Granting of Ibra' by Islamic Banks in Malaysia: A Matter of Discretion or Obligation?

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Debts; Default; Discounts; Early settlement; Islamic finance; Malaysia

Introduction

The majority of the Islamic banking cases, which have been submitted for adjudication before the High Court, are in relation to the retail or corporate *bai' bithaman ajil* (deferred payment sale) (BBA) products, whereby the BBA facility is terminated due to the default by customer in payment of monthly instalments. The most common point of disagreement among the disputing parties is in regards to the banks' quantum of claim. The banks would normally claim the full selling price, while the customer, on the other hand, would argue that the bank should be entitled only to the principal amount plus the profits earned until the settlement date. In addition, the customer would argue that the bank earns the profit on the basis of deferment, and now that the period is shortened, why should the bank be entitled to the full profit? The customer feels that the bank's claim of the so called "future profit" or "unearned profit" is wrong and unfair, especially if he is to compare that with the loan facility offered by the conventional bank. The conventional bank would, in default cases, claim the amount disbursed plus interest, usually agreed by the parties in the agreement. Therefore, the customer would go to the court with the argument that the Islamic bank should not be entitled for the full selling price and that *ibra'* (rebate) should be given in the amount of unearned profit.

The concept of Ibra' in Islam

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. From *Shari'ah* point of view, it is a *mandub* (recommended) action which is based on the authority of the Quran, verse 280 of *Surah Al-Baqarah*, whereby Allah (s.w.t) said:

> "And if the debtor is in difficulty grant him time Till easy for him to repay. But if ye remit it by way of charity, that is best for you if ye only knew."[1]

Further textual evidence is the Hadith of the Prophet (p.b.u.h) in which Prophet said to the Jews of Bani Nadir when instructing them to leave Medina: "Reduce the debts and expedite its settlements."[2] Therefore, most of the *Shari'ah* scholars have discussed the issue of whether *ibra'* can be given in case of early settlement of debt under the umbrella of "reduce and expedite". The *Shari'ah* scholars are divided in their opinions on the permissibility of the "reduce and expedite" and whether in can be as such incorporated in a contract as one of the terms of the agreement.[3]

Majority of the *Shari'ah* scholars in the past and present have prohibited this practice for the reason of it being *riba*-based.[4] Nevertheless, Abd al-Rahman Salih al-Atram argues that 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, 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".[5] They base their argument on the textual evidence of the Hadith[6] of the Prophet (p.b.u.h.) as well as logical explanation that the "reduce and expedite" is not the same as *riba* which means the "increase".

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[1] See the Qur'an, Surah *al-Baqarah*: 280.

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

[3] For further discussion see Adnan Trakic and Norhashimah Moh. Yasin, "'Ibra' and Its Practice by the Islamic Banks: With Reference to Malaysia", in *Islamic Banking and Finance: Principles, Instruments & Operations*, (ed), Adnan Trakic and Hanifah Haydar Ali Tajuddin, Malaysia: Current Law Journal 641–672.

[4] Some of those *Shari'ah* scholars who mentioned the prohibition of "reduce and expedite" are as follow: Umsr 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 4 Imams. They are mentioned by 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.

[5] Some of the *Shari'ah* scholars who have permitted the practice of "reduce and expedite" are as follow: 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, "'Ibra' in Islamic Finance: Adaptation and Application".

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

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 it, many customers would opt for the conventional banks due to that insecurity. The Islamic banks had to find the alternative way of making the granting of *ibra'* in cases of early settlement of debt as a "matter of obligation" as opposed to a "matter of discretion". One of the ways to achieve that was to incorporate *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 for "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, whereas, another group of *Shari'ah* scholars contend that it is not permissible due to the existence of two contracts in one and that such type of transaction could lead to *riba*. Furthermore, Islamic Fiqh Academy in Jeddah has passed the resolution in relation to the "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.[7]

The practice of granting of Ibra' by Islamic banks

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 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 customer started since 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 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 after 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 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 risk 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 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'*.[8] Only the letter of offer contained a statement of policy stating that *ibra'* may be granted by the bank at its own discretion.[9] The upfront contracting of *ibra'* was also not allowed due to notable *Shari'ah* consideration that *ibra'* cannot be contracted upfront under a sale transaction. Upfront contracting of *ibra'* may be logical from financing perspective, but not from the perspective of underlying transection, 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 litigation process when a formula for calculating *ibra'* becomes subject of disagreement between the customer and the bank. The situation was remedied by the subsequent resolutions of the *Shari'ah* Advisory Council of Bank Negara Malaysia (SAC) and Bank Negara Malaysia[10](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 calculating of *ibra'*.[11] 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 case of voluntary early settlement by the customer, granting of *ibra'* in case of

