

Response to feedback received

Qard

Introduction

As part of a series of policies under the Shariah contract-based regulatory framework, the policy document on *Qard* outlines Shariah and operational requirements of *qard* to promote sound application of this Shariah contract in Islamic financial products and services. The policy document also specifies transition requirements that are applicable to existing *wadi'ah yad dhamanah* products involving fungible assets to comply with *qard* requirements.

The Bank received a significant number of responses from Islamic financial institutions, industry associations and regulatory bodies during the consultation period that are broadly supportive of the proposals outlined in the concept paper. Several respondents highlighted implications of key proposals as set out in the concept paper that will require operational adjustments. A series of discussions with industry representatives were held to further resolve issues faced by the industry. This document provides responses to the comments received in the course of the consultation process. Where appropriate, the comments received on the concept paper have been reflected in the final policy document.

Bank Negara Malaysia

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1. Conditions for granting contractual benefit by a borrower to a lender

- 1.1 The concept paper specifically prohibits a borrower from granting any contractual benefit to a lender and provides a non-exhaustive list of arrangements in the *qard* contract that would not be allowed. Many respondents requested for more clarity on the scope of prohibition to ascertain the permissibility of current product propositions such as priority banking and promotional *hibah* practices. Several respondents highlighted challenges to comply with this Shariah requirement, given stiff competition in the current market environment to grow Islamic deposits.
- 1.2 Following from the industry's comments, the Shariah Advisory Council of Bank Negara Malaysia (SAC) clarified its earlier Shariah resolution that the prohibition on the borrower from granting contractual benefit to the lender is referring to any contractual benefit which is dependent on the *qard* contract, derived based on the *qard* amount or provided exclusively to the lender as it will lead to *riba* (usury). A contractual benefit that is generic in nature and not exclusively offered to the lender (i.e. *qard* account holder) is permissible, provided that such contractual benefit is not stipulated in the *qard* contract.
- 1.3 The final policy document prescribes a definition of "contractual benefit" that emphasises on the legal obligation of a borrower to give incentives, gifts or privileges to the lender under the *qard* contract or any other contracts that relate exclusively to the *qard*. The granting of *hibah* based on discretion of Islamic financial institutions continues to be permissible and can be optimised to create value for customers.
- 1.4 The Bank is aware that several Islamic deposit products based on *qard* (or existing *wadi'ah yad dhamanah*), including current accounts, savings accounts and treasury products may need to be revised to comply with the policy document. In this regard, a 24-month transition period has been provided in the policy document for the Islamic financial institutions to review its legal documentation, marketing strategies and materials, internal policies and standard operating procedures to comply with this Shariah requirement.

2. Disclosure of historical information of *hibah* granted

- 2.1 The concept paper contains standards that prohibit any disclosure of indicative rate of *hibah* and usage of historical information on *hibah* granted to promote or market *qard*. Islamic financial institutions are allowed to disclose historical information of *hibah* granted only for purpose of market transparency. Many Islamic financial institutions raised concerns about the difficulty to distinguish between disclosures that are allowed and disclosures that would trigger non-compliance with Shariah requirements, in particular disclosures that would be rendered as indirectly promoting *qard* by creating legitimate expectation for the *hibah* to be granted to the customer.
- 2.2 After deliberating on the above comments from industry, SAC has resolved to allow any disclosure of historical *hibah* granted with conditions that such disclosure must not be construed as an indicative *hibah* or give rise to any obligation on the part of the borrower to provide such *hibah* to the lender.

- 2.3 Several Islamic financial institutions also sought clarification on the difference between indicative rate of *hibah* and historical *hibah* granted. From the Bank's perspective, indicative rate of *hibah* is a rate representing the future prospect of return payable to the customers for money placed with the bank where the rate may be determined based on previous performance or the Islamic financial institution's projection of the future return. In contrast, historical *hibah* granted is the actual *hibah* paid to the customers in the past.
- 2.4 Majority of respondents also suggested that disclosure of *hibah* historical granted should not be made compulsory to cater for differing promotional strategies of each Islamic financial institution. The majority however agreed that the disclaimer should be made compulsory to promote better understanding of the *qard* contractual terms and protect Islamic financial institutions from any legal liability to grant *hibah* according to the disclosed historical rate.
- 2.5 Given the importance placed by SAC on the operationalisation of the conditions stated above, the final policy document stipulates operational requirements applicable to Islamic financial institutions that choose to disclose historical *hibah* granted, namely, to use actual *hibah* rate and to accompany such disclosure with a clear disclaimer that negates any legal liability on the part of Islamic financial institutions to grant *hibah* according to the disclosed historical rate.

