The Shariah Advisory Council of Bank Negara Malaysia (SAC) Ruling on the Shariah Parameters on Transfer of Funds for Funding and Liquidity Risk Management from an Islamic Financial Institution to a Conventional Financial Institution

217th SAC Meeting dated 30 September 2021, 220th SAC Meeting dated 24 January 2022 and 236th SAC Meeting dated 30 January 2024[1]

Part I: SAC Ruling, Its Effective Date and Applicability

Pursuant to section 52 of the Central Bank of Malaysia Act 2009, the SAC ruled that the following parameters shall be complied with by Islamic financial Institutions (IFIs) in determining the permissibility of transfer of funds for funding and liquidity risk management, from an IFI to a conventional financial institution (CFI):

1. In principle, any form of funds transfer from an IFI to a CFI is not permissible as the latter does not carry on financial business in accordance with Shariah unless there is certainty (*al-yaqin*) or high probability (*ghalib al-zann*) that the fund will not be used for non-Shariah compliant activities.

2. Notwithstanding paragraph 1 above, the transfer of funds from an IFI to a CFI either within the same group or otherwise which aims to address a hardship situation is permissible subject to the fulfilment of the requirements as specified in *Hajah* and *Darurah* Policy Document (HD PD)[2]. This include but not limited to the definition of hardship, preconditions in applying *hajah* and *darurah*, the scope of prohibited application, parameters of *hajah* type 1, *hajah* type 2, and *darurah*.

3. In relation to paragraph 2 above, the SAC has resolved that the following transactions involving the transfer of funds from an IFI to a CFI are permissible as they fall under the following types of *hajah*:
   (i) use of conventional nostro account: *hajah* type 1; and
   (ii) transfer of funds or the excess high quality liquid assets (HQLA) to other financial entities within the same group including its conventional parent bank during a stress scenario: *hajah* type 2.

[1] Issuance of this statement is subsequent to the issuance of *Hajah* and *Darurah* Policy Document (HD PD) and it provides further clarity to the IFIs in complying with the HD PD and to ensure the effective application of *hajah* by the IFIs.

[2] Issued by BNM on 3 January 2024.

1.1. This ruling is effective on its publication date on the Bank Negara Malaysia's website and is applicable to the following IFIs:

(a) licensed Islamic banks under the Islamic Financial Services Act 2013 (IFSA);
(b) licensed banks and licensed investment banks approved under section 15(1) of the Financial Services Act 2013 (FSA) to carry on Islamic banking business; and
(c) prescribed institutions approved under section 33B(1) of the Development Financial Institutions Act 2002 (DFIA) to carry on Islamic financial business.

1.2. In line with section 28(1) and (2) IFSA or section 33D(1) and (2) DFIA, as the case may be, IFIs are required to comply with this ruling as compliance with any ruling of the SAC in respect of any particular aim and operation, business, affair or activity of IFIs shall be deemed to be in compliance with Shariah.

Part II: Background

2.1. It is an uncommon practice for an IFI to transfer its funds to a CFI as IFI operations must be Shariah-compliant. However, there are circumstances that necessitate the transfer of an IFI funds to a CFI be it in a normal situation or a stress situation[3]. Under a normal situation, the transfer may be needed to facilitate niche transactions or market-based transactions where the IFI has no market presence or no viable solutions. Example of activity that can occur in a normal situation or stress situation is as follows:

- **Use of a conventional nostro account**
  The necessity to perform transactions via conventional nostro accounts is due to lack of Shariah compliant nostro accounts available in other jurisdictions, or adhering to group risk management policy and efficiency. The transactions performed via nostro accounts are generally for facilitating international trade and foreign exchange transactions where a minimal balance is kept at the end of the day. In addition, nostro account balances typically earn no or minimal returns.

2.2. In the context of a financial group, the transfer of IFI's fund to a CFI may be plausible in a stress situation given the importance of swiftly managing contagion risk and the growing significance of IFI within the group arising from its persistent and rapid growth relative to the overall group. Example of transaction that can occur in a stress situation is as follows:

- **Managing contagion risk from a liquidity stress**
  In managing contagion risk arising from a liquidity stress[4] situation of another financial entity within the group, particularly its conventional parent bank, an IFI may be compelled to transfer funds or the excess HQLA to the other financial entity to avoid spillover effect to the IFI.

[3] Among others includes:
a) a system wide stress scenario, incorporating events that materially affect the functioning of the real economy and financial system;
(b) an idiosyncratic stress scenario, incorporating events that are institution specific and can directly threaten the business and operations of specific significant entities, core business lines or the entire banking institution; and
(c) a combined stress scenario, in which the system wide and idiosyncratic stress events interact and occur simultaneously.

