



# Gap Analysis Between BNM Regulation and Application of *Musharakah Mutanaqisah* in Islamic Banking

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## Abstract

Bank Negara Malaysia resolved the utilization of *Musharakah Mutanaqisah* on the *Shari'ah* Advisory Committee 56<sup>th</sup> meeting in 2010. In practice, most of the banks have adopted *Musharakah Mutanaqisah* for the purpose of home financing. This study examines the gap between the BNM regulation and as practiced by Maybank Islamic and HSBC Amanah. The method of analysis adopts a qualitative study based on the library research. The study discovered one major gap and three minor gaps. The major gap is related to charging an early settlement fee by HSBC Amanah. In addition, three minor gaps are related to *wa'ad* statement in both banks, the pledge statement with respect to Maybank, and default approach compliance in both banks. However, this study does not examine the gap that related to the contract validity. Nevertheless, the discovery of a single gap found may affect contract validity of the product. This study recommends for better monitoring and supervision conducted by all stakeholders. BNM *Shari'ah* Advisory Council and respective Islamic bank committees should verify the practice that may cause the contract to become void. In addition, Islamic financial institutions should strictly follow all the regulations issued by the Bank Negara Malaysia in all their practices and publication in order to make the contracts acceptable according to *Shari'ah* and to cater public confidence. Adhering to guidelines along with the *Shari'ah* standard of the product further increases accountability and trustworthiness of *Shari'ah* compliance in a particular product.

*Keywords:* *Musharakah Mutanaqisah*, Gap Analysis, *Shari'ah* Compliance, Islamic Banks

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## 1. Introduction

The scholars and the independent bodies in the field of Islamic banking and finance have designed financial and deposit products using *Shari'ah* compliant contracts. *Musharakah Mutanaqisah* (MM) is also one of the products suggested for financing purposes. MM is a concept invented by the scholars from *Musharakah* (partnership) as the basis which is one of the nominate contracts (*Al-'uqud Al-Musamma*) in *fiqh*. The AAOIFI defined the MM as follows:

*“Musharakah Mutanaqisah is a form of partnership in which one of the partner promises to buy the equity share of the other partner gradually until the title to the equity is completely transferred to him. This transaction starts with the formation of a partnership, after which buying and selling of the equity take place between the two partners. It is therefore necessary that this buying and selling should not be stipulated in the partnership contract. In other words, the buying partner is allowed to give only a promise to buy. This promise should be independent of the partnership contract. In addition, the buying and selling agreement must be independent of the partnership contract. It is not permitted that one contract be entered into as a condition for concluding the other”* (AAOIFI, 2008, *Shari'ah* Standard No.12, 5/1, p.217).

The AAOIFI definition implies that MM comprises three independent contracts e.g. *musharakah* (joint

venture), *ijarah* (lease), and *bay* (sale). Additionally, it involves a unilateral promise (*wa'ad*) from the buyer to purchase the bank's portion.

Accordingly, MM is basically a partnership contract, whereby the share of one partner as an Islamic Bank diminishes, while another partner, the customer's, share increases until the later becomes the sole owner. The MM can be arranged for the purpose of financing for asset acquisition as well as for financing for business venture. Therefore, according to BNM (2010), if the partnership is established for the purpose of acquiring asset, it should be governed by the rules of *sharikat al milk*, if it is for the business venture, it should be governed by the rules of *sharikat al aqd*. Some studies argue that MM for asset acquisition is considered as *shirkat al-aqd* when the intention of one party to generate returns (AIF, 2013). However, in Malaysia, MM is considered as *shirkat al-milk* as stated in the concept paper, as the own purpose is to jointly own asset rather than profit generation.

Furthermore, the asset in MM contract can be an already completed or incomplete asset (under construction asset). MM for the completed asset may be arranged with *Ijarah* (lease) and sale and for the asset to be constructed may be arranged with *Istisna* contract, *Ijarah mawsu'ah fi zimamah* and sale. On the other hand, MM for venture is governed by the rules of *sharikat al aqd* because it is meant for sharing profits even though there are elements of 'diminishing' to allow the venture capitalist to acquire the business profits. The following figure summarizes the components of MM:

