Mandatory Rebate and Unearned Profit: The Latest BBA Decision

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A recent Malaysian High Court decision in *BIMB v Azhar Osman & Ors.* (2010) held that Bank Islam Malaysia Berhad is not entitled to claim the full sale price under its *bay' bi-thaman 'ājil* (BBA) financing scheme as it is obliged by the implied terms of the contract to grant a 'rebate' or *ibra'* to the customer. This decision – implying a rebate where none is expressly stated – is roiling the Islamic banking community in much the same way as Justice Wahab Patail's decision in *Affin Bank v Zulkifly b. Abdullah* did in 2005. Heads are huddled in Islamic banks to decide how to address the issue that sprang from this judicial determination: customers now are entitled to a rebate on the sale price by way of contractual obligation when in the past *ibrā'* had always been at the discretion of the bank.

Malaysia's Central Bank Act (CBA) of 2009 was amended pursuant to the 2009 Court of Appeal decision in *Arab Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd* (2008) where it overturned Justice Wahab's shocking decision to declare the BBA void a year before. Now the CBA allows *sharī'ah* advice to be sought and obtained from the National Shariah Advisory Council (NSAC) of Bank Negara Malaysia (BNM), whose advice is now binding when hitherto it was merely informative. With this enhancement to its power by the judicial body, it is time that the NSAC is engaged for a ruling (*fatwā*) on whether *ibrā'*, or rebate, in Islamic banking transactions can be made mandatory. The High Court's objective of ensuring certainty for the customers is laudable, but contracting *ibrā'* into the documentation and forcing Islamic banks to grant a rebate on the sale price has serious implications which need addressing quickly. The risk of 'two-pricing' and diluting the meaning of *ibrā'* in the *sharī'ah* are just two layman views on why *ibrā'* should still be discretionary and not be spelled out upfront but rather granted upon full settlement of the sale price.

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When a customer comes to an Islamic bank for a BBA facility he brings with him a sale and purchase agreement (SPA) for a property he intends to purchase and under which he has paid 10 per cent to the developer or vendor of the property. The bank is requested to finance the balance purchase price. Using the concept of 'sale', based on the qur'ānic injunction in 2:275, "Allāh prohibits usury but allows sale", the customer first enters into the Property Purchase Agreement (PPA) where the bank purchases the asset under the SPA from him; the purchase price is the facility amount to be disbursed to the vendor. The customer then, almost immediately, resells the same asset back to the bank under a Property Sale Agreement (PSA) where the price is the sum total of the purchase price plus a mark-up (or profit margin) calculated over the tenure of the BBA facility. This is the sale price which the customer undertakes to pay. However, because the customer is unable to settle the sale price at once, the bank allows or indulges the customer to settle by instalments over, say, 25 years. The BBA is a means to allow a bank customer to benefit from *sharī'ah*-permissible financing by utilising the sale mode and allowing the sale price to be settled by monthly instalments; hence *bay'* (sale) *bi-thaman 'ājil* (on credit or by instalment payments).

A form of debt financing, the BBA is actually a *murābahah* (cost plus) financing where the cost is topped with a premium or margin. The *sharī'ah* allows credit sale under BBA/*murābahah*. The transaction involves two parties, the original asset owner selling and repurchasing the same asset at an inflated credit price, this being a means – in Arabic termed *hiyal* (the plural of *hīlah*) by Muslim jurists – to obtain money from the first cash sale by skirting the prohibition on *ribā* 'by direct lending.

