

Response to feedback received

Rahn

Introduction

The Bank has finalised the policy document on *Rahn* (collateral) incorporating the policy requirements stipulated in the exposure draft (ED) and taking into account the feedback received during the consultation period.

The Bank received written feedback from Islamic financial institutions (IFIs) that are broadly supportive of the proposals set out in the ED. The key comments provided by the IFIs and the Bank's responses are set out in this document.

The Bank appreciates the feedback and suggestions received and wishes to thank all respondents.

Bank Negara Malaysia
18 July 2018

1 Scope and applicability of the policy document on IFI

- 1.1 The ED proposed for the policy document to be applicable to an IFI that offers products or services which apply *rahn* contract.
- 1.2 The Bank received feedback seeking clarifications whether the policy document is applicable to an IFI that–
 - a. offers Islamic pawnbroking product *i.e.* Ar Rahnu only; and
 - b. applies *rahn* contract in financing offered to its employees that is not part of its products or services.
- 1.3 The Bank wishes to reiterate the following:
 - a. The policy document is applicable to an IFI that uses the *rahn* contract for its products and services, including Ar Rahnu; and
 - b. IFI may adopt the requirements of the policy document for financing facilities offered to its employees.

2 Deposit placement as collateral

- 2.1 Some of the respondents sought confirmation on whether customer's asset in the form of deposit or investment account can be pledged as collateral (*marhun*) and whether the deposit can be utilised by the IFI (as pledgee).
- 2.2 The Shariah Advisory Council of Bank Negara Malaysia (SAC) has resolved to allow the practice of accepting deposits or investment accounts to secure a financing obligation.
- 2.3 The SAC at its 182nd meeting dated 28 November 2017 ruled that the deposit can be utilised by IFI (as pledgee) with the consent of customers (as pledgor), subject to the following conditions:
 - a. Customer is allowed to choose any type of account, including deposit or investment account as collateral against the payment of financing obligation; and
 - b. The financial obligation or liability owed by the customer to the IFI does not arise from a loan (*qard*) contract.

3 Allowable expenses to be charged to customers

- 3.1 In line with the SAC's ruling, the ED proposed for any expenses charged to customers must be based on cost that is directly related to *rahn* contract only *i.e.* without profit element.
- 3.2 In relation to paragraphs 16, 29.12 and 29.13 of the policy document, some of the respondents highlighted challenges to determine and measure the expenses directly related to *rahn* contract.
- 3.3 The Bank wishes to emphasise that an IFI may only charge the customer for any identified costs, either actual or estimated amount, that are directly related to *rahn* transaction *e.g.* fee for valuation of collateral. In line with paragraph 33.1, the IFI must review and ensure existing and prospective charges imposed on customer meet this requirement. From this review exercise, the Bank does not expect any increment to the current fees and charges imposed to the customer. IFIs shall be guided by the principles set forth under the Guidelines on Imposition of Fees and Charges on Financial Products and Services.

4 Usability of existing collateral documentation

- 4.1 Under paragraph 29.19 of the policy document, documentation on collateral must include terms that reflect *rahn* transaction and IFI's risk management strategies such as contractual relationship, expenses, terms on liquidation and redemption and rights for IFI to undertake mitigation actions.
- 4.2 Some of the respondents sought clarification–
 - a. whether existing documentation on collateral can be used; and
 - b. on the treatment if the documentation requirements under this policy document contradict with the documentation requirements under various regulations such as charge document that is governed under National Land Code.
- 4.3 The Bank wishes to clarify that existing collateral documentation may be used subject to fulfilling the documentation requirements set forth under this policy document. Where lacking, the IFI may enhance the collateral documentation or supplement with additional documentation. The Bank expects the IFI to undertake assessment and highlight any legal impediments to implement the documentation requirements to the Bank in the implementation plan under paragraph 33.15.

5 Requirement to document consent from IFI, customer or third party pledgor

- 5.1 From Shariah perspective, consent is required to be obtained from the IFI, customer or third party pledgor for certain events e.g. when IFI wishes to utilise the collateral and appoints a party to perform liquidation of collateral. Under paragraph 29.20 of the policy document, such consent must be documented.
- 5.2 Some of the respondents are of the view that the requirement to document consent is irrelevant.
- 5.3 The Bank wishes to emphasise that the requirement for consent to be documented–
- (a) is in line with Shariah requirements;
 - (b) aims to protect the rights of contracting parties; and
 - (c) is only applicable for the events specified in the policy document.

6 Requirement for disclosure of information

- 6.1 Under paragraph 31.3(a) of the policy document, an IFI must inform the customer or third party pledgor at the pre-contractual stage that consent will be sought upon entering the contract in the event where the IFI will utilise the collateral. The ED also proposed for an IFI to disclose the terms of utilisation of collateral such as the purpose, duration and treatment of benefit and liability arising from such utilisation of collateral.
- 6.2 Some of the respondents opine that the information required to be disclosed is too granular and impractical especially when similar information will be disclosed upon entering the contract.
- 6.3 The Bank wishes to reiterate that customer or third party pledgor should be informed or made aware before entering the contract that the IFI will utilise the collateral. Nonetheless, the Bank takes cognisance on the potential challenges for IFI to disclose the proposed information and the need to strike the balance between practicality and disclosure of information. Therefore, the Bank has refined the requirement for the IFI to inform customer or third party pledgor that consent for such utilisation will be sought upon entering the contract. Furthermore, terms on utilisation and consent shall be disclosed and stipulated in the contract in line with the requirement under paragraph 29.19(g)(iv).

7 Requirement for financial disclosure

- 7.1 The ED proposed for separate disclosure of the *qard* (loan) amount and safekeeping fee in respect of Islamic pawnbroking product *i.e.* Ar Rahnū in the financial statement.
- 7.2 Some of the respondents are of the view that such disclosure would not accurately reflect the nature of Islamic pawnbroking transaction.
- 7.3 The Bank wishes to clarify that the requirement for separate disclosure of the loan amount and safekeeping fee for Islamic pawnbroking product is to reflect the nature of the safekeeping fee that does not arise from the provision of loan. In that regard, the Bank expects the IFI to ensure disclosure of Islamic pawnbroking transaction is in line with the requirements under Malaysian Financial Reporting Standards¹ (MFRS) and Guidelines on Financial Reporting for Licensed Islamic Bank.

¹ Including but not limited to MFRS 7 – Financial instruments: Disclosures and MFRS 9 – Financial Instruments.