[4] Refers to a stress event that hampers the ability of the entity to meet short and long term liquidity obligations.

2.3. The SAC opined that there is a need to set out parameters to be complied with by IFIs in determining the permissibility of transferring funds to a CFI, which will be applied on a case-by-case basis.

Shariah Issues

2.4. Taking into account the situations which necessitate the transfer of IFI's funds to a CFI whilst acknowledging the general Shariah prohibition of involvement in forbidden activities, a specific study was commissioned. Among the Shariah questions that need to be answered are:

i) what are the features or scope of mutual assistance (*ta`awun*) that are not allowed by Shariah?;
ii) what is the Shariah basis that can be considered to allow the transfer of IFI's funds to a CFI and specific conditions that need to be fulfilled?; and
iii) are there other Shariah considerations regarding the transfer of an IFI's funds to a CFI within the group during stress scenario?

Part III: Key Discussion

Key conditions considered in establishing the parameters

3.1. The permissibility of a transaction is assessed based on its compliance with Shariah requirements and the purpose of such transaction being concluded. In general, a transaction is permissible if the contracting parties have the capacity (*ahliyyah*) to transact, the transaction complies with all the salient features and essential conditions of the contract and it does not involve elements that are prohibited by Shariah.

3.2. Given that a CFI's core activities are clearly non-Shariah compliant, any consideration to allow the transfer of funds by an IFI to a CFI requires not only in-depth study but also careful consideration on its far-reaching implication to the overall Islamic finance philosophy.

3.3. The study is vital given the variety of possible scenarios of fund transfers involving different transactions. A set of adequately defined parameters and conditions will provide clarity and that ensure consistency in assessing these scenarios. Various aspects have to be considered including business needs, and risk management during stress events.

3.4. Two (2) main factors have been identified in formulating the Shariah parameters for the transfer of funds of an IFI to a CFI. These factors are the:

i) IFIs' funds must be used for Shariah compliant activities only; and
ii) exception to the general non permissibility of funds transfer from an IFI to a CFI must be based on *hajah* and *darurah* requirements.

Condition (1): IFI's funds must be used for Shariah compliant activities only

3.5. An IFI must ensure that its funds are only to be used for Shariah compliant activities. Therefore, in principle, any form of funds transfer from an IFI to a CFI is not permissible as CFI carries on business that is not in compliance with Shariah.

3.6. However, transferring of funds by an IFI to a CFI for the purpose of Shariah compliant activities is permitted. For example, an IFI is allowed to subscribe to a sukuk issued by a CFI where the proceeds from the sukuk is used to finance investments in Shariah compliant activities including investing in Islamic financial instruments.

3.7. The transfer of funds by an IFI to a CFI by providing capital (paid-up ordinary shares) either in a normal or a stress situation is not permitted as it will lead to a direct involvement of the IFI in forbidden activities.

Condition (2): Exception to the general non permissibility of funds transfer from an IFI to a CFI must be based on hajah and darurah requirements

3.8. Exception based on *hajah* principle can be considered in a situation of hardship that will be detrimental to the IFI. In this regard, it may be permissible if the transfer is to facilitate customers' transactions in markets where there is a lack of Shariah compliant infrastructure available. For instance, facilitating international trade transactions via conventional nostro accounts given the absence or limited availability of Shariah compliant nostro accounts in most jurisdictions.

3.9. Temporary exceptional rule based on *hajah* principle can also be considered as a basis in allowing the transfer of IFI funds to a CFI within the group during a stress situation that may otherwise be detrimental to the safety and soundness of the financial institutions within the group including the IFI itself.

3.10. The IFI as an entity within the group can be well positioned to provide financial assistance during a stress event of other financial entities within the group including its conventional parent bank by transferring its funds or excess HQLA to them. The assistance provided is important to avoid the contagion risk to the IFI should the stress scenario become more serious and severe to the detriment of the group, including the IFI. This takes into account interdependences on critical shared services, access to financial market infrastructures, and reputation of their conventional parent bank to obtain funding and carry out banking business.

Effect of permissibility of funds transfer during stress scenario

3.11. The ruling provides clarity to the industry regarding the Shariah permissibility to transfer funds or excess HQLA from an IFI to a CFI within the same group, including its parent, especially during liquidity stress, based on *hajah* type 2 parameters. Consequently, this Shariah permissibility facilitates the industry's assessment on transferability restriction and encumbrance of IFI's excess HQLA for purposes of computing the group's consolidated level Liquidity Coverage Ratio (LCR)[5].