The BBA financing is a two-pronged transaction: it is firstly a *sale transaction* where the buy and sale of asset produces the sale price or proceeds of sale. It is secondly a *financing transaction* where upon the bank's indulgence as the second seller, the customer or original asset owner is allowed to settle the sale price under the PSA by instalments or on credit. Profit for the full financing is already costed by way of the mark up over the purchase price, and *the bank has earned the profit in full upon conclusion of the sale when the PSA is executed.*

It is perhaps the confusion arising from the above flows that brought about the concept of unearned profit (UEP). If one were to examine the Sale flow, it would be obvious that *sale was completed when the asset was exchanged for money* (this being a contract of exchange or *'aqd al-mu'āwadāt*). Once the requisites (*arkān*) and conditions (*shurūṭ*) of an Islamic sale are met, *the sale is complete, and all profits are accounted for.*

But under the second part of the BBA flow, the bank allows the customer to settle by instalments or grants credit to him. This is the Financing transaction where the relationship becomes a long term debtor–creditor relationship: as long as the customer has not settled the sale price in full he remains a debtor, notwithstanding

ing that the asset now is his by way of sale under the PSA by the bank. He has an obligation to pay the sale price in full, and if he defaults, the documentation allows the bank as creditor (cum charge or assignee) to take action to enforce the obligation including termination of the facility.

The debt owing by the customer under the financing flow does not translate into unearned profit before the latter belongs to the sale flow: in fact, no profit remains to be earned once the PSA was executed as the sale was completed having complied with all the requisites and conditions of a *sharī'ah* sale.

It is not proper to refer to the balance unpaid instalments as 'unearned profit' since the bank has already earned the profit at the time of execution of the PSA. The sale is over, and what remains is a new relationship established upon the customer's request to settle the balance sale price by instalments, viz. a debtor–creditor relationship. The customer cannot in default cry that the bank is enriching itself unjustly by claiming the full sale price when the default is in the early stages of the tenure; he has agreed to pay the full sale price under the PSA which did not state payment has to be varied according to when the facility is terminated upon default; this would be against *sharī'ah* stricture not to have more than one price in the '*aqd* or contract. The bank is not enriching itself because it is entitled to the balance unpaid sale price which the customer has undertaken to pay under the PSA; under BBA, the buyer can settle the price either in one lump sum, or on credit by instalment payments. The fact that the bank indulges the customer's request to allow him to pay on credit what he is owing under the sale price shows that there is no unjust enrichment as the bank is fully entitled to the sale price. In fact, it is the customer who is unjustly not keeping to his agreement to settle the sale price in full by defaulting and he cannot come to court with 'dirty hands' asking for equitable relief.

In the view of this writer, terms like UEP are alien to Islamic banking as the Islamic *bay'*, or sale, does not mesh with the conventional lending principles: once the sale is complete, all profit is earned justly; in lending, *unearned income* comes into play when the tenure is interrupted and the bank is not supposed to levy more than the loan drawn down and enjoyed by the customer. The financing flow in the BBA transaction could have inevitably confused all parties when the proceeds of sale of the PSA, named 'sale price', is wrongly thought to be a loan to the customer. Despite being a facility extended upon request, it is nothing but a debt owing by a customer who ought to have settled the BBA price, but who is allowed by the bank's indulgence to settle by instalments. Hence it is a debt by instalments rather than a loan on tenure. The conventional term 'unearned income' is now known as 'unearned profit', but this is indeed a strange term to use, since UEP does not even exist in the context of a *bay'*, or sale, that is complete and has met its requisites and conditions.

The practice of paying up the sale price in full and granting a discretionary rebate, or *ibrā'*, to ensure equity and fairness is in accordance with the *sharī'ah* as firstly the customer is bound by his agreement under the PSA to pay the full sale price, and as even under civil law, one is bound by one's signature and cannot claim ignorance when the bank enforces its claim. Secondly, *ibrā'* is a discretion, but because the need to ensure Islamic financing is fair, all financiers inevitably grant *ibrā'*, despite the absence of a mandatory clause to force them to do it. It has become a common practice, but it is still within the realm of discretion as intended under the stipulations of *ibrā'*.

Islamic bankers have to think how they can contest the ruling while remaining true to their professed calling of offering equitable financing at reasonable profit. However, this writer urges that recourse be made to the NSAC at BNM to pose the following questions: Can *ibrā'* – being a discretionary rebate – be made mandatory by contracting it in the documentation? Can the concept of unearned profit be imported into Islamic financing when the sale is already complete and the bank as seller under the PSA has earned all its profit under the mark up to the purchase price? It is imperative that these issues are settled.