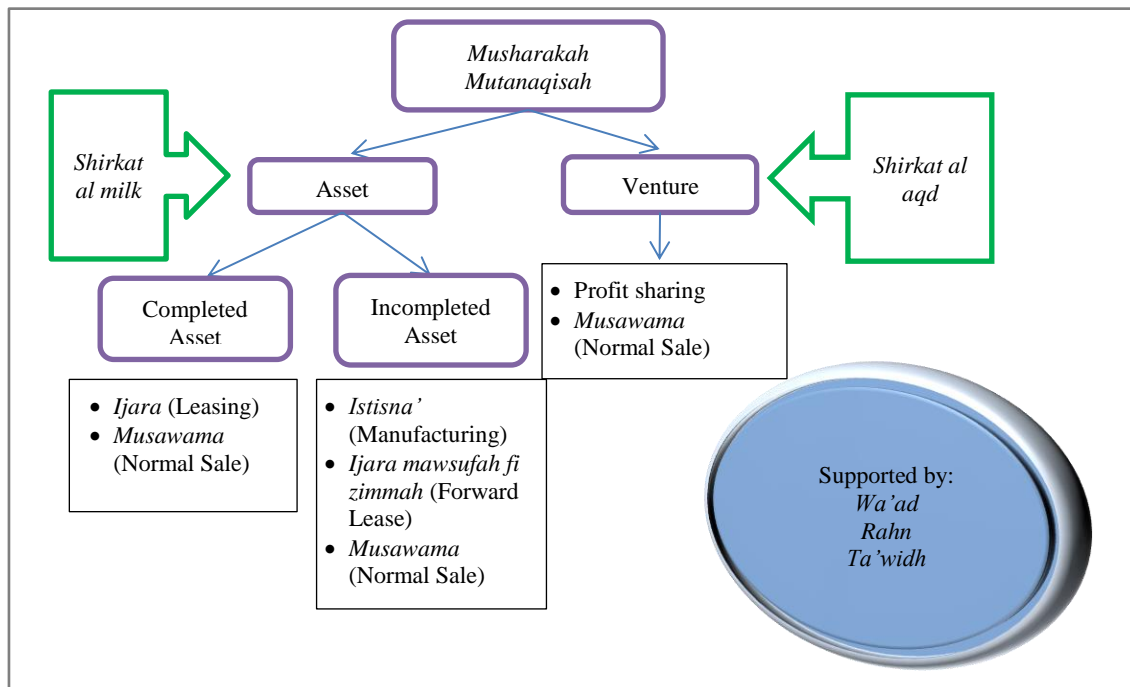


Figure 1: *Musharakah Mutanaqisah* Contract Scheme

MM is a product approved by Bank Negara Malaysia. According to the BNM *Shari'ah* Advisory Committee 56<sup>th</sup> meeting (2010), it resolved that MM is:

*“collective usage of contracts of musharakah, ijarah, and sale in one document of agreement is permissible as long as all contracts are concluded separately and clearly”. The resolution considered that “a musharakah mutanaqisah contract that uses both musharakah and ijarah contracts is deemed as one form of contemporary contract (‘uqud mustajiddah) recognised by fiqh scholars in order to fulfill the contemporary needs of Islamic mu`amalah” (BNM, 2010).*

The operational requirement of MM is regulated under BNM Regulations issued by Bank Negara

Malaysia. Few Islamic banks in Malaysia adopt the MM product especially for home financing (Lung, 2013). The objective of this study is to examine the regulations of BNM which is represented by *Shari'ah* standard and exposure draft in comparison with MM which are actually been practiced by the Islamic banks in Malaysia. Besides that, it also to find the gap between BNM regulation and the practices.

According to the research carried out by Lung (2013), there are only six banks having MM concept for home financing. Maybank Islamic and RHB Islamic as the representative for the local banks and Asian Finance Bank, HSBC Amanah Malaysia, Kuwait Finance House, OCBC Al-Amin Bank, and Standard Chartered Saadiq as the representative of foreign banks.

Table 1: Lists of Bank in Malaysia implemented *Musharakah Mutanaqisah*

Bank	Home Financing Products	<i>Shari'ah</i> Concept
<b>Local Bank</b>		
Maybank Islamic Bank	Home Equity-i	MMP
RHB Islamic Bank	Equity Home Fin.-i	MMP
<b>Foreign Bank</b>		
Asian Finance Bank (min. financing amount of RM500,000)	Home Fin.-i	MMP
HSBC Amanah Malaysia	Home Smart-i	MMP
Kuwait Finance House	MM Home Financing-i	MMP
OCBC Al-Amin Bank	Manarat Home-i	MMP
Standard Chartered Saadiq	Saadiq My Home-i	MMP

Source: Lung (2013)

