Malaysian banking: is the current practice of ibrāʾ (rebate) reflecting its true meaning?

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Abstract

Purpose – This paper aims to investigate the current regulation of ibrāʾ (rebate) set by the Central Bank for the Islamic banks in Malaysia and how far its original concept has been compromised to make it adaptable to the modern financial system.

Design/methodology/approach – This study, with regard to practising ibrāʾ in Islamic banking in Malaysia, is qualitative in nature, using semi-structured interviews carried out with two types of informant: members of either the National Sharīʿah Advisory Council (NSAC) or the Internal Sharīʿah Committee (SC). All data are analysed based on the content analysis method.

Findings – The findings reveal that while stipulating an ibrāʾ clause makes practising ibrāʾ stray from its original concept, it has successfully tackled the current problem. However, the long-term consequences should be a concern, particularly Islamic banking products, which have been significantly influenced by the conventional system, including interest rates and the debt structure, neither of which should be identified with Islamic banking.

Research limitations/implications – This study is limited because it focuses on the practice of ibrāʾ in Malaysian Islamic banking. Moreover, data are collected from nine interviewees from NSAC and SC from different Islamic banks. Thus, the results cannot be generalised to other countries.

Originality/value – This paper provides a fresh discussion of ibrāʾ from the perspective of regulators and the experience of practitioners in Malaysia, particularly in respect of aspects of Sharīʿah and current actual practice.

Keywords Islamic banking, ibrāʾ (rebate)

Paper type Research paper

Introduction

As one of the largest players in the Islamic banking world, Malaysia is actively promoting this industry through a comprehensive legal framework. The role of the Central Bank of Malaysia has undeniably contributed to this development (Hasan, 2011). Many regulations have been established to sustain the Islamic banking industry and to protect its customers. In other words, even though Islamic banking has proven its resilience since its first emergence, this industry is still struggling to adapt its systems to the modern banking industry, which seems not wholly conducive to its progress ISRA (2011).

A clear example would be introducing a floating rate for Islamic products. In general, financing in Islamic banks must be structured with a fixed-rate to avoid gharar (uncertainty), which is considered the principal fundamental prohibition in financial activities (Ariff and Iqbal, 2011). However, it is argued that fixed-rate financing can affect the competitiveness of Islamic banks, because it makes Islamic banks vulnerable to market volatility (Adawiah, 2006). Therefore, to preserve the viability of Islamic banking, it is suggested that variable rate financing be offered to customers and, to harmonise with
Islamic jurisprudence, a ceiling rate be introduced to avoid gharar in the contract (Lahsasna, 2014). As a result, the gap between the variable rate and the ceiling rate is considered ibrā’ (rebate) from Islamic banks towards their customers. For example, the selling price could be based on a profit rate of 10 per cent, but Islamic banks only require the current financing rate, which starts from 5 per cent. However, if this rate climbs to more than 10 per cent, Islamic banks will not charge more than 10 per cent (BNM, n.d.). (See Figure 1).

However, the significant role of ibrā’ is when customers make voluntary early settlement, or when they are declared in default. In both cases, ibrā’ is granted to release the Islamic bank’s future profits, also known as unearned profits, which takes effect between the settlement date and maturity date (Mohammaed Fairooz, 2013). Without ibrā’, customers need to pay the whole selling price, which is significantly high. For example, if the financing tenure is 10 years, but customers want to settle their debt in Year 7, Islamic banks only claim the principal amount, while their future profit will be released as ibrā’ (Figure 2). The situation is also similar in the case of default (Mohammaed Fairooz, 2013).

BNM (2013) issued a special regulation that Islamic banks must incorporate an ibrā’ clause, and its calculation, in their financing agreements. This decision is carried out on the basis of mašālah (public interest) to ensure that Islamic Financial Institutions (IFIs) honour the undertaking or promise to grant ibrā’ to their customers (BNM, 2013). In more detail, it is required for IFIs to accord ibrā’ to their customers who settle their debt obligation arising from sale-based contract prior to the agreed settlement period to eliminate any uncertainty with respect to the customer’s entitlement to receive ibrā’. The ibrā’ formula is standardised by the Central Bank (BNM, 2013).

