

## Application and Development of *Ibra'* in Islamic Banking in Malaysia

*Abdul Hamid Mohamad\** and *Adnan Trakic\*\**

### Abstract

*Ibra'* (rebate) is a term used in Islamic banking and finance literature which denotes the granting of rebate by Islamic banks, at their discretion, to their customers who settle their debt obligations arising from sale-based contracts prior to the agreed settlement period. The issue of the application of *ibra'* in default cases arose in court since the first known reported case in 1994. Beginning from 2007, some High Court judges tried to resort to *ibra'* in their attempt "to be fair and equitable" to customers of Islamic banks. However, they were reversed by the Court of Appeal to comply with the Shari'ah and "to support" the industry. At the same time, while the banks were insisting on judgment for the "full purchase price" and that *ibra'* was at their discretion, they were in fact giving *ibra'* to customers "for early settlement" at the amount determined by them in order to be competitive with their conventional counterparts. Practice varies. Bank Negara Malaysia (BNM), concerned about what was happening in the courts, the lack of standard practice by the banks, the unhappiness of the customers and the competitiveness of Islamic banking, went to the Shari'ah Advisory Council (SAC) for a resolution that empowers BNM to issue Guidelines to require the banks to grant *ibra'* for early settlement cases and the mechanism thereof. While the SAC resolution did not specifically state that "early settlement" includes default cases, the Guidelines clearly say so. If banks were to follow the Guidelines (which under the law they should) and, if they don't, the courts were to enforce them (which they should too), it appears that the issue is now settled in favour of the customers. The High Court judges who were "wrong" earlier have been vindicated, the Islamic banks are now at par with their counterparts and it is also a milestone in the development of Shari'ah spearheaded by Malaysia. This paper traces and discusses that development.

**Keywords:** *Ibra'*, Early Settlement, Default Cases, Guidelines on *Ibra'* (Rebate), Shari'ah Advisory Council.

---

\* Former Chief Justice of Malaysia, Chairman of Law Harmonization Committee, Central Bank Malaysia, Member of Shariah Advisory Council, Central Bank of Malaysia and the Securities Commission of Malaysia. He can be contacted at [tunabdulhamid@gmail.com](mailto:tunabdulhamid@gmail.com). See also [www.tunabdulhamid.my](http://www.tunabdulhamid.my).

\*\* Lecturer, Department of Business Law and Taxation, Monash University, Sunway campus. He can be contacted at [trakic.adnan@gmail.com](mailto:trakic.adnan@gmail.com).

## 1. Introduction

The first product introduced in Islamic banking in Malaysia for financing purchases of houses and cars, the most common items, was *Bai-Bithaman Ajil* (BBA). Islamic banking being a new thing and the customers being accustomed to conventional banking, it was natural that they thought of it in the light of what they were accustomed to. Take, for example, the customer who wants to buy a house but does not have sufficient cash. He goes to the bank because he needs money to pay for the house he has purchased or would like to purchase from the developer. Having lived in the conventional surroundings all his life, in his mind, he simply wants to borrow money from the bank. He does not go there to sell the house he has bought from the developer to the bank at a cheaper price than the price he bought it and buy it back at a higher price. The bank too is not interested in doing business of buying and selling houses. But both enter into a contract to buy and sell in order to follow the procedure under the Shari'ah. Indeed, many customers do not really care about the Shari'ah-compliant factor. They desperately want the money, by whatever name it is called—"loan" or "facility". After all, the amount the customer is taking is the same, the period for repayment by instalments is the same and amount of the instalments is the same as in a conventional loan. There is a "bonus" here. It is "Islamic". It makes him feel a bit pious.

What strikes his mind at that point of time is: what is the difference between the conventional and the "Islamic" facility? Is it only in which forms or agreements that he signs? The buying and selling of the house at almost the same time seems artificial to him, particularly when the same property may be given three different values at about the same time: the price the customer agrees to buy from the developer, which is the market price, the price he sells to the bank, which is the amount of facility he wants to take from the bank, and the price the bank sells back to him, which depends on the amount of the facility and the length of the period of instalments. Normally, when you sell a landed property, it will follow with a transfer as provided by the National Land Code. But not here.

Then let us take the less likely situation where, after paying the instalments for a few years, the customer has extra cash and wants to settle the debt earlier. He approaches the bank. The officer tells him he has to pay the full amount. That comes as a shock to him. It just does not make sense to him and this is supposed to be "Islamic".

Explanations that there is a difference between the "conventional" and the "Islamic", that one is based on loan and interest and the other is based on sale and purchase (capital and profit) and that in the case of the latter, he has to pay the full purchase price because that was the price at which the property was sold by the bank to him, which he has not settled, does not convince him either. Wasn't the sale price by the bank calculated on the "profit" (he has learned another terminology) for the whole period of the instalments?

Now that he is settling the debt earlier and effectively shortening the period for full settlement, why should the bank be entitled to the full profit? Had he offered to take the facility for a shorter period at the beginning, the bank would have calculated it differently and the sale price would have been less. In the end, most likely, he would not settle his debt with the bank earlier as he had wanted to. At the very least, are we not discouraging a Muslim from settling his debt as soon as he could?

Let us now take the other situation which is more common. After paying his instalments for a few years, the customer is unable to pay. The bank goes to court to obtain an order for sale under the National Land Code to auction the charged property. Having received the papers from the court, the customer goes and sees a lawyer, a common law lawyer. The lawyer, being used to similar applications in conventional transactions, straightaway sees a “discrepancy” in the amount of debt claimed. “Normally” (he is a common law lawyer and to him the conventional transaction that he is used to is the “normal” transaction) the bank would claim the amount disbursed plus interest, usually, as agreed by the parties in the agreement. Here, the (Islamic) bank is claiming the full sum including “future profit” or “unearned profit”. He feels that for the bank to claim the full purchase price is wrong and unfair or, at least, more than it should claim. To him this is a good ground on which to challenge the application. He goes to court with that argument.

The judge is a common law judge. He also hears similar applications arising from conventional loans. The same laws apply to both, except where there is a Shari’ah issue raised, in which case there is an additional issue in the Islamic banking case. When making the order for sale he has to ascertain the debt as at the date of the order consisting of the principal amount and the interest thereon up to that day. This is provided for by the rules of court. This is to tell the customer that if he wants to avoid an auction, he could tender that amount to the bank. Now he is told that the amount is the full purchase price, which, everything being equal, is much more than the amount in the conventional case.

## 2. What is *Ibra’*?

Literally, *ibra’* can be defined as “elimination, release, acquittal, and removal of something”.<sup>1</sup> A technical definition of it is: “any act by a person to withdraw his rights (to collect payment) from a person who has the obligation to repay the amount borrowed from him”.<sup>2</sup>

Generally speaking, *ibra’* is a recommended or *mandub* (action) which has a meaningful purpose and which should be encouraged. In other words, the

---

1 See Dr Abd al-Rahman Salih al-Atram, “*Ibra’* in Islamic Finance: Adaptation and Application”, paper presented at the International Shariah Scholars Dialogue, Conference, Putrajaya, Malaysia, November 8–9, 2006, organised by Bank Negara Malaysia.

2 Ibid.

creditor who absolves his rights to help the debtor who is having difficulties in repaying the debt, is doing a great thing by helping the debtor. In addition, even if the debtor is not having difficulties in repaying the debt, *ibra'* is still recommended as it can develop the relationship of trust and friendship between the creditor and the debtor. Allah (s.w.t.) clearly mentions in the holy Qur'an the following:

And if the debtor is in difficulty grant him time Till is easy for him to repay. But if ye remit it by way of charity, that is best for you if ye only knew.<sup>3</sup>

In conventional banking, whether in the case of (voluntary) early settlement or in the case of default, the bank will only claim the outstanding principal amount plus the earned interest up to the date of settlement. In the Islamic banking system, the situation is different due to the completely different structure of products. The Islamic banking products are not based on interest and in most of the cases they involve different types of sale transactions, whereby contractually the agreed sale price needs to be paid in full by the customer in case of early settlement of the debt. However, this arrangement would definitely place the Islamic banks in a disadvantageous position compared to their conventional counterparts and the "level playing field" would not be achievable. Therefore, the general practice among the Islamic banks is to grant *ibra'*, at their discretion, to the customers who voluntarily settle their debts before the agreed settlement period. In this way the Islamic banks are back at par with the conventional banks. Nevertheless, the Islamic banks need to ensure that their practice of *ibra'* is done in a manner which is allowed by the Shari'ah. Thus, it would be very useful to explore the position of *ibra'* in the cases of early settlement of debt under the Shari'ah.