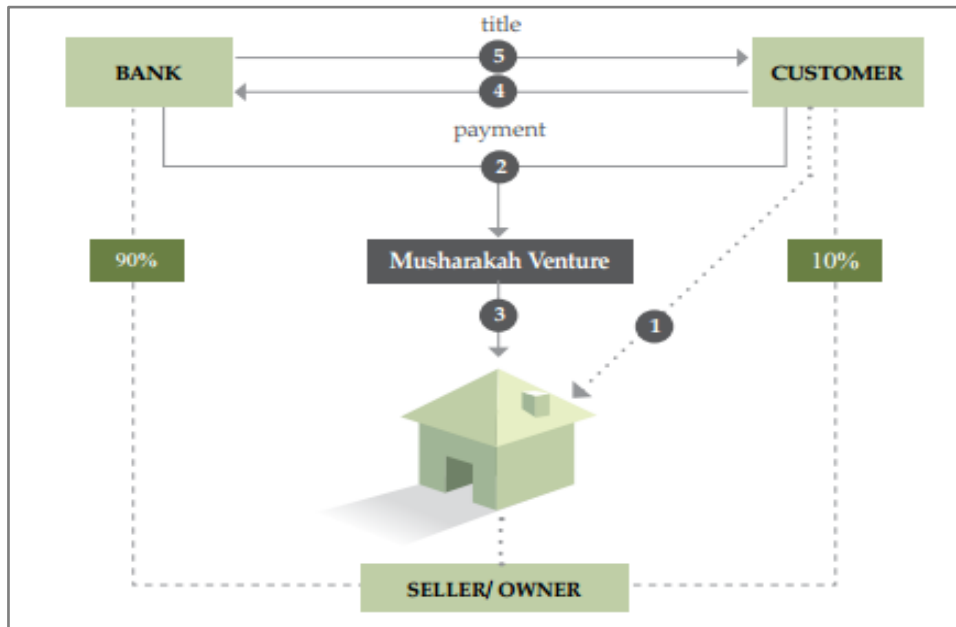
This study examined Maybank Islamic and HSBC Amanah respectively to represent the local bank and foreign bank. Likewise, this study focuses on the practice of MM for completed asset. The method adopted in this analysis is qualitative based on the library research. The primary resources come from BNM regulations, BNM guidance, concept paper and product disclosure sheets on the respective banks. The secondary resources come from research articles. On the next section, it reviews the literature which consists of *Musharakah Mutanaqisah* Concept, Practical Issues, and BNM Regulation.

## 2. Literature Review

### 2.1 *Musharakah Mutanaqisah* Concept

MM is normally utilized for financing the asset acquisition. According to Usmani (2004), MM is established by having joint ownership in the property (*Shirkat al Milk*). For utilization of the property, the customer lease the asset and subsequently pays the rental to the bank. Afterwards, customer promises to the bank that the customer will reduce bank's unit share by purchasing the bank's portion. At the end time, customer will be the sole owner of the asset.

According to the BNM *Shari'ah* Advisory Committee 56<sup>th</sup> meeting (2010), it resolved that collective contracts, which comprise of *musharakah*, *ijarah* and sale are allowed, as long as they are concluded separately and clearly. The MM model can be executed for different applications. However, most of banks use this model for home financing purposes. The MM scheme for home financing may be structured as follows:

Figure 2: *Musharakah Mutanaqisah Model*

Source: ISRA (2010): Bulletin Managing Default in *Musharakah Mutanaqisah*

The steps of MM start, firstly, with the customer by choosing house and apply for financing to the bank. Secondly, bank considers to approve or not to approve the customers' application. Once, it has been approved by the bank, bank and customer will incorporated the *musharakah* agreement. Thirdly, the customer leases the bank's portion of the house. Fourthly, a monthly payment must be paid with along with the rental payment in order to purchase the bank's share. Finally, the partnership will be ended by the customer owning 100% of the house and ownership title will be transferred to the customer.

## 2.2 Practical Issues

In practice, According to Meera and Razak (2009), *Musharakah Mutanaqisah* implementation is not exactly in line with Sharia law. Several practical issues arise in the MM implementation specifically which influenced the changes on the rental rates, *wa'ad*, defaults, and early termination of contract.

### 2.2.1 Rental rates

The rental issue is very important as its utilization in MM home financing could replace interest rate as a benchmark. Hashim and Hassan (2015) stated that the current practice to determine the lease rental based on the conventional benchmark like KLIBOR and LIBOR. Besides, it can also use market price by inventing the market price which has been practiced in US by Lariba. In agreement with Hashim and Hassan (2015), Taib et al (2008) and Smolo and Hassan (2011) stated that MM home financing can solve the use of interest rate as a benchmark through the utilization of the rental income. Those scholars opined that benchmarking or setting the rental level with market interest rates is not by itself prohibited. However, certain conditions have to be followed, such as, (i) the rental since the first period of the contract have to be determined, (ii) subsequent periods have to be specified to a certain benchmark on condition that such a benchmark is based upon a clear formula. The formula is not subject to dispute.

In accordance with above, an Al-Baraka *fatwa* stated in relation to interest rate benchmarking,

*"There is no prohibition in relying on the interest rate benchmarking in pricing the Islamic products of which such use of benchmark does not contradict the products' nature of conforming to the Shari'ah upon its usage"* (INCEIF, 2015).