On the one hand, this regulation seems to be contrary to the original concept of ibrā’, which should be based on the bank’s discretion (Dusuki et al., 2010). In fact, ibrā’ comes
under charitable contacts in Islam, such as *hibah* (gift). Moreover, other bodies, such as the International Fiqh Academy, have issued a similar resolution that *da‘ wa ta‘jil* (reducing the amount for early payment), which is the underlying concept of *ibrā‘*, is allowed as far as it is not agreed-upon in advance (*IIFA, 1992*). On the other hand, it is argued that the different approach by the Central Bank is aimed at protecting the *maslahah* (well-being) of customers and of Islamic banks themselves (*BNM, 2010*). In this regard, this paper attempts to investigate the current practice of *ibrā‘* from the perspective of law, Islamic jurisprudence and *maqasid al-Sharī‘ah*. As the data are retrieved from nine interviewees, the outcome may not fully represent the situation in the whole country.

**Literature review**

Technically speaking, *ibrā‘* is an action by lenders to withdraw their rights to collect the debt from their borrowers (*Mohamad and Trakic, 2013*). The discussion of *ibrā‘* among classical scholars can be classified as follows: *ibrā‘* must be carried out without condition; *ibrā‘* can be mentioned in the contract without being bilateral; and *ibrā‘* can be mentioned as a bilateral contract (*Dusuki et al., 2010*). However, the majority of scholars prefer the first one.

Over the period, practising *ibrā‘* has become the subject of serious discussion in Islamic banking. As its original concept is based on *tabarru‘* (voluntary donation), Islamic banks view granting *ibrā‘* as totally at their discretion (*Mohammaed Fairooz, 2013*). In other words, Islamic banks have full rights whether to give it or not, regardless of their customers’ circumstances. As a result, this practice has caused dissatisfaction among customers, especially when Islamic banks claim the full amount, including future profit in the case of default, which is significantly higher when compared to their conventional counterparts. According to the International Sharī‘ah Research Academy for Islamic Finance, between 2003 and the end of 2009, the majority of cases in the court regarding Islamic banks and their customers was because of *ibrā‘* (*Dusuki et al., 2010*).

To overcome this problem, the Central Bank of Malaysia has issued a special regulation that Islamic banks must incorporate an *ibrā‘* clause, and its calculation, in their financing agreements. This clause would require Islamic banks to honour the promise to grant *ibrā‘* to their customers (*BNM, 2007*). Abdul Hamid argued that this approach ends the major dissatisfaction towards Islamic banking regarding its demand for the “full purchase price” in the case of early settlement and default, because that was considered unjust and inequitable when compared with the amount that would have been paid under the conventional loan. He claimed this means that Islamic banking is adapting to be more relevant and, ironically in this case, it is the conventional system that is stimulating these developments (*Mohamad and Trakic, 2013*). At the same time, stipulating *ibrā‘*, which makes it bilateral, is important to avoid *ribā* (interest). In other words, the unearned profit collected by IFIs in the event of early settlement of a deferred sale price is considered *ribā* because it is a stipulated excess without a counter-value in a sale contract. Moreover, this approach is essential for IFIs to remain competitive with their conventional counterparts, as conventional financial institutions allow customers to pay the principal and accrued interest up to the date of early settlement only (*Abdul Khir, 2016*).