The question whether *ibra'* can be given in case of early settlement of debt has been discussed by the Shari'ah scholars under the umbrella of "reduce and expedite". This concept has its root in the Hadith of the Prophet (p.b.u.h.) in which the Prophet said to the Jews of Bani Nadir when instructing them to leave Medina: "Reduce the debts and expedite its settlements".<sup>4</sup> The "reduce and expedite" refers to the situation where the creditor asks the debtor to expedite the payment of the debt and in return the creditor will reduce the debt, or the debtor may ask the creditor to reduce his debt and in return he will expedite the settlement of his debt. The Shari'ah scholars are divided in their views as to the permissibility of the "reduce and expedite" mechanism. The majority of the Shari'ah scholars in the past and present have prohibited this practice for the reason of it being *riba*-based.<sup>5</sup> Nevertheless, according

---

3 See the Qur'an, Surah al-Baqarah: 280.

4 Narrated by al-Tabarani in al-Kabir, al Hakim in Al-Mustadrak, verse 2, 52.

5 Some of those Shari'ah scholars who mentioned the prohibition of "reduce and expedite" are as follows: Umar al al-Khattab, Ibn Umar, Zayd bin Thabit, and Miqdad, al-Hasan, Salim, al-Hakam, Hisyam ibn 'Urwah, Ibn Uyaynah, Ibn 'Aliyah, al-Thawri, al-Musayyib and scholars from the four Imams. They are mentioned by Dr Abd al-Rahman Salih al-Atram, op cit (supra, n 1).

to Abd al-Rahman Salih al-Atram, the nature of “reduce and expedite” is different from the nature of “increase and extend”. The objective of “reduce and expedite” is noble, whereby the debtor will be released from his liability and the creditor will get the settlement of his property faster. Furthermore, according to him, the “reduce and expedite” implies the reduction in time and quantity whereas the “increase and extend” implies the “increase in time and quantity”. The increase in time and quantity indicates the presence of *riba* element for which “increase and extend” practice is strongly prohibited. Contrary to that, “reduce and expedite” means the reduction in time and quantity and as such it does not contain the element of *riba*. There are also a group of Shari’ah scholars who have permitted the practice of “reduce and expedite”.<sup>6</sup> They base their argument on the textual evidence of the Hadith<sup>7</sup> of the Prophet (p.b.u.h.) as well as the logical explanation that “reduce and expedite” is not the same as *riba* which means “increase”.

Another issue in relation to the early settlement of debt is whether the “reduce and expedite” could be incorporated into a contract as one of the terms of the agreement. The general practice of the Islamic banks was to grant *ibra’* in cases of early settlement of debt at their discretion. Therefore, there was a sense of insecurity felt by the customers since *ibra’* was completely dependent on the discretion of the bank. As a result of this, many customers would opt for the conventional banks due to that insecurity. The Islamic banks had to find an alternative way of making the granting of *ibra’* in cases of early settlement of debt a “matter of obligation” as opposed to a “matter of discretion”. One of the ways to achieve that was to incorporate an *ibra’* clause or “reduce and expedite” into a financing agreement. However, in order to do that it needs to be seen whether Shari’ah would permit “reduce and expedite” to be incorporated into a contract?

There are two views regarding the permissibility of the stipulation of “reduce and expedite” in the contract itself. One group of Shari’ah scholars argue that it is permissible for “reduce and expedite” to be incorporated into a contract. Another group of Shari’ah scholars contend that it is not allowed to include “reduce and expedite” in the contract due to the existence of two contracts in one and that such type of transaction could lead to *riba*. Furthermore, the Islamic Fiqh Academy in Jeddah has passed a resolution in relation to “deferred sales” and one of the points highlighted by their resolution was that the “the reduction of the deferred debt due to early settlement whether at the request of the creditor or debtor is permissible if there is no prior agreement”.<sup>8</sup>

6 Some of the Shari’ah scholars who have permitted the practice of “reduce and expedite” are as follows: Ibn ‘Abbas, Zayd ibn Thabit, ‘Ikrimah, al-Dahhaq, Ibrahim al-Nakha’I, Zufar, Abu Thawar, Ibn Taymiyah, Ibn al-Qayyim etc. They are also mentioned by Dr Abd al-Rahman Salih al-Atram, op cit (supra, n 1).

7 See the Hadith of the Prophet (p.b.u.h.) in which the Prophet said to the Jews of Bani Nadir when instructing them to leave Medina: “Reduce the debts and expedite its settlements”.

8 See the Resolution No 7/2/66 on “deferred sales” passed by the Islamic Fiqh Academy, Jeddah, Kingdom of Saudi Arabia, May 9–14, 1992.

Having discussed the above, granting of *ibra'* by the banks to customers who default in payment of their instalments is the most common and contentious issue when it comes to *ibra'*. In other words, whether banks are obliged to give *ibra'* when there is settlement by customers in the case of default? The default in payment of instalments by the customer is one of the main reasons for Islamic banking cases to go for adjudication. Research conducted by ISRA shows that from 2003 until the end of 2009, there were 3,185 registered *muamalat* cases. Approximately 90% of those cases registered before the High Court of Kuala Lumpur are in relation to retail and corporate BBA products, whereby the contracts were terminated due to the customer's default in payment and the issue raised was in relation to quantum of the bank's claim.<sup>9</sup> Normally, the Islamic banks would claim the full purchase price in case of default of payment on the part of customer due to the existence of pure sale agreement between the parties. The conventional banks, on the other hand, do not have this problem because in case of default of the customer they would claim the principal amount plus the accrued interest without any so called "unearned profit".<sup>10</sup> This practice by the Islamic banks in claiming the full purchase price in case of default in payment on the part of customer could affect their competition with the conventional counterpart. Therefore, there is a need for the Islamic banks to come out with an acceptable solution.

Even though, from the beginning, *ibra'* was a matter of discretion of the bank and the customer has no right to it, the application of the principle had not remained static. There had been developments over the last 30 years both in the court (at High Court level), in the banks, the SAC as well as in BNM. This paper will trace the development and see whether the problem has in fact been finally solved.

### 3. Development in the courts

*Bank Islam Malaysia Bhd v Adnan bin Omar* [1994] 3 AMR 2291 (Ranita Hussain JC) (July 18, 1994) is perhaps the earliest reported case on point. In that case, the plaintiff bank had granted to the defendant a facility amounting to RM583,000 under the Islamic concept of *Bai-Bithaman Ajil* (BBA), involving three simultaneous transactions whereby the defendant had sold to the plaintiff on March 2, 1994, a piece of land for RM265,000. On the same day, the plaintiff resold the said land to the defendant for RM583,000, payable by the defendant in 180 monthly instalments. The land was charged to the bank. Upon default by the defendant, the plaintiff filed an originating summons seeking an order for sale of the charged land. The issue was whether the plaintiff was entitled

---

9 See Marjan Muhammad, "The Implementation of *Ibra'* in Islamic Banking and Finance: An Analysis in Terms of Banking Operations and Maqasid Al-Shari'ah", *ISRA International Journal of Islamic Finance*, Vol 2, Issue 1 (2010), 157. See also Hakimah Yaacob, "Sale Contract in *Bai' Bithaman Ajil*: Pay the Full Purchase Price and No *Ibra'* (rebate)", *ISRA Bulletin*, Vol 7, January 2011, 12.