It means that interest-rate benchmarking is allowed for the financial instruments which do not engage in *qard*. In addition, the absence of representative Islamic financial benchmark as one strong reason. Syekh Taqi Usmani warned that:

*“It is however true that the Islamic banks and financial institutions should get rid of this practice as soon as possible, because, firstly, it takes the rate of interest as an ideal for a halal business which is not desirable, and secondly because it does not advance the basic philosophy of Islamic economy having no impact on the system of distribution. Therefore, Islamic banks and financial institutions should strive for developing their own benchmark”* (Usmani, 2014).

### 2.2.2 Wa’ad application and its implication

*Wa’ad* with the intended effect to guarantee the payment for the share of the other partner raise Shariah issue in MM. It is not permitted for one party to establish *wa’ad* to purchase the other’s party share at the value of the share on the day of the partnership is created. The reason stated that *wa’ad* become a guarantee to the share of the partner. In MM, unilateral *wa’ad* is utilized for from sides of the bank or customer. The bank sells its shares on periodical basis to the customer or *wa’ad* from the customer to purchase the bank’s shares (Smolo, 2011). The *wa’ad* utilization is catered as a risk mitigation tool to evade any financial loss against the bank and show the parties’ commitment to perform their contract as mutually intended (Abdullah, 2009; Dar, 2010).

In the default case, discontinuation of MM can be solved with two methods, i.e. without *wa’ad*, or with *wa’ad*. If it solves without *wa’ad*, the underlying asset will be disposed to the market and the proceeds will be shared according to the latest ownership share ratio (after all the outstanding costs and payments settled such as outstanding rents and legal fees). If it solves with *wa’ad*, the customer have to purchase the remaining shares of the bank. *Wa’ad* in the default make a legal obligation on the customer to purchase all outstanding shares of the bank and to pay outstanding rental and other fees. After that, debt is created and this debt is to be settled by the customer (Smolo, 2011).

According to Hanafi (2012), this practice with *wa’ad* caters as ‘capital guarantee’ over the bank’s credit risk. The use of purchase undertaking should be done with necessary caution, as it will contradict the basic principles of a profit and loss sharing contract, as it cannot be systematically made dependant on collateral, or guarantees, to reduce credit risk (Sundararajan and Errico, 2002; Smolo, 2010; Naim, 2011). In addition, since MM for asset acquisition based on *shirkat al-milk*, when it comes to the loss, each partner shall bear ownership related expenses/liabilities or loss, on pro rate basis. In addition, the practice of transferring all the obligations on the maintenance and *takaful* solely to the customer (even has been agreed upon by both parties) may suggest that the bank does not ‘truly’ have ownership risk over the house. Hence, such a practice does not render genuine *musharakah* when one party has superior advantage over the other party.

### 2.3 BNM Regulation

Compliance with *Shari’ah* requirement is a prerequisite to ensure the legitimacy of Islamic financial products and services. The *Shari’ah* contract-based regulatory policy is intended to ensure end-to-end compliance with the *Shari’ah* and hence, enhance the integrity and sustainability of the IFI. In policy document, there are two denotations. “S” means a standards, and obligation, a requirement, specification, direction, condition and any interpretative, supplemental and transitional provisions that must complied with. If non-compliance occurs, it may result in enforcement actions. “G” means as guidance which may comprise of statements or information, intended to promote common understanding and advice or recommendations which are encouraged to be adopted. In this research, *musharakah* and *ijarah* BNM *Shari’ah* standards are examined as the main contracts and also relevant concept paper for the supporting contracts such as *wa’ad* and *ta’widh*. In addition, guidelines on *ibra’* (rebate) for sale-based financing is also used.

### 3. Discussion and Findings

The tables below describes the regulations that governed MM and the practices of both banks. Since the MM is hybrid contract, this study refers to the BNM *Shari’ah* standards of *musharakah* and *ijarah*. Furthermore,

for the supporting contracts, we referred to the concept paper on *wa'ad*, *ibra* and *ta'widh*. To find out the banking practices on relevant aspects, the study focuses on their product disclosure sheets (PDS), banks' policy on payment and profit calculation.