[7] 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.
[8] See Fakihah Azahari, "Ibrar and the Rights of the Consumer under the BBA Home Financing" at *http://nfcfakihah.wordpress.com/2011/09/19/ibra-and-the-rights-of-the-consumer-under-the-bba-home-financing/* [Accessed July 3, 2013].
[9] See Fakihah Azahari, "Ibrar and the Rights of the Consumer under the BBA Home Financing".
[10] Bank Negara Malaysia, which is written in Malay, refers to Central Bank of Malaysia.
[11] For further details about the SAC's Resolutions see Bank Negara Malaysia, *Shari'ah Resolutions in Islamic Finance*, 2nd edn (Kuala Lumpur: Bank Negara Malaysia, 2010), 127.The latest SAC Resolution and BNM Guidelines on Ibra' will be discussed later in the paper.

default, at least until the issue of the BNM 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 courts are of the view that *ibra'* is not applicable in default cases and that customer is not entitled to get *ibra'* upon termination of contract due to default,[12] in practice the Islamic banks would voluntarily still consider granting of rebate even in cases of default.

This was done even before the BNM Guidelines on Ibra' were issued. 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 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 BNM Guidelines on Ibra'. A portion of the sale price that represented the amount not collectible (from 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 collectible. 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) was introduced, *ibra'* is required to be contracted in the legal documentation. Accordingly, rebate amount needs to be mentioned in both the statement for early settlement outside court as well as in the pleadings.

Malaysian courts' approach to Ibra'

The issue of the application of *ibra'* in default cases arose in Malaysian court since the first known reported Islamic banking case in 1994, *Bank Islam Malaysia Bhd v Adnan bin Omar*.[13] 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 MYR 265,000. On the same day, the plaintiff resold the said land to the defendant for MYR 583,000, 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 to the full amount of MYR 583,000. 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*)[14] in the event of early recovery.[15]

On that issue, the court held that the defendant does not have a right to the rebate as the rebate or "*muqassah*" is practised by the plaintiff on a discretionary basis. There is 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 facility.

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.

Beginning from 2005, some High Court Judges tried to resort to *ibra'* in their attempt "to be fair and equitable" to customers of Islamic banks.[16] In *Arab-Malaysian Merchant Bank Bhd v Silver Concept Sdn Bhd*,[17] 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 A.M.R. 2291; [1994] 3 C.L.J. 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 property is ordered to be auctioned

[12] See the Court of Appeal Civil Appeal No.W-02-609-2010 *Bank Islam Malaysia Berhad v Mohd Azmi Bin Mohd Salleh* (Zaleha Binti Zahari JCA, Zainun Ali JCA and Clement Allen Skinner JCA). See also 2 subsequent High Court decisions in *CIMB Islamic Bank Bhd v LCL Corp Bhd* (2011) 7 C.L.J. 594 and *Bank Kerjasama Rakyat Malaysia Berhad v Flavour Right Sdn Bhd* [2011] 1 L.N.S. 1165. These cases have been discussed in the earlier part of the paper.
[13] *Bank Islam Malaysia Bhd v Adnan bin Omar* [1994] 3 A.M.R. 2291.
[14] 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".
[15] Partly from the head note as reported in the law report.
[16] See *Affin Bank Bhd v Zulkifli bin Abdullah* [2006] M.L.J. 67; *Malayan Banking Berhad v Ya'kup bin Oje* [2007] 6 A.M.R. 135; *Arab-Malaysia Finance Bhd V Taman Ehsan Jaya Sdn Bhd*; *Koperasi Seri Kota Bukit Cheraka Bhd (Third Party)* [2009] 1 C.L.J. 419.
[17] *Arab-Malaysian Merchant Bank Bhd v Silver Concept Sdn Bhd* [2005] 5 A.M.R. 381.

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*,[18] 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 MYR 346,000. The facility was to be repaid over 18-year tenure by 216 monthly installments and a charge was registered against the title. After making several payments totaling MYR 33,454.19, the defendant defaulted. The plaintiff issued a notice of default STARTin Form 16D of the National Land Code seeking the repayment of MYR 958,997.21. 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 MYR 33,454,19 in installments:

"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."[19]

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*.[20] 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 they would give a rebate upon recovery of the proceeds of sale and specifying the amount of rebate before making the order for sale.

On July 18, 2008, Abdul Wahab Patail J. decided the case of *Arab-Malaysia Finance Bhd v Taman Ehsan Jaya Sdn Bhd*; *Koperasi Seri Kota Bukit Cheraka Bhd (Third Party)*.[21] 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.

[18] *Affin Bank Bhd v Zulkifli bin Abdullah* (2006) M.L.J. 67 (December 29, 2005).
[19] Head note of the case as reported in the law report.
[20] *Malayan Banking Berhad v Ya'kup bin Oje* [2007] 6 A.M.R. 135 (August 30, 2007).
[21] *Arab-Malaysia Finance Bhd v Taman Ehsan Jaya Sdn Bhd*; *Koperasi Seri Kota Bukit Cheraka Bhd (Third Party)* [2009] 1 C.L.J. 419.