10 See Marjan Muhammad, *supra*, n 9, p 158.

to the full amount of RM583,000. One of the grounds put up by the defendant was that the amount stated by the plaintiff as unpaid under the charge was subject to rebate (*muqassah*)<sup>11</sup> in the event of early recovery.<sup>12</sup>

On that issue, the court held that the defendant did not have a right to the rebate as the rebate or *muqassah* was practised by the plaintiff on a discretionary basis. There was also no question of an early repayment as the loan was not a term loan. The defendant had breached the agreement by failing to pay the instalments and the plaintiff had a right to terminate the facility and demand full repayment of the loan.

We see that from the first known reported case, the dissatisfaction was over the “full amount” that customer has to pay in the case of default compared to a conventional loan of similar amount and length of instalment payment. Counsel for the defendant tried to apply the principle of *ibra’* to reduce the amount but failed.

In *Dato’ Hj Nik Mahmud bin Daud v Bank Islam Malaysia Bhd* [1996] 4 MLJ 295 (Idris Yusoff J) (September 27, 1995), also a BBA case, the issue was also the amount required to be paid by the defaulting customer. However, the case was fought on land law issues and the issue of *ibra’* was not raised or considered. Again the court held that the full purchase price must be paid.

Ten years later (June 30, 2005), in *Arab-Malaysian Merchant Bank Bhd v Silver Concept Sdn Bhd* [2005] 5 AMR 381, on the issue of deprivation of the right to *ibra’*, Suriyadi J ruled:

It is normal, as in this case that under the contract of *al-Bai Bithaman Ajil*, the relevant bank will provide facilities of *muqassah* or rebate for any customer who prepays (*Bank Islam Malaysia Bhd v Adnan Omar* [1994] 3 AMR 2291; [1994] 3 CLJ 59, encl 2). Such a facility only occurs on the assumption that the customer sticks to his instalment schedules without default. As it were here, as the defendant had failed to keep up to its bargain, which had triggered the recalling of the facilities, any rebate if given would absolutely be based on pure sympathy and indulgence. On the other hand for the sake of discussion, technically speaking if the plaintiff auctions off the impugned property, and a full sum is recovered surely it could be construed that the account is settled completely earlier than expected even though besmirched by the default, thus entitling some rebate? I will not speculate whether the sale price obtained from the auction will be more than enough to cover the utilized facilities, something that can be answered only after an order of sale has been made. In the circumstances of this current case, in the event the

---

11 Initially the “rebate” granted by the banks to their good customers was called “*muqasah*”, although the original meaning of the term is “set-off” and not “rebate”. Soon after, the mistake was spotted by the Islamic banks and “*muqasah*” was replaced with the correct term “*ibra’*”.

12 Partly from the headnote as reported in the law report.

property is ordered to be auctioned off, the period that has lapsed from the default date until now, is about the same length of period to complete the deferred payments as in the agreements. That right to rebate, if any, thus had dissipated not only with the precipitation of the default instalment, but also the exhaustion of time with the completion contractual time having arrived. Based on all these grounds, the issue of the defendant being deprived of the rebate, by reason of the recalling of the facilities cannot qualify as a "cause to the contrary".

In brief, what the learned judge says, *inter alia*, is that the agreed final settlement date would have arrived and the question of "early settlement" and *ibra'* becomes obsolete.

Six months later, the case of *Affin Bank Bhd v Zulkifli bin Abdullah* [2006] MLJ 67 (December 29, 2005) was decided by Abdul Wahab Patail J. In that case, the defendant bought a double story link house and secured a home Islamic financing facility under the Shari'ah principle of BBA from the plaintiff for a sum of RM346,000. The facility was to be repaid over an 18-year tenure by 216 monthly instalments and a charge was registered against the title. After making several payments totalling RM33,454.19, the defendant defaulted. The plaintiff issued a notice of default in Form 16D of the National Land Code seeking the repayment of RM958,997.21. Subsequently, two actions were filed, namely an order for sale and an order to recover such sums in the event of a deficiency in the proceeds of sale. The issue before the court was the actual amount that a customer has to pay to the provider of a BBA facility in the event of a default, in this case, after having paid RM33,454.19 in instalments.

Held, granting the order for sale and reducing the amount of repayment:

- (1) If the customer is required to pay the profit for the full tenure, he is entitled to have the benefit of the full tenure. It follows that it would be inconsistent with his right to the full tenure if he could be denied the tenure and yet be required to pay the bank's profit margin for the full tenure. To allow the bank to also be able to earn for the unexpired tenure of the facility, means the bank is able to earn a profit twice upon the same sum at the same time.
- (2) The profit margin that continued to be charged on the unexpired part of the tenure cannot be actual profit. It was clearly unearned profit. It contradicted the principle of *Al-Bai Bithaman Ajil* as to the profit margin that the provider was entitled to. Obviously, if the profit had not been earned it was not profit, and should not be claimed under the *Al-Bai Bithaman Ajil* facility.

Obiter:

When the gratification of being able to satisfy the pious desire to avoid financing containing the elements of *Riba* gives way to the sorrow of default before the end of tenure of an *Al-Bai Bithaman Ajil* facility, the revelation



that even after the subject of security had been auctioned at full market value there remains still a very substantial sum still owing to the bank, comes as a startling surprise. All the more shocking when it is further realized that a borrower under conventional loan is far better off. The consequence of a default under the Al-Bai Bithaman Ajil facility proved to be far more burdensome upon the unfortunate and bewildered defaulter.<sup>13</sup>

We will notice that in this case, from the judgment, no reference was made to *ibra'*. However, the learned judge found a way to reduce the amount due by deducting "unearned profit".

About one and a half years later Hamid Sultan J delivered his judgment in *Malayan Banking Berhad v Ya'kup bin Oje & Anor* [2007] 6 AMR 135 (August 30, 2007). The facts are materially similar to the other BBA cases discussed earlier. In this case, the learned judge ordered the bank to file an affidavit stating that it would give a rebate upon recovery of the proceeds of sale and specifying the amount of rebate before making the order for sale.

The learned judge, inter alia, held:

2. (a) The sum of RM167,797.10 that the defendants had to pay to the plaintiff as the amount due and owing under the BBA when the defendants only received RM80,065 to finance the purchase of the property was clearly excessive and abhorrent to the notion of justice and fair play when compared and contrasted with secular banking facilities.
- (b) The syllogism that the Quranic injunction required parties to honour the contract they entered into, and consequently that a contract under the BBA must be honoured, was a fallacy within the framework of Islamic jurisprudence. A contract under the BBA, like any other Islamic commercial transaction, was subjected first and foremost to the Quranic injunction to act with justice and equity.
- ...
- (d) The practice of Islamic banks to exercise their discretion and give a rebate to their borrowers following an order for sale as a result of the borrowers' default in payment was in keeping with the true spirit and intent of justice and equity under the Syariah law.
- (e) Equity applied both to the plaintiff as well as the defendants. In the circumstances, the plaintiff should demonstrate equitable conduct by filing an affidavit stating that they would give a rebate upon recovery of the proceeds of sale and specifying the amount of rebate to the satisfaction of the court before the court would make an order for sale or any other order as the justice of the case required.<sup>14</sup>

---

13 Headnote of the case as reported in the law report.

14 Headnote of the case as reported in the law report.

On July 18, 2008, Abdul Wahab Patail J decided the case of *Arab-Malaysia Finance Bhd. v Taman Ehsan Jaya Sdn Bhd & Ors; Koperasi Seri Kota Bukit Cheraka Bhd (Third Party) and Other Cases* [2009] 1 CLJ 419. It was a familiar case of a BBA facility, there was default by the customer, the bank applied for an order for sale and the issue was the full purchase price claimed by the bank. The learned judge granted the order for sale subject to the return of the original facility amount by the customer. The learned judge held:

- (5) Where the bank purchases directly from its customer and sells back to the customer with deferred payment at a higher price in total, the sale is not a bona fide sale, but a financing transaction, and the profit portion of such Al-Bai' Bithaman Ajil facility renders the facility contrary to the Islamic Banking Act 1983 or the Banking and Financial Institutions Act 1989.

*Ibra'* was not mentioned in the judgment.