Table 2: Definition Application of *Musharakah Mutanaqisah*

Institution	Information	Note
BNM Regulation	<i>Musharakah</i> may be entered into by two or more parties on a particular asset or venture which allows one of the partners to gradually acquire the shareholding of the other partner through an agreed redemption method during the tenure of the contract. Such arrangement is commonly referred to as <i>musharakah mutanaqisah</i> (diminishing <i>musharakah</i> ) (BNM Regulation, 2015, <i>Musharakah</i> , provision 21.1).	Guidance – Two main essences are shareholding and partners to gradually acquire
Maybank Islamic	<i>Musharakah mutanaqisah</i> (diminishing partnership). This is an Islamic property financing based on a combination of <i>Shari'ah</i> contracts of <i>musharakah</i> (partnership) and <i>ijarah</i> (leasing). It is a form of diminishing partnership contract whereby the customer and the bank jointly acquire and own a property. Once the bank leases the property to the customer, the installment payments shall gradually transfer the bank's ownership to the customer. (PDS, p.2).	<b>No gap</b> – different terms used which are jointly acquire and own a property and gradually transfer
HSBC Amanah	The customer and the bank will be in a partnership to purchase a property. The bank's share of the property will diminish over time during the tenure, while the customer's share of the property will increase at the same time as a result from the monthly payments to the bank. Ultimately, the bank will transfer the full ownership of the property to the Customer at the end of the facility or upon early settlement by the customer, whichever is earlier" (PDS, p.1).	<b>No gap</b> - different terms which are partnership and diminish
Comment	The essence of definitions for BNM and Maybank Islamic are similar. However, HSBC Amanah stated that the full transfer of property ownership can be conducted by the customer either at the end of tenure or upon early settlement, of which Maybank Islamic only mentioned about transfer of ownership at the end of the tenure. Since, the essence of definitions is similar, it does not deviate from the definition which is guided by BNM.	

Table 3: Contract Application on *Musharakah Mutanaqisah* for Asset Acquisition Purpose

Institution	Information	Note
BNM Regulation	<i>Musyarakah mutanaqisah</i> for the purpose of acquiring completed assets may be arranged whereby the partners jointly purchase an asset from a third party. Subsequently, one of the partners will lease his share of the asset ownership to the other partner based on <i>ijarah</i> . Simultaneously, the partner who is the lessee will purchase the share of the other partner on a gradual basis and ultimately become the sole owner of the asset. (BNM Regulation, 2015, <i>Musharakah</i> , provision 22.2)	Guidance – three contracts: jointly purchase, lease, and gradually purchase the other partner's share
Maybank Islamic	<i>Musharakah Mutanaqisah</i> (diminishing partnership). This is an Islamic property financing based on a combination of <i>Shari'ah</i> contracts of <i>musharakah</i> (partnership) and <i>Ijarah</i> (leasing). It is a form of diminishing partnership contract whereby the customer and the Bank jointly acquire and own a property. Once the Bank leases the property to the customer, the	<b>No gap</b> – three contracts: partnership, leasing, and gradually transfer the Bank's ownership

installment payments shall gradually transfer the bank's ownership to the customer. (PDS<sup>1</sup>, p.2)

HSBC Amanah	The <i>Shari'ah</i> concept applicable is diminishing <i>musharakah</i> (co-ownership). Diminishing <i>musharakah</i> involves three underlying contracts independent from each other, those are: a) Co-ownership: the bank participates as a financial partner in the acquisition of the property. You and the bank contribute the capital to own the property. b) Lease: the Bank then leases its share of the property to you for 'rental payment'. c) Purchase: on monthly basis, you purchase a portion of the bank's shares. This purchase is affected against "purchase price" paid by you (PDS: No.1-I,II,III)	<b>No gap</b> – three contracts: co-ownership, lease and purchase the bank's share
Comment	Maybank Islamic and HSBC Amanah stated similar contract application of MM as stated on BNM Regulation. The terms used by HSBC Amanah slightly different but it gives the explanation.	

Table 4: *Wa'ad* (Promise) Application on *Musharakah Mutanaqisah*

Institution	Information	Note
BNM Regulation	A partner may, at the time of entering into the contract, request other partner to give a promise ( <i>wa'ad</i> ) to gradually purchase the former's share of the asset over an agreed period of time at market value, fair value or any price to be agreed by the partners. (BNM Regulation, 2015, <i>Musharakah</i> , 22.5).	Guidance – <i>wa'ad</i> needed from the customer to purchase bank's share
Maybank Islamic	Product disclosure sheet does not stated about <i>wa'ad</i> (purchase undertaking)	<b>Gap</b> - PDS does not stated anything about <i>wa'ad</i>
HSBC Amanah	Product disclosure sheet does not stated about <i>wa'ad</i> (purchase undertaking)	<b>Gap</b> - PDS does not stated anything about <i>wa'ad</i>
Comment	The gap is found since PDS of Maybank Islamic and HSBC Amanah does not stated anything about <i>wa'ad</i> . However, this gap does not affect product validity and the legal requirement, because <i>wa'ad</i> in the contract is only the guidance of BNM regulation. In order to fully comply with BNM regulation, PDS should present the <i>wa'ad</i> .	