**Methodology**

As this paper is based on qualitative research, semi-structured interviews are the preferred research method on the issue of *ibrā‘* in Malaysia. This method is utilised as it is a practical
way to gather facts, attitudes and opinions, and to provide researchers with the opportunity to raise new issues that are important, through open-ended questions (Wilson, 2014). In this regard, interviews were conducted with three members of the NSAC of the Central Bank and six members of Internal Sharī‘ah Committees (SCs) from different Islamic banks: two Islamic subsidiaries of the conventional banks, two fully Islamic banks and two foreign Islamic banks. While NSAC’s perspective might focus on the aspect of regulation, because they represent the highest authority for the interpretation of Islamic financial rules in Malaysia, SC’s perspective comes from the real practice of ibrā‘ as they actively monitor the banking practices to ensure that they are compliant with Islamic rules. The interviewees are listed Table I.

After the process of transcription, the data are analysed based on the content analysis method. In fact, this method provides a systematic and objective means to make valid inferences from verbal, visual or written data to describe and quantify specific phenomena (Bengtsson, 2016). As a result, the researcher can achieve a comprehensive understanding of the practice of ibrā‘ through the experiences of interviewees and their opinions.

**Result**

*The response to the new regulation*

This study found that the ibrā‘ clause and its formula must be stated clearly in Islamic financial contractual agreements. All interviewees supported this requirement from the Central Bank of Malaysia because of previous problems in practising ibrā‘. However, they have different opinions with regard to those problems. For example, IV2, IV4, IV7 and IV8 blamed improper practice among Islamic banks. In more detail, IV2 claimed:

Islamic banks did not understand the practice of ibrā‘. Some of them, especially conventional banks who offered Islamic windows, didn’t even have a specific formula to calculate ibrā‘.

IV6, IV7 and IV9 believed that customers’ misunderstanding is the reason why ibrā‘ cannot be practised in its original concept (without mentioning the amount of ibrā‘ in the contract). Specifically, IV9 referred to non-Muslim customers who might not understand the Islamic financial system, as he said:

Obviously, many foreign non-Muslim customers complained when we didn’t clearly mention ibrā‘ in our financial agreement.

IV1 and IV8 took the view that the practice of ibrā‘ needs to be modified, as the previous formulation had experienced problems in terms of legal implications. IV1 commented:

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<tr>
<th>Interviewee</th>
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<tr>
<td>Interviewee 1 (IV1)</td>
<td>Member of NSAC</td>
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<tr>
<td>Interviewee 2 (IV2)</td>
<td>Member of NSAC</td>
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<td>Interviewee 3 (IV3)</td>
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<td>Interviewee 4 (IV4)</td>
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<td>Interviewee 5 (IV5)</td>
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<td>Interviewee 6 (IV6)</td>
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<td>Interviewee 7 (IV7)</td>
<td>SC</td>
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<tr>
<td>Interviewee 8 (IV8)</td>
<td>SC</td>
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<tr>
<td>Interviewee 9 (IV9)</td>
<td>SC</td>
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Table I. The list of interviewees
In fact, the Central Bank ordered all Islamic banks to mention the ibrā’ clause in their contracts due to a recent court judgement. In conventional practices, if the customer defaults, judges will determine the amount that needs to be paid to banks. If customers delay the payment, they will incur interest at a certain rate. However, when Islamic banks went to the court, they would claim the full amount (selling price), as judges cannot do like conventional banks because Islamic banks cannot take interest.

Ibrā’ from the perspective of Islamic jurisprudence

In general, all interviewees agreed that practising ibrā’ in Malaysia nowadays is different from its original concept, as understood from a reading of the majority of classical works of scholars. In this regard, IV1, IV3 and IV4 took the view that the significant difference between the two concepts is that the former requires the inclusion of ibrā’ in the contractual agreement. In contrast, in the original concept of ibrā’, this rebate is only granted on the day of maturity, without being determined upfront. As a result, as mentioned by IV1, there is no element of tabarru’ (of it being voluntary) in this practice, which represents its original objective:

Ibrā’ should be practised based on a charitable concept whereby it must not be mentioned in the contract. However, because of the order from the regulator (the Central Bank) to include an ibrā’ clause in the contract, it has affected the element of charity. Maybe, this is not ibrā’ anymore.