On August 26, 2009, the Court of Appeal delivered its judgment in the case of *Bank Islam Malaysia Berhad v Lim Kok Hoe & Anor (and 8 Other Appeals)* [2010] 2 AMR 647. The court affirmed the validity of BBA contracts and ruled that the full purchase price must be paid. *Ibra'* was not one of the issues considered by the court. Both the judgments of the High Court in *Affin Bank Bhd v Zulkifli bin Abdullah* and *Malayan Banking Berhad v Ya'kup bin Oje & Anor* were affected by this judgment.

However, on January 28, 2010, at the hearing of one of the cases sent back by the Court of Appeal to the High Court on the issue of quantum, Rohana Yusuf J raised the issue again. The case is *Bank Islam Malaysia Berhad v Azhar bin Osman (and 3 Other Suits)* [2010] 3 AMR 363. In that case, the plaintiff contended that under a BBA contract, it has a legal right to claim for the full sale price as stipulated in the property sale agreement ("PSA") irrespective of the fact that there was a premature termination of the contract. The learned judge held that:

1. (a) Although a BBA contract in a way differs from conventional banking because it is a sale transaction, it cannot however be regarded as a sale transaction simpliciter. The BBA contract is secured by a charge and concession as *ibrah* is given as a matter of practice to all premature termination. Further, it is not a simple sale because even if the bank does not make payment of the full purchase price under a property purchase agreement the bank would still be entitled to claim the amount already paid. Whereas in a simple sale if the first leg of the transaction fails, the bank's right to the amount paid will not ipso facto accrue since the sale was never completed.
- (b) In order to be fair, the bank cannot be allowed to argue that a sale transaction must be adhered strictly to the letter only on the part of the customer. From the practice of the bank it is clear that the insistence on

enforcing payment of the full sale price appears to be merely an attempt to adhere to written text but it is doubtful whether such an appearance achieves its purpose. This is because, despite the written term of the agreement, the bank in reality does not enforce payment of the full sale price upon a premature termination. It always grants rebate or *ibrar* based on “unearned profit”.

- (c) On the authorities, when a BBA contract is prematurely terminated upon default by the borrower, the bank is not allowed to enforce the payment of the full sale price in a premature termination. The underlying principles which come to fore, derived from these decisions is clear. The court does not enforce payment of the full sale price but intervenes on equitable grounds, albeit based on different approaches.
- (d) An order granting the full sale price in an order for sale application, will defeat the requirement of s 266(1) of the National Land Code 1965 (“NLC”). Section 266 of the NLC is designed to protect the chargor who is on the brink of having his property sold at an auction to know exactly where he stands in terms of the amount of repayment in order to give him the opportunity to redeem his position under s 266 of the NLC. Further, it would mean that when a customer wants to tender payment under s 266(1) of the NLC, he will have to fork out and pay the bank the full sale price and then wait at the mercy of the bank for a rebate. In doing so, the protection intended by s 266 will be rendered meaningless.
- (e) On the facts, for the purpose of determining the quantum of claim, an implied term of Islamic banking practice was enforced, wherein when an Islamic bank practices granting of rebate on a premature termination, it creates an implied term and legitimate expectation on the part of the customer. Accordingly it is only proper that such expectation and practice be read into the contract.
- (f) A bank should not be allowed to enrich itself with an amount which is not due while at the same time taking cognisance of the customer’s right to redeem his property. Therefore where the BBA contract is silent on issue of rebate or the quantum of rebate, as an implied term, the bank must grant a rebate and such rebate shall be the amount of unearned profit as practiced by Islamic banks.

On October 20, 2010, the Court of Appeal reversed the High Court judgment in *Bank Islam Malaysia Berhad v Azhar bin Osman*.<sup>15</sup> Unfortunately, the court did not issue a full written judgment but only what it called “Broad Grounds”. Since it is not reported in the law reports, to prevent it from being lost and forgotten, we think we should reproduce the whole “Broad Grounds” here:

---

15 Court of Appeal Civil Appeal No W-02-609-2010, *Bank Islam Malaysia Berhad v Mohd Azmi bin Mohd Salleh & Two Other Appeals* (Zaleha Binti Zahari JCA, Zainun Ali JCA and Clement Allen Skinner JCA).

We heard counsel for the Appellant and after reading the cause papers and authorities we unanimously allowed the appeals. The decision of the learned High Court judge is set aside. Our reasons are stated below. We find that:

“In cases involving BBA contract, we agree with the Appellant counsel that the court is to give full effect to the terms of the contract since a BBA contract is a sale contract and is a trade transaction, where there is a purchase and a sale agreement.

The learned judge had misdirected herself in stating that a BBA contract is not a sale transaction simpliciter.

The learned judge misdirected herself in equating “*ibra*” or rebate with “unearned profit” and in holding that the Appellant bank grants “*ibra*” based on “unearned profit”.

The learned judge erred in holding that by implied terms the Bank must grant “*ibra*” or rebate in cases of premature termination and that such rebate shall be the amount of unearned profit. Thus the judge erred when she held that in an order for sale application the bank must deduct unearned profit as at that day on which the Order for Sale is made.

The learned judge erred in failing to appreciate that “*ibra*” is normally granted in cases of early settlement and is not applicable in default cases; and that the granting of “*ibra*” and its quantification is at the bank’s discretion.

The learned judge misdirected herself in relying on the testimony of witnesses or the evidence adduced in other cases and of matters not before the court to compute the amount due to the Appellant.

The learned judge erred in not holding that the sum due and payable upon termination is the balance sale price. There is no issue of the tenure not being completed as it is a sale contract. It is only the Bank’s selling price by the customer that was deferred.

We agree with paragraphs (24) and (27) of the findings of the court in *Bank Islam Malaysia Berhad v Lim Kok Hoe & Anor and other appeals* [2009] 6 CLJ 35. In that regard the learned judge had misconstrued the doctrine of stare decisis.

The learned judge erred in not granting judgment as claimed when there was no defence nor appearance filed in the Writ action.

The learned judge erred in not granting the Order for Sale in the O.S. as no affidavit in reply was filed and no cause to the contrary was shown. Order for Sale should have been granted as claimed. The amount due (under Sections 257(1)(c) and 266(1) of the National Land Code and Order 83 Rule 3(d) of the Rules of the High Court) is the outstanding sale price, which the learned judge failed to appreciate.”

In our view the BBA contracts found in the present appeals are valid where parties had freely entered into the contract which is not vitiated by any vitiating factors. The court is under a duty to enforce the contract entered into between the parties.

Thus the court will give effect to the full sale price. Full acknowledgement of the right of the bank is given to enforce payment of the full sale price under the Property Sale Agreement (PSA). If some payments had been made, the sum due and payable upon termination is the balance sale price.

On June 9, 2011, Mohd Zawawi Salleh J delivered his judgment in *CIMB Islamic Bank Bhd v LCL Corp Bhd & Anor* [2011] 7 CLJ 594. It was decided almost a year after the SAC resolution on *ibra'* (May 20, 2010) was made and about five months before the Guidelines on *Ibra'* came into effect (November 1, 2011).

The case arose from a claim by the bank for the sum owing under a term financing facility granted under the BBA facility. One of the defences was that the defendants were entitled to *ibra'*. The learned judge rejected the defence and entered judgment for the bank. This is perhaps the best judgment of a Malaysian court on Islamic banking to date. The learned judge held:

[37] The SAC in its 95th meeting held on 28 January 2010 had decided that in line with the need to safeguard *maslahah* (public interest) and to ensure justice to the financiers and customers, Islamic banking institutions are obliged to grant *ibra'* to customers for early settlement of financing based on buy and sell contracts (such as *bai' bithaman ajil* or *murabahah*). In order to eliminate uncertainties pertaining to customers' rights in receiving *ibra'* from Islamic banking institutions, the granting of *ibra'* must be included as a clause in the legal documentation of the financing. The determination of *ibra'* formula will be standardised by Bank Negara Malaysia (see Resolutions of Shariah Advisory Council of Bank Negara Malaysia on Ta'widh, *Ibra* and Late Payment Charge, Islamic Banking and Takaful Department, BNM/RH/NT 008-8, at p. 2). The effective date of this resolution is 7 June 2010.