Table 5: Pricing Method

Institution	Information	Note
BNM Regulation	The contracting parties may agree for the rental amount- a) To be paid in a fixed amount b) To be determined via a reference to a specified benchmark or formula; or c) To be paid using a combination of paragraph 14.3(a) and 14.3(b) above (BNM Regulation, <i>Ijarah</i> , provision 14.3).	Guidance – 3 types of pricing method i.e. fixed, specified benchmark or combination
Maybank Islamic	The pricing is competitive as per the conventional loan which could be offered under: ▪ Fixed rate; or (Refer to BNM Regulation point a)	<b>No Gap</b> – BFR as the benchmark

<sup>1</sup> PDS: product disclosure sheet

	<ul style="list-style-type: none"> <li>▪ Floating rate; or (Refer to BNM Regulation point b)</li> <li>▪ A combination of fixed rate and floating rate. (MMTFI- Maybank)<sup>2</sup> (Refer to BNM Regulation point c)</li> </ul> <p>The profit rate used for computation of Selling Price Rate is determined upfront i.e. BFR + 4% or 10.00% whichever is higher upon the offer and acceptance of financing. This Selling Price or known as ceiling rate provides the customers with maximum capping for the total amount of financing payment regardless of periodical changes in the BFR. (PDS, p.1).</p>	Ceiling rate is stated
HSBC Amanah	<p>Your monthly payment and total amount to be paid will vary if the BR (Base Rate) changes. (PDS, p.2)</p> <p>The Home Smart-i profit rate is pegged to Base Financing Rate (BFR) with a spread (PDS, p.1).</p> <p>Effective from 2 January 2015, the Home Smart-i profit rate is pegged to Base Rate (BR) with a spread.</p>	<p><b>No Gap</b> – BR as the benchmark</p> <p>Ceiling rate is not stated</p>
Comment	<p>BNM stated that rental amount of MM can be determined fixed amount, reference to specified benchmarks, or combination of both. Maybank Islamic and HSBC Amanah follow the guidance to determine the rental amount. Therefore, there is no gap in term of method between BNM regulation and bank practices. However, Maybank Islamic and HSBC use different approach for their rate. Maybank Islamic use BFR and HSBC Amanah use BR as the recent reference rate. Since both banks using BR and BFR, question arises which one is better for the customer, bank, and its shareholders.</p>	

Table 6: Pledge

Institution	Information	Note
BNM Regulation	A partner may pledge his ownership share of the completed asset as collateral to the other partners (BNM Regulation, 2015, <i>Musharakah</i> , 22.8).	Guidance – customer pledge his ownership for security purpose
Maybank Islamic	This facility is secured against residential or commercial properties. Nonetheless, additional security such as fixed deposits, guarantors, etc. may be requested depending on the credit assessment.	<b>Gap</b> – different approach for pledge
HSBC Amanah	Customer are pledging the house as a security for this financing (PDS, pg.1).	<b>No gap</b> – exactly following BNM Guidance
Comment	<p>BNM Regulation stated guidance (G) that the customer may pledge his ownership share to the bank. HSBC Amanah requires the customer to pledge the property as the security in the financing arrangement. However, Maybank Islamic state some security arrangement at the time of MM contract, not specifically related to pledging of ownership. Since, it is only the guidance by the BNM, Maybank Islamic does not follow strictly. This difference cannot be considered as a major gap. However, it is important to note here that pledging the asset is more useful for the bank because the title ownership of the house registered in Malaysia under the customer's name as the legal owner. It might carry severe problem.</p>	

<sup>2</sup>Maybank2u.com *Musharakah Mutanaqisah* Term Financing (MMTF-i)



Table 7: Early Payment

Institution	Information	Note
BNM Regulation	Where the customer wishes to make an early settlement of the <i>musharakah</i> financing, the amount to be paid to the IFI shall be the outstanding amount (principal plus accrued profit) (BNM Regulation, 2015, <i>Musharakah</i> , 34.1). An IFI shall not claim any penalty charges or impose any other charges on the customer unless the charges represent the costs incurred by the IFI due to early settlement by the customer. The reasonable estimation of costs to be incurred must be in line with the Guidelines on <i>ibra'</i> (Rebate) for sale-based financing (BNM Regulation, 2015, <i>Musharakah</i> , 34.2).	Standard – Islamic bank cannot charge early settlement fee
Maybank Islamic	No early settlement fee will be charged (PDS, point 7, p.4). Customer will need to pay the outstanding balance, current monthly profit and any amount due and payable to the bank (PDS, point 7, p.4).	<b>No Gap</b> – no early settlement fee charged
HSBC Amanah	Early termination fee = (2% x Facility Amount x Number of remaining months within the lock-in period) / Total lock-in period in months (PDS, point 6, p.3). Customers can request for early settlement and redeem the financing by providing the bank 1 month written notice or pay 1 month profit in lieu of notice. If Home Smart-i financing is still within the lock-in period, customers are required to pay the early settlement charges (HSBC FAQ, point 8, p.2)	<b>Gap:</b> Early Termination Fee
Comment	Based on BNM Regulation, Bank has no right to charge early settlement fee. Maybank Islamic complies by not charging early settlement fee but customers have to pay outstanding balance, current monthly profit and amount due and payable to the bank. However, HSBC Amanah charges early termination fee as stated in their product disclosure sheet. HSBC Amanah needs to follow the standard because it will cause the legal impact and affect contract validity. Moreover, it will lead to non-compliance practice in both <i>Shari'ah</i> and regulation perspective. In case the bank already takes the early settlement fee, it is recommended for the respective bank to channel those funds to the charity.	

