

Response to feedback received

Ijarah

Introduction

The Bank has finalised the policy document on *Ijarah* incorporating the policy requirements stipulated in the concept paper and taking into account the feedback received during the consultation period and the developments taking place until the issuance of the policy document.

The Bank has received written responses from financial institutions and industry associations during the consultation period. A series of engagement sessions were also conducted to allow for a more focused and in-depth discussions on issues and the proposed requirements.

The Bank appreciates the feedback and suggestions received throughout these periods. Key comments received and the Bank's responses are provided in the following sections. Other comments and suggestions for clarification have been incorporated in the final policy where appropriate.

Bank Negara Malaysia
19 August 2016

1. Mechanism to transfer the ownership of asset upon maturity

- 1.1 The Concept Paper (CP) proposed several mechanisms that can be used to transfer the asset ownership upon maturity in structuring an *ijarah* financing and sought comments on standardising the mechanism to conditional *hibah* by the IFIs given that the customer would already settle all financial obligations.
- 1.2 Some respondents highlighted that the customer may be unfamiliar with the conditional *hibah* as the use of *wa'd* to purchase by customer is a more common mechanism and widely used by the industry. In addition, the scope of coverage of *hibah* in the Hire-Purchase Act 1967 (HPA) is currently under the review of Kementerian Perdagangan Dalam Negeri, Koperasi dan Kepenggunaan (KPDNKK).
- 1.3 To ensure operational efficiency of IFIs and promote product innovation, the final policy document provides the flexibility for the IFIs to adopt several mechanisms to reflect the customer's intention to own the asset or the IFIs' intention to transfer the ownership of the asset to the customer upon maturity.

2. Operational requirements in the case of customer's demise

- 2.1 Upon demise of either the contracting parties, Shariah provides the right to the legal heirs to either continue or discontinue the *ijarah* contract i.e. neither *ijarah* becomes an inherited debt, nor does demise trigger the dissolution of *ijarah* contract.
- 2.2 There were mixed practices in the industry related to the settlement and resolution mechanism in the case of demise of customer. However, majority of respondents treats *ijarah* financing similar to debt-based financing where the *ijarah* financing obligation is considered as liability of the heirs or triggers the purchase undertaking.
- 2.3 To ensure that market practices are in line with the Shariah requirements, the final policy document provides further guidance for IFIs to determine the appropriate resolution mechanism due to the demise of the customer that include the following:
 - (a) to claim from the takaful¹ (if any) the outstanding amount due from the deceased customer;
 - (b) to incorporate specific provision in the *ijarah* financing agreement to enable the legal heir of the deceased to continue with the *ijarah*; or
 - (c) in the case where the legal heir opts to discontinue with the *ijarah* financing, the IFIs may repossess the leased asset and terminate the *ijarah* contract.

¹ For example, takaful credit protection scheme, reducing takaful or mortgage reducing term takaful.

3. Treatment of total loss due to *force majeure* events

- 3.1 Shariah requires the lessor to be responsible to restore the usufruct of an impaired *ijarah* asset, which commensurate with the right of the lessor in the ownership of the *ijarah* asset. However, both the lessor and the lessee may mutually agree to obtain takaful coverage for the leased asset and identify the party(ies) who will bear the cost of takaful. In addition, Shariah also ruled that the *ijarah* dissolves if the leased asset is completely destroyed unless there is a prior arrangement for the lessor to replace or substitute the damaged leased asset.
- 3.2 The industry sought for clarification to ascertain the permissibility of the existing practice of *force majeure* resolution in the case of AITAB. The IFIs highlighted that the existing AITAB financing agreement provided the option for the IFIs to sell the completely damaged asset following *force majeure* events to the lessee by invoking the *wa'd* (promise) to purchase that is provided by the lessee.
- 3.3 In line with Shariah requirements, the final policy document provides clarification that the IFIs are disallowed to invoke the *wa'd* to purchase the completely damaged asset due to *force majeure* events. The policy document emphasizes that the IFIs need to explore and establish appropriate resolution mechanism to address potential losses from such incidences, which may include employing a takaful coverage for specific risk events such as flood.

4. Legal certainty of AITAB

- 4.1 Some respondents sought clarification on the legal certainty of AITAB, given that the current HPA which governs hire purchase transactions does not address Islamic hire purchase. There are several HPA provisions that are inconsistent with Shariah such as the execution of two contracts of hire and purchase simultaneously in an agreement and the imposition of interest charges.
- 4.2 While the initiatives spearheaded by KPDNKK to revise the HPA to include provisions to cater for Islamic hire purchase is on-going, the issuance of the policy document shall enhance the legal certainty of the AITAB given that the rulings of Shariah Advisory Council (SAC) has legal standing under the Central Bank of Malaysia Act 2009 and the Islamic Financial Services Act 2013.