[38] This resolution was made pursuant to the several issues on *ibra'* rose at the court of law particularly at Kuala Lumpur High Court and the inconsistency of practices amongst the Islamic Banks in imposing *ibra'* amount (see Prof Madya Dr Asyraf Wajdi Dusuki & Ors, *Implimentasi Ibra' Dalam Produk Berasaskan Harga Tangguh Dalam Sistem Perbankan Islam: Analisis Dari Perspektif Operasi Perbankan Dan Maqasid Syariah*, ISRA Research Paper (No. 16/2010), at pp. 1–3).

[39] Before this, in its 24th meeting held on 24 April 2002, SAC resolved that Islamic banking institutions may incorporate the clause on undertaking to provide *ibra'* to customers who make early settlement in the Islamic financing agreement and with the inclusion of *ibra'* clause, the bank is bound to honour that promise. This resolution is made pursuant to the practice of the bank giving rebate solely on their discretion which caused confusion amongst the customer whether they are eligible to receive *ibra'* when they

make early settlement (see Shari ah Resolutions in Islamic Finance, Bank Negara Malaysia, 2007, p. 41).

[40] The crucial word here is “an early settlement”. Do these words include the early termination by the plaintiff upon default on the part of the defendants?

[41] In this case, the relationship between the plaintiff and the 1st defendant is regulated by the terms and conditions they agreed upon as become apparent in the letter of offer dated 17 April 2009 and the asset purchase and asset sale agreements mentioned in para. 19.

[42] On that basis, this court finds that in paras. 21 and 22 of the letter of offer, it was agreed that the 1st defendant shall be given the right to make early settlement on the BBA Facility and the plaintiff shall be entitled to grant *ibra'* and the plaintiff's calculation of *ibra'* shall be final and binding. It was further agreed that for entitlement of *ibra'* on early settlement basis of the selling price, the 1st defendant is required to give three days advance notice to the plaintiff, which early settlement must be made on a profit payment date. However, should the notice is less than three days, the plaintiff shall be entitled to grant a lower *ibra'*.

[43] On the plain reading of the said letter, the early settlement only refers to a situation when the 1st defendant makes early payment of the BBA Facility before the end of the tenure without compulsion. Unfortunately, it was not the defendants' case as until to date, there is still no effort to settle the outstanding.<sup>16</sup>

Based on the ruling of the courts, “the law” on *ibra'*, as it stands today, is that *ibra'* is normally granted in cases of early settlement but is not applicable to default cases and that the granting of *ibra'* and its quantification is at the bank's discretion. This is the effect of the Court of Appeal's judgment when it reversed Rohana Yusuf J's judgment in *Bank Islam Malaysia Berhad v Azhar bin Osman*. Unfortunately, as this judgment is only in point form and is not reported, even Mohd Zawawi J in *CIMB Islamic Bank Bhd v LCL Corp Bhd & Anor* did not refer to it even though on the issue of *ibra'* for early settlement, he could have easily followed it. Most likely even the counsel were not aware of the Court of Appeal's decision and of the “Broad Grounds” it gave. In any event, Zawawi J came to the same conclusion relying on what had been agreed by the parties.

#### 4. Development in the banks

16 The learned judge referred to a resolution purportedly made in the “95th Meeting on 28 February 2010”, the content of which appears to be similar to the content in the resolution made in the 101st meeting on May 20, 2010. Officers of the Islamic Banking and Takaful Department of BNM confirmed to us that no such resolution was made in the 95th Meeting on February 28, 2010. It could be that the number and the date of the meeting were wrongly cited. The resolution in question, as published in the Second Edition of the SAC Resolutions and referred to in the BNM Guidelines was made in the 101st Meeting on May 20, 2010.

The general notion that prevails today is that Islamic banks always claim the full purchase price whenever there is default and that *ibra'* is only given, completely at the discretion of the bank, in the case of voluntary early settlement by the customer. However, this is not entirely true. The practice of giving rebate or discounts by Islamic banks to their customers started in the early days of Islamic banking. The rebate was given as a reward to good customers whose credit rating was good based on customers' financing data. So, if the record kept by the bank shows that the customer paid his monthly instalments promptly and regularly the bank would discount the amount that customer needs to pay. This rebate granted by the banks to good customers was initially called "*Muqasah*", although the original meaning of the term is "set-off" and not "rebate". Soon afterwards, the mistake was spotted by the Islamic banks and "*Muqasah*" was replaced with the correct term "*Ibra'*". Therefore, it can be said that granting of *ibra'* by Islamic banks was done since the very beginning of the Islamic banking industry, much before any regulatory guidelines were issued.

One of the motivating factors for the practice of *ibra'* by Islamic banks was the competition with the conventional counterparts. The Islamic banks needed to have a similar competitive mechanism whereby they could waive the so called "unearned profit", otherwise they risked losing a huge pool of customers to conventional banks. However, devising a mechanism for granting rebate for Islamic banks was not as easy as one may think. The Islamic banks faced many legal and Shari'ah challenges. Should *ibra'* be granted for both types of early settlement, i.e. voluntary settlement by the customer and forced settlement by the bank (which could happen due to many reasons such as death of customer, bankruptcy, default in monthly payment)? Should granting of *ibra'* remain to be at the discretion of the bank or not? These were some of the important questions which had to be resolved in a way which is acceptable to all stakeholders and yet remain in compliance with laws and Shari'ah requirements.

Initially, the security documents signed between the customer and the bank did not contain any provisions on *ibra'*.<sup>17</sup> Only the letter of offer contained a statement of policy stating that *ibra'* may be granted by the bank at its own discretion.<sup>18</sup> The upfront contracting of *ibra'* was also not allowed due to the notable Shari'ah consideration that *ibra'* cannot be contracted upfront under a sale transaction. Upfront contracting of *ibra'* may be logical from a financing perspective, but not from the perspective of the underlying transaction, i.e. sale. This has led to many uncertainties in terms of final amount due and payable by the customer. These uncertainties become evident during the

---

17 See Fakhah Azahari, "Ibrar and the Rights of the Consumer under the BBA Home Financing", <http://nfcfakhah.wordpress.com/2011/09/19/ibra-and-the-rights-of-the-consumer-under-the-bba-home-financing/>. (Accessed on January 22, 2013.)

18 Ibid.

litigation process when a formula for calculating *ibra'* becomes the subject of disagreement between the customer and the bank. The situation was remedied by the SAC's subsequent resolutions and BNM Guidelines on *Ibra'* which made it compulsory for the Islamic banks to include *ibra'* in the legal documentation of the financing and to follow Bank Negara Malaysia's formula in the calculating of *ibra'*.<sup>19</sup> The SAC allowed upfront contracting of *ibra'* to safeguard public interest and to ensure justice to the financiers and customers. In this way, the SAC removed the unwanted uncertainty which prior to that existed in financing based on buy and sale contracts.

As a result, it has been said that granting of *ibra'* in early settlement situations is not an issue any more. While, this can be safely said in the case of voluntary early settlement by the customer, granting of *ibra'* in the case of default, at least until the issue of the Guidelines on *Ibra'* and the subsequent clarification by the SAC of its resolution made in the 101st Meeting, was somewhat contentious and unclear. However, despite the fact that the current law is that *ibra'* is not applicable in default cases and that a customer is not entitled to get *ibra'* upon termination of the contract due to default<sup>20</sup>, in practice the Islamic banks would voluntarily still consider the granting of rebate even in cases of default.

This was done even before the BNM Guidelines on *Ibra'* were issued.<sup>21</sup> The claim for the full price was only made in the statement of claim, i.e. when a legal action was filed in court against a defaulting customer. However, this was done in order to secure the maximum judgment amount against the judgment debtor for contingency purposes. Rebate was given based on the negotiation between the two parties and the timing of the full settlement actually effected by judgment debtor.