However, the High Court judgments on grating of *ibra'* (or unearned profit as they called it), were reversed by the Court of Appeal in *Bank Islam Malaysia Berhad v Lim Kok Hoe*[22] to comply with the *Shari'ah* and "to support" the industry. 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.

Soon after the issue was raised again by the High Court decision in *Bank Islam Malaysia Berhad v Azhar bin Osman*[23] where the learned High Court judge Rohana Yusuf J. (as then she was) held: "… the bank must grant a rebate and such rebate shall be the amount of unearned profit as practiced by Islamic banks." However, it did not take long for the Court of Appeal in *Bank Islam Malaysia Berhad v Mohd Azmi Bin Mohd Salleh*[24] to deliver, not a fully written judgment but only what is called "Broad Grounds", to reverse the High Court's judgment in *Bank Islam Malaysia Berhad v Azhar bin Osman*. The Court of Appeal observed:

> "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."

Therefore, as far as the court is concerned, the Court of Appeal decision clearly points out that the term "early settlement" does not include cases of default and that *ibra'* is only given at the discretion of the bank. The same views have been adopted by a recently decided High Court decision in *CIMB Islamic Bank Bhd v LCL Corp Bhd*[25] which was later on followed in *Bank Kerjasama Rakyat Malaysia Berhad v Flavour Right Sdn Bhd*.[26] The High Court judge did not refer to the Court of Appeal "Broad Grounds" in *Bank Islam Malaysia Berhad v Mohd Azmi Bin Mohd Salleh Appeal,* most likely because the learned judge was not aware of it, neither was it brought to his attention by learned counsel. But interestingly, he arrived to the same conclusions as the Court of Appeal.

All of the above mentioned cases have been decided before the BNM Ibra' Guidelines came into force, i.e. before November 1, 2011.[27] Therefore, the Court of Appeal's interpretation that "early settlement" does not include default cases and that *ibra'* is given only at the discretion of the banks is the outcome that could be expected given the fact that there were no any BNM Guidelines which would clarify the matter.

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*.

Normally, the court will enforce the BNM Guidelines, but in this case no reference was made to the BNM Ibra' Guidelines. We presume that this is due to the lack of publicity of the Guidelines and it is very possible that the court, as well as the counsels in the case, were unaware of the Guidelines' existence. Despite the fact that the Guidelines came into force on November 1, 2011, they were only issued by BNM on January 31, 2013.[28]

Shari'ah Advisory Council's Resolution on Ibra' and Bank Negara Malaysia Guidelines on Ibra' (Rebate) for Sale Based Financing

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 of the BNM (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. The SAC, in its 101st meeting dated May 20, 2010, issued such resolution which unambiguously clarifies that BNM is the authority which may require Islamic financial institutions to grant *ibra'* for early settlement cases. 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

[22] *Bank Islam Malaysia Berhad v Lim Kok Hoe* [2010] 2 A.M.R. 647.
[23] *Bank Islam Malaysia Berhad v Azhar bin Osman* [2010] 3 A.M.R. 363.
[24] *Bank Islam Malaysia Berhad v Mohd Azmi Bin Mohd Salleh* Court of Appeal Civil Appeal No.W-02-609-2010.
[25] *CIMB Islamic Bank Bhd v LCL Corp Bhd* [2011] 7 C.L.J. 2010.
[26] *Bank Kerjasama Rakyat Malaysia Berhad v Flavour Right Sdn Bhd* Johor Bahru High Court NC v No.22A-40-2011.
[27] Bank Negara Malaysia Guidelines on Ibra' (Rebate) for Sale Based Financing came into force on November 1, 2012.
[28] See *http://www.bnm.gov.my/index.php?ch=en_announcement&pg=en_announcement_all&ac=213&lang=en* [Accessed July 3, 2013].

> 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."[29]

The authors 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.

Armed with the resolution of the SAC, BNM issued Guidelines on Ibra' (Rebate) for Sale Based Financing.[30] While the SAC resolution did not specifically state that "early settlement" includes default cases, the Guidelines clearly says so. Paragraph 6 of the BNM Guidelines on Ibra' provides:

> "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."[31]

The authors opine 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 customer's entitlement to receive *ibra'* from Islamic financial institution. BNM will determine the *ibra'* formula.

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 judgement becomes obsolete. Since it is not reported, it would soon be forgotten. Hopefully, that is the approach that banks will take. It 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.

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 the conventional loan. *Shari'ah* reason 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. The Guidelines on Ibra' have been issued by BNM on January 31, 2013 and they are effective. If banks fail to comply, customers would raise

[29] Bank Negara Malaysia, *Shari'ah Resolutions in Islamic Finance*, Resolution No.78, 124.
[30] See BNM Guidelines on Ibra' (Rebate) for Sale Based Financing.
[31] See para.6 of the BNM Guidelines on Ibra'. Emphasis added.

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.