However, IV2, IV7 and IV8 believed that the modern ibrā’ is still being practised under the framework of Islamic jurisprudence, which means that there should be no Sharī’ah issues arising from the latest regulation introduced by the Central Bank. In more detail, IV2 claimed that what is being practised now is based on the view of some Hanafi scholars. Moreover, IV7 argued that Islamic jurisprudence is flexible as there are many opinions in respect of ibrā’.

Interestingly, IV3 and IV6 stated that the modern ibrā’ itself is not only different from its original concept in terms of the inclusion of its clause but also in its practice. The former argued that practising ibrā’ among Islamic banks nowadays is, in fact, influenced by the interest rate. As for IV6, he explained that in classical practice, ibrā’ was granted by lenders to release the principal amount of debt towards their borrowers. However, in current practice, he claimed, Islamic banks have already secured the principal amount, plus their profit, before granting ibrā’ to their customers for unearned profits. In other words, the practice of ibrā’ seems to adapt Islamic financial instruments, which should be fixed price, into something like the conventional system, based on uncertainty.

Stipulating an ibrā’ clause and its formula in contractual agreements from the perspective of maqāṣid al-Sharī’ah

All interviewees took the view that stipulating an ibrā’ clause, and its formula in the contract brings maslahah for both customers and Islamic banks, except IV4, who believed it brings maslahah only for customers. Regarding the maslahah of customers, this regulation promotes transparency and makes the financial agreement appear fair for both parties, especially when customers prefer to make early settlement, or in the case of default. As for the maslahah of Islamic banks, this decision has improved their image, because people used to claim their products were expensive, and that their approach towards defaulting customers was inconsiderate in claiming the whole selling price. Moreover, regarding the previous practice of ibrā’, when Islamic banks used the phrase “banks may grant ibrā’” in
their contract, it led to serious problems, especially when it came to the court, due to the lack of certainty.

Many interviewees believed that the environment of the modern banking system has affected the original maslahah of ibrā’. This includes the intervention of the Central Bank, the long-term financing tenure of Islamic products, the legal implications and different practices of ibrā’ itself, because it aims to waive unearned profit, instead of releasing the debt principal. In other words, it is a complicated system instead of a financial agreement between two parties. Other interviewees argued that in the current situation, maslahah to protect customers should be prioritised.

In terms of the achievement of maslahah, it is clear that the majority of interviewees agreed that stipulating an ibrā’ clause in the contract is a practical solution to the current problem. However, IV4 and IV9 believed that ibrā’ needs to be returned to its original concept. The former argued as follows:

Based on classical fiqh al-Islāmī, ibrā’ is a part of charitable contracts. Thus, how can we enforce it before the right situation has occurred? For me, the Central Bank just considered one side, which is customers. I think they should establish internal rules for Islamic banks to practise ibrā’, instead of disclosing it to customers. So, we can harmonise between fiqh al-Islāmī and the regulator’s aspiration.

IV9 came up with a solution to this issue:

For me, if we want to find an alternative, include the ibrā’ into the selling price. Make it like pure murābāhah (mark-up selling). The problem is when we introduce the ceiling rate, which makes the selling price skyrocket. In fact, ibrā’ emerged because of the ceiling rate.

Data analysis

It is learnt that stipulating an ibrā’ clause and its formula has been imposed as a regulation by the Central Bank of Malaysia due to negative consequences of its previous practice. This includes several court cases between Islamic banks and their customers, the weak SOP among Islamic banks in practising ibrā’ and the negative perception among judges when Islamic banks claimed the whole amount from defaulted customers. In fact, before stipulating ibrā’ was required by the rules, judges tried to render this practice fair and equitable through their judgements. For example, in the case Arab-Malaysian Merchant Bank Bhd v. Silver Concept Sdn Bhd, the judge ruled:

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”. (A.M.R. 381)

Meanwhile, in the case of Affin Bank Bhd v. Zulkifli bin Abdullah, the judge also explained why ibrā’ must be granted, as unearned profit was no longer relevant:

