraged to ensure that Islamic financial instruments are fully Shariah-compliant and to preserve Islamic finance reputation from prohibited elements in Shariah. This is in line with the *hadith* of the Prophet PBUH who called upon people to abide by the Shariah according to their ability as follows:

عن أبي هريرة رضي الله عنه عن النبي صلى الله عليه وسلم قال: "دعوني ما تركتكم: إنما أهلك من كان قبلكم كثرة سؤالهم ، واختلافهم على أنبيائهم، فإذا نهيتكم عن شيء فاجتنبوه، وإذا أمرتكم بأمر فأتوا منه ما استطعتم" ((متفق عليه))

*It was narrated by Abu Hurairah RA that the Prophet PBUH said, "Do not ask me unnecessarily about the details of the things which I do not mention to you. Verily, the people before you were doomed because they were used to putting many questions to their Prophets and had differences of opinions with their Prophets. Refrain from what I forbid you and do what I command you to the best of your ability and capacity." (Sahih Bukhari)<sup>8</sup>*

#### **Permissibility to use conventional term reference rate by Islamic financial institutions in the absence of a reliable Islamic term reference rate**

- 4.5. Reference to a reliable term reference rate for financial instruments is important to determine the right pricing that is reflective of prevailing market conditions and ensure market stability. In the absence of a reliable Islamic term reference rate, Islamic financial institutions are allowed to use a widely accepted conventional term reference rate to avoid market disruption based on the following Islamic legal maxim:

الأمر إذا ضاق اتسع وإذا اتسع ضاق

*"When in a predicament, facilitation (rukhsah) is given. When the predicament ceases to exist, then it is back to the original ruling."<sup>9</sup>*

### **Part V: Implication of the SAC Ruling**

- 5.1. The SAC ruling provides clarity and certainty to the market on the Shariah status of the new MYOR-i. This SAC ruling clarifies that the reference to MYOR-i is very appropriate and fulfil Shariah requirements for Islamic financial instruments in interbank money market and wholesale banking products. Notwithstanding, reference to conventional term reference rate is allowed only on temporary basis for term-based instruments until a reliable Islamic term rate can be derived. In addition, this statement also provides clear signal to the industry to step up efforts and take the necessary actions in ensuring proper development of a reliable Islamic term reference rate.

<sup>8</sup> Al-Bukhari (2002), *Sahih Bukhari*, Damascus-Beirut: Dar Ibn Kathir, p. 1800, hadith no. 7288.

<sup>9</sup> 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. 272.