[5] Liquidity Coverage Ratio is a quantitative requirement which seeks to ensure that a banking institution holds sufficient HQLA to withstand an acute liquidity stress scenario over a 30-day horizon. This requirement is applicable at both the entity and consolidated levels. Financial institutions shall refer to paragraph 12 of the Liquidity Coverage Ratio Policy Document for detailed requirement on encumbrance and transferability of assets.

Part IV: Basis of Ruling

Condition (1): IFIs' funds must be used for Shariah compliant activities only

4.1. In general, mutual assistance is permissible except in matters that are prohibited by Shariah. In this regard, al-Qur'an forbids mutual assistance in matters that are prohibited as evidenced by the following verse of al-Qur'an:

وَلَا تَعَاوَنُوْا عَلَى الْاِثْمِ وَالْعُدْوَانِ[6]

"...and do not help one another in what is wicked and sinful..."

4.2. The prohibition of mutual assistance in non-Shariah compliant matters is further reinforced by the following hadith which prohibits the involvement of a person in alcohol-related activities.

عن أنس بن مالك قال لعن رسول الله صلى الله عليه وسلم في الخمر عشرة عاصرها ومعتصرها وشاربها وحاملها والمحمولة إليه وساقيها وبائعها وآكل ثمنها والمشتري لها والمشتراة له

"It was narrated by Anas bin Malik RA that: Prophet PBUH cursed ten people with regard to alcohol: the one who squeezes, the one for whom it is squeezed, the one who drinks it, the one who carries it, the one to whom it is carried, the one who pours it, the one who sells it and consumes its price, the one who buys it and the one for whom it is bought. (Sunan Tirmizi:1295)

It can be inferred from the hadith that any form of involvement that can lead to prohibited activities is cursed and not permissible by Shariah.

Condition (2): Exception to the general non permissibility of funds transfer from an IFI to a CFI must be based on hajah and darurah

4.3. Exceptions from the original rule based on the principle of *hajah* can be considered as a basis in allowing the transfer of funds to CFI to address hardship. The following verse of the *al-Quran* and the *hadith* imply the general permissibility for application of *hajah*:

يُرِيدُ ٱللَّهُ بِكُمُ ٱلْيُسْرَ وَلَا يُرِيدُ بِكُمُ ٱلْعُسْرَ[7]

"Allah intends ease for you, not hardship"

عن أنس رضي الله عنه قال: رخص رسول الله ﷺ للزبير وعبد الرحمن بن عوف رضي الله عنهما في لبس الحرير لحكة بهما. رواه البخاري ومسلم.

[6] Surah al-Ma'idah, verse no. 2.
[7] Surah al-Baqarah, verse no. 185.

"Anas (may Allah be pleased with him) reported: The Messenger of Allah (peace and blessing of Allah be upon him) permitted Zubair and `Abd al-Rahman bin `Auf (may Allah be pleased with them) to wear silk because they were suffering from an itch."

4.4. The following Islamic legal maxims provide basis for the general permissibility of *hajah* and *darurah*:

المشقة تجلب التيسير[8]

"*Hardship begets facility*"

الضرر يزال[9]

"Harm must be removed"

إذا ضاق الأمر اتسع وإذا اتسع ضاق[10]

"When a matter is constricted/constrained (by the hardship), flexibility is accorded but when the hardship is addressed, the flexibility is rescinded"

Part V: Implication of the SAC Ruling

5.1. The SAC ruling provides clarity and certainty to IFIs on the parameters to be complied with for transactions involving the transfer of an IFI's funds to a CFI. In addition, these parameters can foster uniform implementation and promote equitable treatment across all IFIs. The *hajah* element included in the parameters accords flexibility to IFI with specific needs in stress situations.

5.2. This ruling shall complement the SAC ruling on Financing to a Party Who Explicitly Performs Non-Shariah Compliant Activities.[11]

5.3. The issuance of this ruling supersedes the Circular on Prohibition on Specific/Restricted and Loss Bearing Fund Placement from Islamic Banks to Parent Banking Institutions issued on 13 January 2010.

[8] Al-Suyuti, *Al-Ashbah wa Al-Naza'ir,* Dar Al-Kutub Al-`Ilmiyyah, 1983, p. 76.
[9] Ibid, p. 83.
[10] Muhammad Mustafa al-Zuhaili, *al-Qawaid Al-Fiqhiyyah wa Tatbiqatuha fi al-Mazahib al-Arba`ah, Dar al-Fikr,* 2006, v. 2, p. 272.
[11] Shariah Advisory Council of Bank Negara Malaysia, Shariah Resolutions in Islamic Finance (Second Edition), Bank Negara Malaysia, 2010, p. 199 – 200.