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. (Affin Bank bhd vs Zulkifli Abdullah, 2006)

From the perspective of maqāṣid al-Sharī‘ah (objective of Islamic law), the Central Bank of Malaysia argued this decision was carried out to protect maslahah of customers. Technically speaking, maslahah can be defined as an attribute of an act that realises benefits
which always or usually benefit the public or individuals (Bin al-ʿAshūr, 2001). This concept represents the wisdom that is emphasised by God in his rules (Al-Yūbī, 1998). Thus, instead of being restricted to literal textual meaning, verses pertaining to a rule in Islamic sources, namely, the Qurʾān and the Hadīth, must be engaged implicitly and understood in the right context, particularly what maṣlaḥah is behind the rule (Al-Kālāmī, 2008). In other words, outcomes of rules also need to be considered as to how far they bring maṣlaḥah in reality (Al-Raʾisūnī, 1995).

It should be understood that maṣlaḥah or maqāṣid al-Sharīʿah is a wide topic, the subject of detailed discussions within Islamic jurisprudence. However, for this discussion, two perspective of maṣlaḥah can be analysed:

1) **Priority of maṣlaḥah**: In fact, to achieve the more important maṣlaḥah, in some cases, the less important maṣlaḥah needs to be compromised. In the case of ibrāʾ, the maṣlaḥah of transparency between contracting parties must be considered a priority, instead of the original maṣlaḥah of ibrāʾ, which is to show benevolence. In other words, the former represents general maṣlaḥah, which affects both the customers’ interest and the viability of the Islamic banking industry, while the latter only involves two contracting parties.

2) **Harm must be eliminated**: Applying rules must not only consider their maṣlaḥah but also their mafsadah (harm) during implementation. In this regard, the effort should begin with tackling the current mafsadah before it becomes worse. In the case of the previous practice of ibrāʾ, many disputes between Islamic banks and their customers occurred because of the unclear and unfair practice of ibrāʾ. It was a mafsadah that had the potential to become more serious in terms of public confidence towards Islamic banking industry.

Thus, it can be concluded that the Central Bank of Malaysia has taken the right decision for the sake of the Islamic banking industry and its customers. Nevertheless, it should be noted that the real issue here is not the way of practising ibrāʾ, but the structure of Islamic products themselves. While Islamic banks have been established more than a half-century, their products are being significantly influenced by interest rates, as well as in respect of debt structure, like conventional contracts. On top of that, controversial contracts such as tawarruq (monetisation), bayʿ bithāman ājīl (deferred payment sale) and bayʿ al-ʿInah (sale and buyback) are still preferred by Islamic banks as their main financing. In fact, those controversial contracts are at risk of being declared void or non-Sharīʿah compliant. Therefore, for the sake of long-term consequences, Islamic banking players must strengthen their effort to establish a better concept of financing for Islamic banking. For example, with equity-based products like a mushārakah (partnership) contract where there is no ibrāʾ in its practice. In fact, without a proper theoretical structure to Islamic products, there will be negative consequences in term of their implementation and towards the viability of Islamic banking itself.

**Conclusion**

This paper has attempted to investigate the practice of ibrāʾ in Malaysia from the perspective of NSAC and SC. It can be understood that practising ibrāʾ in Malaysia is unique, following the establishment of a special regulation to require IFIs to include an ibrāʾ clause and its formula clearly in their financial contracts. To summarise, it can be concluded that implementing ibrāʾ seems to adapt Islamic banking products to the modern financial system, particularly to engage with the impact of floating interest rates. It also acts as a special mechanism in the case of early settlement and default, for the sake of fairness and equity among contracting parties; thus it needs to be mentioned
upfront in any agreement. Nevertheless, this regulation undeniably makes the current practice of ibrā’ depart from its original concept. While this approach has already solved the current problem between Islamic banks and their customers in Malaysia, it might encourage Islamic banks to offer debt-based financing, something that should not form part of the identity of this industry.

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