Table 8: Late Payment

Institution	Information	Note
BNM Regulation	Compensation ( <i>ta'widh</i> ) can be charged. However, this amount shall not be more than 1% per annum (Table 3.2, regulation and supervision, BNM). <ul style="list-style-type: none"> <li>▪ The overdue installments of the Islamic product in the case of default of scheduled payments; or</li> <li>▪ The outstanding balance of the Islamic product where a default results in the entire facility being recalled or brought to court for judgment prior to maturity.</li> </ul> For delays occurring after maturity of a financing contract, Islamic banks are only allowed to charge <i>ta'widh</i> at a reduced rate based on daily overnight Islamic interbank money market rate.	The rate 1% for <i>ta'widh</i>
Maybank Islamic	Overdue Installment or Scheduled Payment : a) 1% p.a. on the installment amount in arrears from the date of the first drawdown of the Facility until its Maturity Date (PDS, point 6, p.4) b) Upon Maturity Date of the Facility or upon judgment, whichever is earlier: Prevailing daily overnight Islamic Interbank Money Market (IIMM) rate on the outstanding balance due and payable	<b>No Gap</b> – the rate is 1% p.a.

HSBC Amanah	<p>During financing tenure: 1% p.a. on the overdue installment. Example: overdue installment amount in arrears x 1% x n/365 (n= number of days overdue (PDS, point 6, pg.3). After expiry of financing tenure. At a rate not exceeding the prevailing IIMM-rate, on the outstanding amount financed (after the tenure). (IIMM-rate is the daily weighted average overnight rate for Islamic financial instruments quoted in Malaysia's Islamic Interbank Money Market.</p>	<b>No Gap</b> – the rate is 1% p.a.
Comment	BNM regulation, Maybank Islamic, and HSBC Amanah have similar statement regarding to the ta'widh during the financing tenure. IIMM-rate utilization as the rate for outstanding balance stated by BNM, Maybank Islamic, and HSBC Amanah.	

Table 9: In Case of Customer Default

Institution	Information	Note
BNM Regulation	<ul style="list-style-type: none"> <li>a) Promisee invokes the promise to purchase and where the promisor fails to perform the promise, the partners shall jointly sell the asset to a third party.</li> <li>b) The proceeds of the sale shall be allocated to all partners based on the ownership share at the point of sale based on the following options:</li> <li>c) allocation to all partners is made after deducting all costs related to asset liquidation from the proceeds of the sale; or</li> <li>d) (ii) allocation to all partners is made without prior deduction of costs related to asset liquidation from the proceeds. Under this approach, the cost related to asset liquidation is deducted only from promisor's share of the proceeds.</li> <li>e) The promisee may claim the rental due (if any) from the promisor's</li> <li>f) share of the proceeds.</li> <li>g) The promisee may claim a compensation amount from the promisor's share of the proceeds. The compensation amount shall be the difference between the agreed purchase price (as promised) and the realized proceeds portion allocated for the promisee.</li> <li>h) In the event that the promisor's share of the proceeds is inadequate to meet the claim under paragraph (d), the promisee may demand the remaining difference from the promisor.</li> <li>i) In the event that the promisee's share of the proceeds is equivalent to or higher than the promised purchase price, the provisions on compensation under paragraph (d) and (e) shall not be applicable.</li> <li>j) In the event that the promisee's portion of proceeds exceeds the promised purchase price, the promisee may share his excess proceeds with the promisor (BNM Regulation, 2015, <i>Musharakah</i>, Point 22.10, Approach 1).</li> <li>k) The promisee may invoke the promise to purchase. Where the promisor fails to perform the promise, the promisee may sell his remaining ownership share to the promisor on credit based on a price agreed by both parties.</li> <li>l) The promisee may take the asset as collateral to secure the payments of the deferred price as agreed under paragraph (a).</li> <li>m) In the event that the promisee as the creditor liquidates the collateral, the following may be applied: <ul style="list-style-type: none"> <li>i. The promisee may claim the rental due, the purchase price as agreed in the promise to purchase and costs related to liquidation of the collateral.</li> </ul> </li> </ul>	Guidance – two different approaches in case of customer defaults