3. Acceptance of funds from Shariah non-compliant sources

- 3.1 Several Islamic financial institutions suggested a review of the Shariah requirement to reject placement of money from Shariah non-compliant sources as reflected in the concept paper citing *khilaf* (differences of opinion) among Shariah scholars on the permissibility of such practice. Industry also requested clarification on the permissibility of accepting funds that are mixed between Shariah compliant and Shariah non-compliant sources.
- 3.2 SAC in its recent resolution has recognised that, in principle, it is permissible for Islamic financial institutions to accept funds from Shariah non-compliant sources, given their role as financial intermediaries. As such, the policy document has been revised to require Islamic financial institutions to formulate an internal policy on the acceptance of funds for deposits or other liabilities, which must be approved by the Board and endorsed by the Shariah Committee, to ensure no direct involvement by Islamic financial institutions in any unrighteous activities (*wala ta`awanu `alal ithmi wan `udwaan*) that could have adverse impact on their reputation.

4. Fees and charges

- 4.1 The concept paper required the Islamic financial institutions to develop a parameter for the determination of actual cost that are chargeable to customers based on the actual amount paid or expenses incurred in completing the *qard* transaction. Majority of respondents asserted that they do not currently have specific internal policies on actual costs of completing *qard* transaction and sought further clarification on determination of actual costs.

- 4.2 Following from the industry's comments, the Bank decided to adopt the concept of "direct cost", replacing previous references to actual cost. In making this revision, the Bank took into account practical challenge of ascertaining actual cost at transactional level (which may vary from customer to customer) and the use of estimates by Islamic financial institutions in submission of fees and charges for the Bank's approval.
- 4.3 The relevant Shariah requirements in the policy document are further clarified to differentiate between imposition of fees and charges reflecting direct costs for identified services, benefits and privileges that relate to the *qard* and imposition of *ujrah* (fees, which may contain profit or mark-up element) for identified services, benefits and privileges that do not relate to the *qard*. From Shariah perspective, this distinction is critical to avoid imposition of fees that may lead to *riba*.
- 4.4 The requirement to establish detailed parameters on actual costs has been replaced with an obligation on Islamic financial institutions to establish an internal policy on fees and charges that needs to be endorsed by their Shariah Committee. For identified services, benefits and privileges that relate to the *qard*, the Shariah Committee must be satisfied that such fees or charges do not contain any profit or mark-up element.
- 4.5 Several Islamic financial institutions also sought clarification on the permissibility of imposing mark-up fee charged by the operator of international payment card networks (the operators e.g. Visa and Mastercard) for transactions in foreign countries. In this regard, an Islamic financial institution is allowed to impose such fees charged by the operator of international payment card networks if they form part of the direct costs involved for the services rendered. In addition, for credit card transactions in currency other than Ringgit Malaysia, there is a mark-up fee charged by the operator to cover foreign currency conversion cost due to fluctuation of the exchange rate. In this case, the fee shall be construed as the fee in providing identified services, benefits or privileges (i.e. currency conversion) which is permissible.

5. Applicability of the policy document on deficiency rectification of Participants' Risk Fund (PRF)

- 5.1 Several takaful operators sought further clarity on the applicability of the policy document on *Qard* to rectify deficit in PRF, in particular, the elements of contracting parties, offer and acceptance of the *qard* contract, charges on the *qard* amount including late payment charges, and the completion of *qard* contract.
- 5.2 All of the general Shariah requirements in the policy document would be applicable to deficiency rectification of the PRF. However, the corresponding operational requirements of the *qard* contract in takaful will be further elaborated in the Guidelines on Takaful Operational Framework.
- 5.3 Takaful operators and retakaful operators must observe all applicable policy documents such as Guidelines on Takaful Operational Framework and *Wakalah*, which must be read together with SAC resolutions on *qard* as mechanism to rectify deficit in PRF.

6. Third party guarantee

- 6.1 The concept paper initially stipulated that money placed by a customer under a *qard* contract must be guaranteed by the Islamic financial institution. Several Islamic financial institutions sought clarification on whether the money borrowed may be guaranteed by a third party.
- 6.2 The policy document has been revised to reflect more accurately the nature of the the Islamic financial institution's obligation to repay the money borrowed in full and incorporate a guidance in paragraph 13.3 that the obligation to repay the money borrowed may be secured through arrangement such as third party guarantee (*kafalah*), pledge/charge (*rahn*) and takaful.