The terms "unearned profit" and "unutilised tenor" were there to evidence the practice of granting *ibra'* long before the introduction of the BNM Guidelines on *Ibra'*. A portion of the sale price that represented the amount not collectible (from the financing perspective) was rebated under both cases of early settlement of financing facility or settlement of judgment debt. The amount was part of the profit margin in respect of the unutilised financing tenor. This portion was considered to be the unearned profit that was not

---

19 For further details see the discussion on the "Development in the Shari'ah Advisory Council (SAC)" and "Development in Bank Negara Malaysia", deliberated in the subsequent part of the paper.

20 See the Court of Appeal Civil Appeal No. W-02-609-2010 *Bank Islam Malaysia Berhad v Mohd. Azmi bin Mohd. Salleh & Two Other Appeals* (Zaleha Binti Zahari JCA, Zainun Ali JCA & Clement Allen Skinner JCA). See also two subsequent High Court decisions in *CIMB Islamic Bank Bhd v LCL Corp Bhd & Anor*. [2011] 7 CLJ 594 and *Bank Kerjasama Rakyat Malaysia Berhad v Flavour Right Sdn Bhd & Ors* [2011] 1 LNS 1165. These cases have been discussed in the earlier part of the paper.

21 For further details see discussion on "Development in Bank Negara Malaysia", deliberated in the subsequent part of the paper.



collectible. A certain amount was deductible for costs incurred by the bank as a direct result of the customer's/judgment debtor's default, e.g. costs of notices, postage, legal/court costs, etc.

After the BNM Guidelines on *Ibra'* (which will be discussed in the later part of the paper) were introduced, *ibra'* is required to be contracted for in the legal documentation. Accordingly, the rebate amount needs to be mentioned in both the statement for early settlement outside court as well as in the pleadings.

## 5. Development in the Shariah Advisory Council (SAC)

We have been made to understand that *ibra'* is discretionary on the part of the bank. There is no entitlement by the customer. High Court judges who hear applications for an order for sale in both conventional and Islamic banking cases side by side, even in the same sitting, were perturbed by the "unfairness" suffered by the customers of Islamic banks. They were "shocked" to see that Islamic bank customers have to pay more than conventional bank customers in a similar situation. So, in trying to be fair and equitable, they resorted to two methods. First, by ruling that banks are not entitled to "unearned profits". Secondly, by resorting to *ibra'*, insisting that it should not only be paid, but it must be stated clearly by the banks in their affidavits before the court would make the order for sale.

However, they were overruled by the Court of Appeal believing that the High Court judges had acted contrary to Shari'ah and "to support" the industry. The Court of Appeal, like most of us, believed that the Shari'ah view is only one view and it is definite: *ibra'* is discretionary on the part of the banks.

Shari'ah scholars criticised the judgments of the High Court judges in *Bank Islam Malaysia Bhd v Adnan bin Omar*, *Dato' Hj Nik Mahmud bin Daud v Bank Islam Malaysia Bhd*, *Affin Bank Bhd v Zulkifli bin Abdullah*.<sup>22</sup> However, Dr Engku Rabiah Adawiyah Bt Engku Ali had made one important point on the views of the traditional *ulama's* regarding *ibra'*. She wrote:

In view of the court's adverse opinion on the discretionary rebate or discount on the "unearned" profits in the case of *Affin Bank v Zulkifli Abdullah* in the event that the debt matured earlier than scheduled due to default by the buyer, it is suggested that Islamic banks take the pro-active step of undertaking to grant the rebate together with the formula of calculation in their statement of claims presented before the court, since this is not against the Islamic legal rules, especially in the case of the debt becoming due in the event of default. It is felt that the express undertaking by the bank to give the rebate, together with a pre-determined formula, will give comfort

---

<sup>22</sup> See Dr Engku Rabiah Adawiyah Bt Engku Ali, "Constraints and Opportunities in Harmonization of Civil Law and Shariah in the Islamic Financial Services Industry", [2008] 4 MLJ i.

to the court who is concerned that justice is done to the parties and that the settlement is not arbitrary. This will also prevent adverse perception and allegations against Islamic banking practices being oppressive on the customer due to the large amount of profits taken even in the event of early settlement of the debts on default, as evident in the comments made by the judge in *Affin Bank's* case. The view of the judge in the case seemed to be more in line with that of the Hanafi jurists who made it compulsory for the seller in *murabahah* sales to give a discount on the *murabahah* profits if there is early settlement of the *murabahah* debts because the tenure of payment is one of the main factors for the calculation of the initial mark-up contracted in the *murabahah* agreement. It is therefore logical that when the tenure of payment is shortened due to default or otherwise, the amount of profit or mark-up is also reduced accordingly.<sup>23</sup>

Perhaps, this paragraph is a consolation to the High Court judges. Most likely, they, not being Shari'ah scholars, did not know that there is a minority view of at least one Mazhab that supports their concern and their sense of fairness. So, they resorted to fairness and equity to find a way in order to be fair and equitable and one of the ways that they tried was to apply the principle of *ibra'*. Actually, even though they could not justify it from the Shari'ah perspective, they were not totally wrong. Traditional *ulama's* had also been concerned about the same issue and they too must have felt the same way as those judges, even though they did not have the conventional counterpart to compare. Unfortunately, as far as we know, no Shari'ah scholar in Malaysia had pointed that out earlier. It took an *ulama'* from Pakistan, Mufti Muhammad Taqi Usmani, to research and come out with that statement. It shows that the instinct of fairness and equitability of the High Court judges is not totally foreign from the Shari'ah perspective.

With that preamble, let us now look at the development in the SAC.

It is obvious that the view of the SAC was and is that in a BBA transaction, in the case of early settlement or default, the bank is entitled to the payment of the full purchase price, that the customer is not entitled to *ibra'* and that *ibra'* is a matter of discretion of the banks. Indeed in the "Basis of the Ruling" in Resolution No 79 (February 27, 2003), we find the following statement:

Thus, the financier may apply *ibra'* in whatever forms at his discretion.<sup>24</sup>

However, in the 13th Meeting on April 10, 2000, the SAC issued a resolution whereby Islamic banking institutions (IBIs) may incorporate a clause on the undertaking to provide *ibra'* to customers who make early settlement in the financing agreement on the basis of public interest (*maslahah*). The inclusion

---

23 Ibid.

24 Bank Negara Malaysia, *Shari'ah Resolutions in Islamic Finance*, 2nd edn (Kuala Lumpur: Bank Negara Malaysia, 2010), p 127.

of an *ibra'* clause in the financing agreement would require IBIs to honour the undertaking or promise to grant *ibra'* to their customers.<sup>25</sup>

On February 27, 2003, in its 32nd Meeting, the SAC resolved that both methods of *ibra'* (namely *ibra'* for early settlement and monthly *ibra'* to match the effective profit rate with current market rate) in a financing agreement are permissible.<sup>26</sup> We reproduce the Resolution here:

The SAC, in its 32nd meeting dated 27 February 2003, has resolved that both methods of *ibra'* (namely *ibra'* for early settlement and monthly *ibra'* to match the effective profit rate with current market rate) in a financing agreement are permissible.

About three years later (December 27, 2006), another resolution followed under the title of "*Ibra' in Home Financing Product Linked to a Wadi`ah or Mudarabah Deposit Account.*"<sup>27</sup> For convenience, we reproduce it here:

The SAC, in its 63rd meeting dated 27 December 2006, has approved the proposal on home financing product linked to a *mudarabah* deposit account with the condition that the cost associated with the *ibra'* shall be borne solely by the Islamic financial institution. However, the SAC, in its 64th meeting dated 18 January 2007, has resolved that the proposal to link the home financing product with a *wadi`ah* deposit account is not allowed because of the concern that its nature is *syubhah* to *riba*.

We now come to the most recent resolution of the SAC on *ibra'*. It was made in its 101st meeting held on May 20, 2010.<sup>28</sup> The Resolution states as follows:

The SAC, in its 101st meeting dated 20 May 2010, has resolved that Bank Negara Malaysia as the authority may require Islamic financial institutions to accord *ibra'* to their customer who settled their debt obligation arising from the sale-based contract (such as *bai` bithaman ajil* or *murabahah*) prior to the agreed settlement period. Bank Negara Malaysia may also require the terms and conditions on *ibra'* to be incorporated in the financing agreement to eliminate any uncertainty with respect to customer's entitlement to receive *ibra'* from Islamic financial institution. The *ibra'* formula will be determined and standardised by Bank Negara Malaysia.