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	<ul style="list-style-type: none"> <li>ii. In the event that the proceeds from the liquidation of the collateral is inadequate to meet the claim under paragraph (i), the promisee as creditor may demand the remaining difference.</li> <li>iii. If there is any excess amount from the proceeds of the collateral liquidation after the deduction of claims under paragraph (i), the excess amount shall belong to the promisor. (BNM Regulation, 2015, <i>Musharakah</i>, Point 22.10, Approach 2).</li> </ul>	
Maybank Islamic	<ol style="list-style-type: none"> <li>1. In the event of default (non-payment) on three consecutive payments of profit pending the commencement of instalment or during the payment of monthly instalment.</li> <li>2. The bank shall be entitled to convert the agreed rate to BFR+2.5% per annum calculated <u>in</u> the daily balance basis or such other rate as the Bank may prescribe from time to time subject always to the Selling Price (PDS, p.4).</li> <li>3. Right to set-off: bank has the right to set-off any credit balance in your deposit accounts maintained with the bank against any outstanding balance (PDS, p.4).</li> <li>4. Right to commence recovery or legal action. Legal action will be taken if the customer <u>fails</u> to respond to remainder notices. Customer's property maybe subjected to foreclosure and customer will have bear all the costs. The bank has a right to comments recovery activities (including engaging third party debt collections agencies) foreclosure and bankruptcy proceedings (PDS, p.4).</li> <li>5. Right to review and terminate the facility upon the occurrence any other events of defaults as agreed in terms and condition of the facility (PDS, p.4).</li> </ol>	<p><b>Gap</b> Since Maybank does not follow exactly the guidance given by the BNM</p> <p>Inconsistency issue</p>
HSBC Amanah	<ol style="list-style-type: none"> <li>1. Right to set-off: The Bank have the right to set-off any credit balance in customer account(s) maintained with us against any outstanding balance in this financing account (PDS HSBC, p.3).</li> <li>2. Legal action will be taken if customer fails to respond to reminder notices issued. Customer property may be foreclosed and customer will have to bear all related costs. Customers are also responsible to settle any shortfall after your property is sold (PDS HSBC, p.3).</li> <li>3. Legal action against customer may affect the customer credit rating leading to the credit being more difficult or expensive to customer (PDS HSBC, p.3).</li> </ol>	<p><b>Gap</b> Since HSBC does not follow exactly the guidance given by the BNM</p>
Comment	<p>The BNM has given the two possible approaches that the Islamic Bank can do in case of their customer defaulting, however, in the real practice Maybank and HSBC do not follow exactly the recommendation given by the BNM, these different approaches implemented by both Banks cannot be considered a major gap, since it is only the guidance and not standard.</p> <p>In Maybank practice, in the case of default, the bank converts the agreed profit rate into BFR + 2.5% or any rate the bank wishes. The question is, this type of practice is considered <i>Shari'ah</i> compliant or not? since the bank already have the agreement with the customer upfront about the profit rate.</p>	

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#### 4. Conclusion and Recommendation for Future Research

MM has been implemented in Malaysia by several Islamic banks. This financing mode is regulated under BNM regulation. Along the way, in real practices, banks may perform differently. This study found the gap between BNM regulation and both Maybank Islamic and HSBC Amanah practices related to Musharakah Mutanaqisah. In the aforementioned eight points, there are four gaps consist of one major gap and three minor gaps, the major gap is related to charging early settlement fee by HSBC Amanah. In addition, three minor gaps are related to *wa'ad* statement in both banks, pledge statement in Maybank side, and default approach compliance in both banks. Furthermore, this study found the possible *Shari'ah* issue on Maybank practice in the default cases where the bank has right to change the already agreed profit rate to whatever they like.

However, this study does not examine the gap that related to the contract validity. Nevertheless, even a single gap, which found in each bank practice, it can be considered the serious issue because this gap affects the contract validity of the product. By uncovering several gaps that existed in their practices, this study suggests for better monitoring and supervision conducted by all involved parties. BNM *Shari'ah* Advisory Council and *Shari'ah* Committee of respective Islamic Bank should verify the practice that may cause the contract to become void. In addition, the Islamic Financial Institutions should strictly follow all the regulation issued by the Bank Negara Malaysia even it was the guidance in all their practices and publication in order to make the practices fully compliant with BNM regulations and to cater public confidence.

This study is conducted by identifying two major Islamic banks in Malaysia, which are Maybank Islamic and HSBC Amanah. As this research only found one major gap between the practice and regulations, it still needs further development for future research by analyzing and examining more Islamic banks that offers this type of product and also by conducting interviews and field based group discussion. The researchers believe that there are still many gaps to be exposed if the future researcher is willing to do the complex research by comparing multiple banks and interviewing the respective bank for the product that they offer.

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