Looking back, the issue of *ibra'* was raised in the first known reported case on the point, *Bank Islam Malaysia Bhd v Adnan bin Omar* [1994] 3 AMR 2291 (Ranita Hussain JC) (July 18, 1994). High Court judges had been holding the view that *ibra'* was a matter of discretion of the banks and that banks were entitled to

25 Para 1.6, Guidelines on *Ibra'* (Rebate) for Sale-Based Financing issued by Bank Negara Malaysia, effective from November 1, 2011.

26 Bank Negara Malaysia, *Shari'ah Resolutions in Islamic Finance*, supra, n 24, Resolution No 79, pp 126–127.

27 Ibid., Resolution No 80, p 128.

28 Ibid., Resolution No 78, p 124.

the full purchase price in the case of default. It was only in 2007 that Hamid Sultan J in *Malayan Banking Berhad v Ya'kup bin Oje & Anor* [2007] 6 AMR 135 (August 30, 2007), directed the bank to file an affidavit stating that “they would give a rebate upon recovery of the proceeds of sale and specifying the amount of rebate to the satisfaction of the court before the court would make an order for sale or any other order as the justice of the case required”. This was “followed” by Rohana Yusuf J in *Bank Islam Malaysia Berhad v Azhar bin Osman (and 3 Other Suits)* [2010] 3 AMR 363 (January 28, 2010). In other words, until 2007, even though the issue of *ibra'* was raised, it was never successful. Yet, we see that as early as 2000, then in 2003 and 2006, the SAC was already considering the issue of *ibra'*. The first three resolutions (in 2000, 2003 and 2006) were clearly initiated by the banks. It means that, even though until then banks were successful in resisting the claim to the “right to *ibra'*”, banks were already trying to find ways to “compromise” on the issue. They must have had business reasons for that, because, Shari'ah was on their side.

At the same time, BNM, probably after Rohana Yusuf J's judgment in *Bank Islam Malaysia Berhad v Azhar bin Osman (and 3 Other Suits)* (January 28, 2010), must have started work on the issue too.<sup>29</sup> That culminated in the resolution of May 20, 2010. Perhaps, not knowing what was going on, when *Bank Islam Malaysia Berhad v Azhar bin Osman (and 3 Other Suits)* came up before the Court of Appeal, the court, on October 20, 2010, reversed Rohana Yusuf J's judgment. But, in spite of the Court of Appeal's judgment which strengthened the position of the banks in respect of *ibra'*, BNM appears to have proceeded to work on the Guidelines on Ibra' which came into effect on November 1, 2011. What it means is that, even though as it stands (indeed until the day we are writing this article) the Court of Appeal's judgment confirms the bank's discretion to grant or not to grant *ibra'* and also the amount thereof, Bank Negara proceeded to direct banks to grant *ibra'* in accordance with the formula fixed by BNM, which is quite similar to what the High Court judges had been advocating unsuccessfully.

We believe that the resolution must have been initiated by the officers of BNM themselves. They must have been following what was happening in the industry. They must have heard of the dissatisfaction of the customers, the lack of competitiveness of Islamic banking vis-à-vis conventional banking and the feeling of unfairness to the customers of Islamic banking among the judges and the image of Islamic banking as a whole. They must have directed the Islamic Banking Division and the Secretariat of the SAC to research on the issue and try to come up with a solution. The result was a paper put up to the SAC for consideration and ruling. And that was how the ruling came about. It was not just an academic exercise by the Shari'ah scholars in the SAC.

---

29 By the way, she was a Deputy Director, Department of Islamic Banking and Takaful, BNM before she became a judicial commissioner and then judge.

## 6. Development in Bank Negara Malaysia

Armed with the resolution of the SAC at the 101st meeting on May 20, 2010, BNM issued the Guidelines on Ibra' (Rebate) for Sale Based Financing. While the SAC resolution did not specifically state that "early settlement" includes default cases, the Guidelines clearly say so. There are few paragraphs in the Guidelines which we would like to emphasise and these are as follows:

- 1.3 Granting of ibra' by IBIs is an important consideration for the IBIs to remain competitive with conventional banking institutions, as conventional banking institutions allow customers to pay the principal and accrued interests up to the date of early settlement only. Apart from the event where customers approach the IBIs for early settlement, other circumstances tantamount to settlement prior to maturity where ibra' could also be granted include settlement arising from a restructuring exercise, default cases and termination of contracts.
  - 1.4 Given that ibra' is a discretionary consideration of the IBIs, the right to grant ibra' remains with the IBIs. However, it has been observed that while a number of IBIs grant discretionary ibra' and include such commitment in the offer letter and legal documents of the financing, there are also IBIs that are silent on the applicability of granting ibra'. The different practices among the IBIs need to be harmonised to avoid confusion to the public and provide greater transparency and clarity.
- ...
- 4.1 The Guidelines are issued pursuant to section 53A of the Islamic Banking Act 1983 (IBA), section 126 of the Banking and Financial Institutions Act 1989 (BAFIA) and section 126 of the Development Financial Institutions Act 2002 (DFIA).
- ...
- 6.1 IBIs are required to grant ibra' to all customers who settle their financing before the end of the financing tenure. Settlement prior to the end of the financing tenure by the customers shall include, but is not limited to the following situations:
    - (i) Customers who make an early settlement or early redemption, including those arising from prepayments;
    - (ii) Settlement of the original financing contract due to financing restructuring exercise;
    - (iii) Settlement by customers in the case of default; and
    - (iv) Settlement by customers in the event of termination or cancellation of financing before the maturity date.<sup>30</sup>

---

30 Emphasis added.

We must say that the resolution is a clever way of handling the problem. It recognises the power of the BNM as the supervisory authority to require Islamic financial institutions to accord *ibra'* to their customers who settled their debt obligation arising from the sale-based contract (such as *bai' bithaman ajil* or *murabahah*) prior to the agreed settlement period. BNM may also require the terms and conditions on *ibra'* to be incorporated in the financing agreement to eliminate any uncertainty with respect to customers' entitlement to receive *ibra'* from Islamic financial institution. BNM will determine the *ibra'* formula. The ruling does not change the Shari'ah position ("law"). However, when BNM issues a circular or guideline, all banks are bound to comply by force of law.

The Guidelines are self-explanatory. However, we need to highlight a few things.

First, as stated by paragraphs 1.3 and 1.4, the main reasons for the issue of the Guidelines are to enable IBIs to remain competitive with conventional banks and to "harmonise" the different practices among the IBIs to avoid confusion to the public and provide greater transparency and clarity.

Secondly, Paragraph 4.1 narrates the different laws under which the Guidelines are made. The Guidelines were not made under s 59 of the CBMA 2009 as we thought they were. Perhaps, the reason is that s 59 refers only to "Islamic financial institutions" (IFI) which term may not cover all the institutions the Guidelines are intended to cover. However, making them under the three laws, first, creates an anomaly in the punishment. That is because the three laws provide different punishments for what will be the same offence. The only difference is under which law the institution falls. It is like saying you will be punished according to who you are. The laws were made at three different times to cover three different types of institutions. Now, they are lumped together. Hence the anomaly.

The other point is that it would be quite a problem to frame the charge for the offence committed. If the institution falls under the IBA 1983, the charge would have to state "*contravenes or fails to comply with ... regulations made ...*" under the Act. Section 50 provides the punishment for that. But, look at s 53A under which the Guidelines were made. That section talks about "guidelines, circulars". The word "regulations" is not mentioned. It could be argued that s 53A does not empower the making of "regulations" which are punishable under s 50.

Take an institution which falls under BFIA 1989. Section 126 clearly empowers the making of "guidelines". But s 104, which provides for the punishment, talks about contravening:

- (b) any specification or requirement made, or any order in writing, direction, instruction, or notice given, or any limit, term, condition or restriction

imposed, or any other thing howsoever done, in the exercise of any power conferred under, pursuant to, or by virtue of, any provision of this Act or regulations made under it, ...

“Guidelines” are not mentioned. Actually, this provision is not referring to things like regulations, guidelines and circulars of general application, but to specifications, requirements, directions, instructions etc. imposed on a particular institution.

The position under DFIA 2002 is similar to that under BFIA 1989—see ss 126 and 107.

This discussion may sound trivial but we are dealing with criminal law here: the punishment must be for the same offence as charged.

It is worthwhile to make a study whether the institutions which are required to grant *ibra'* would fall under the definition of IFI under CBMA 2009. If they do, one way out is to reissue the guidelines under s 59 of the CBMA 2009. Alternatively, if all the institutions fall under the new Islamic Financial Services Act 2012, the guidelines could be reissued under the new law. Otherwise, the Acts under which the Guidelines were made might have to be amended to standardise the provisions.

Until then, it is hoped that the necessity to resort to criminal charge against any institution would not arise. It is hoped that they would all comply with the Guidelines and grant *ibra'* as required. In any event, the fear of being challenged in a criminal proceeding should not be the reason not to enforce the Guidelines. They should be allowed to take effect and whatever improvement necessary may be made as and when required.

Thirdly, pursuant to these Guidelines, banks must not only give *ibra'* to customers who (voluntarily) make an early settlement or early redemption but also to customers who settle their original financing contract due to financing restructuring exercise, where there is “settlement by customers in the case of default” as well as in the event of termination or cancellation of financing prior to the agreed settlement period. Of the four types mentioned in the guidelines, which are not exhaustive, “settlement by customers in the case of default” is the most pertinent in our discussion in this paper. It is also the one that seems to be quite ambiguous. That is because of the use of the words, “settlement by customers” before the words “in the case of default”. When we talk about “early settlement” in the other three examples, the customer actually wants to pay whatever he has to pay to settle the whole debt prior to the agreed settlement period. It is in such a situation that the bank is required to give *ibra'*. However, in the case of default, the customer fails to pay even the monthly instalments. He is not “settling” his debt. It is the bank that takes recourse to auction the charged property to recover the debt. (Of course, it could be argued that the “early settlement” comes in when the proceeds of

the sale is received by the bank and the amount is sufficient to settle the full amount of debt due. Perhaps that is the way the Shari'ah scholars look at it.)

However, the courts do not look at cases of default as an "early settlement". The Court of Appeal in *Bank Islam Malaysia Berhad v Mohd Azmi bin Mohd Salleh* (Civil Appeal No W-02-609-2010 (unreported), in which two other appeals including *Bank Islam Malaysia v Azhar bin Osman* were jointly heard and decided, had expressed the view:

The learned judge [of the High Court – added] erred in failing to appreciate that "*ibra'*" is normally granted in cases of early settlement and is not applicable in default cases; and that the granting of "*ibra'*" and its quantification is at the bank's discretion.

Indeed, subsequent to the issuing of the resolution dated May 20, 2010, Zawawi J was faced with the same issue in *CIMB Islamic Bank Bhd v LCL Corp Bhd & Anor* [2011] 7 CLJ 594. The judgment was issued on June 9, 2011. As mentioned earlier, the learned judge (mistakenly in our view) referred to the resolution of the 95th Meeting of the SAC held on February 28, 2010 but not to the resolution of the 101st Meeting held on May 20, 2010. He also did not refer to the unreported "Broad Ground" of the Court of Appeal in *Bank Islam Malaysia Berhad v Mohd Azmi bin Mohd Salleh*, most likely because he was not aware of it; neither was it brought to his attention by learned counsel. But, interestingly, he arrived at the same conclusion as the Court of Appeal in *Bank Islam Malaysia Berhad v Mohd Azmi bin Mohd Salleh* that cases of default do not fall under the term "early settlement". Zawawi J's judgment in *CIMB Islamic Bank Bhd v LCL Corp Bhd & Anor* was subsequently followed by Kamardin Hashim J in *Bank Kerjasama Rakyat Malaysia Berhad v Flavour Right Sdn Bhd & Ors* (Johor Bahru High Court NC v No 22A-40-2011) (September 23, 2011). In other words, as far as the court is concerned, the term "early settlement" does not include cases of default and the problem of *ibra'* in cases of default remains unsolved.

But, to Shari'ah scholars "early settlement" includes cases of default. Since that is their view, it should be clearly stated in the resolution. We are happy to note that the SAC at its 131st Meeting on January 22, 2013 resolved that the "formula for the implementation of *ibra'* in early settlement cases is also applicable to default cases".<sup>31</sup> This makes it clear that the statement to the same effect in the Guidelines is consistent with the resolution of the SAC. With that there is no more room for doubt that the guidelines apply to default cases, that banks are obliged to apply the guidelines to default cases in their claims in court, that there would be no more complaints by customers that the banks are not giving *ibra'* and that judges too would now be able to make

---

31 Our translation. Original text of the minutes reads: "... kaedah pelaksanaan *ibra'* bagi kes-kes penyelesaian awal juga terpakai bagi kes-kes kemungkiran".



a “more fair and equitable” order regarding the amount that the customer will have pay to the bank as they had wanted to do in the last two decades. We believe that the problem has now been finally solved.

There is, however, a temporary irritation. The judgment of the Court of Appeal in *Bank Islam Malaysia Berhad v Mohd Azmi bin Mohd Salleh* is standing in the way, until the Court of Appeal gets the opportunity to revisit it in the light of the new resolution of the SAC and the Guidelines of BNM. But, the Court of Appeal may never get such an opportunity as the issue may not arise anymore. Banks are required by law to comply with BNM Guidelines. If they do (and we do not think any bank would be foolish enough to defy BNM Guidelines), then they would say so in relevant documents, including the statement of claim and affidavits and the court would give effect to it. Customers get their *ibra'*. The judgment becomes obsolete. Since it is not reported, it would soon be forgotten. Hopefully, that is the approach that banks will take. If they choose to defy the Guidelines and argue that they are entitled to follow the judgment of the Court of Appeal and the two High Court judgments, then the Court of Appeal would get the opportunity to reconsider *Bank Islam Malaysia Berhad v Mohd Azmi bin Mohd Salleh* in so far as the issue of *ibra'* is concerned, consequent to the issuance of the Guidelines. When that happens, it is hoped that the Court of Appeal will then give effect to the Guidelines, thus solving the problem once and for all.

## 7. Conclusion

The main dissatisfaction with Islamic banking since its introduction was over the “full purchase price” that customers who would like to make an early settlement and defaulting customers would have to pay. Many people, including judges of the civil court who hear such cases, think that it is unjust, inequitable, “clearly excessive and abhorrent to the notion of justice and fair play” when compared with the amount that would have to be paid under a conventional loan. Shari’ah reasons could be given but it is the bottom line that matters. Why should something “Islamic” be so “unfair”? We are quite sure that many Muslims had turned away from Islamic banking because of that.

While on the face of it, it looks as if Islamic banks are the ones that benefit, in the long run, it works against them. They become uncompetitive. That was the reason why BNM tried to find a way to overcome the problem. They got a resolution from the SAC and issued the Guidelines thus putting Islamic banking at par with conventional banking, making the customers happy and the judges satisfied because they are now able “to do justice” to customers of Islamic banks who are unable to service their debts. For the Guidelines to be effective, they should be made public so that, if banks fail to comply, customers would raise the issue and the court would enforce it. The decisions of the courts would then be consistent with the Guidelines. That is besides any disciplinary action by BNM against any recalcitrant bank, if it needs be

---

but hopefully not. Of course, it takes about three decades for the Shari'ah to develop to overcome this problem. But, three decades in the history of Shari'ah is a short period. It shows that Shari'ah is developing in order to be relevant, and ironically in this case, it is un-Islamic conventional system that pushes it to develop. That is the beauty of competition and, perhaps, the wisdom of having two parallel systems running side by side.