FATWA IN ISLAMIC FINANCE

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IBRA' AND ITS APPLICATION IN ISLAMIC FINANCE

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DEFINITION OF *IBRA'*

Literally, the word *ibra'* connotes to exonerate and dissociate from something. In the context of debt obligation, *ibra'* means to absolve a debtor from a debt or obligation that is established in his liability. Technically, *ibra'* is "an act of absolving one's financial rights established in another person's liability which leads to discharging the other from liability to fulfill the obligation". It is a unilateral waiver of right by a party to the contract which is granted out of his benevolence (*ihsan*) at his sole discretion. This signifies that if the claims and rights are not the liability of the latter, such as right of *shuf'ah*, then the relinquishment would not be considered *ibra'* but merely an absolution of rights (*isqat*). On this basis, every act of *ibra'* is considered isqat (mere absolution of right) and not every absolution is deemed *ibra'*. Shariah scholars argue that *ibra'* assumes a distinctive feature of having the element of *isqat* and *tamlik* (ownership); because in the context of debt obligation, *ibra'* means absolution of one's financial right (*isqat min al-dayn*) and assigning ownership to the debtor (*tamlik li al-madin*).

INHERENT NATURE OF *IBRA'*

The inherent nature of a financial contract constitutes a fundamental basis for all rulings related to that particular financial contract in which violation may render the financial contract null and void. Hence, it is extremely significant to generally understand the inherent nature of *ibra'* that can be deduced from the major *fiqh* (Islamic jurisprudence) literatures. This is to ensure that the application of *ibra'* is in tandem with its inherent nature and the very objective intended by the Lawgiver from its legality and permissibility. Generally, *ibra'* is a benevolent contract which is given at sole discretion of the creditor without any consideration or counter-value. Jurists stipulates that the execution of *ibra'* contract should not be made contingent upon a certain condition which is not acceptable or subjected to a trigger event in the future. The reason being is that *ibra'* consists of the element of transferring ownership, which does not allow it to be *ta'liq* (suspending). The above discussion shows that giving *ibra'* is not mandatory even if it is stipulated upfront in financing agreement. In addition, it can be said that the cardinal principal that constitutes the basis of *ibra'* is the principle of *ihsan* (benevolence). *Ihsan* in this regard signifies the act of discharging an obligation beyond the required level which entails that there should not be any counter-value given as consideration. Hence, *ihsan* forms the basis for all charitable contracts like *hibah*, *waqf*, *kafalah* etc., in which the ownership of an asset is transferred without any counter-value. However, if *ihsan* comes from both contracting parties, i.e., the debtor and the creditor, in a deferred sale, like in the case of bilateral *ibra'* (*ibra' mutabadal*), the financial contract may have a feature of *mu'awadah*; and hence, the ruling of *mu'awadah* (compensation) may have to be applied accordingly based on the principle of justice not *ihsan*. This issue can be obviously seen in the case of absolution on part of the deferred debt on account of prepayment of part of the outstanding debt that is considered a contentious issue in contemporary Islamic finance.

LEGAL CONSEQUENCES OF *IBRA'*

The legal consequences of *ibra'* takes effect immediately after its execution as *ibra'* consists of the element of transferring ownership (*tamlik*), which does not admit any form of contingency or conditionality. In this case, *ibra'* causes the debtor to be released from debt liability, which thereafter eliminates the creditor's right to claim the debt. However, the aforementioned legal consequences can only take effect when all the conditions of *ibra'* related to absolving the creditor (*mubri'*), the debtor (*mubra'*), the debt and absolution by verbal expression are completely fulfilled. Once they are met, any claim made by the creditor in relation to *ibra'* would not be considered.

APPLICATION OF *IBRA'* IN ISLAMIC FINANCE

In essence, the concept of *ibra'* has been widely used by Islamic financial institutions in their products and services, which reflect that *ibra'* plays an important role in making Islamic banking products and services viable and relevant in contemporary time. The significance of *ibra'* in contemporary Islamic finance can be viewed from two perspectives as follows:

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- *Ibra'* is significant to make Islamic financial products and services competitive with that of conventional. The incorporation of *ibra'* in terms and conditions of a financing agreement makes Islamic products and services more attractive to the customer and the customer may have a chance to pay lesser than the agreed selling price.
- *Ibra'* serves as a significant mechanism to resolve disputes arising from Islamic financial products and services. *Ibra'* in this regard functions as a method of reconciliation (*sulh*) between the contracting parties when it comes to settling disputes in courts, which may have required a longer process and incur more costs.

The above significance of *ibra'* in contemporary Islamic finance can be seen more clearly in various instances of contemporary application of *ibra'*. Generally, *ibra'* in Islamic finance is applied to prepayment of debt in deferred sale, adoption of variable profit rate and adjustment of *ibra'* formula to compensate for the cost of fund incurred by the bank in case the customer defaults.

ABSOLUTION DUE TO PREPAYMENT OF DEBT

It is acknowledged that many banks do not include *ibra'* clause in their financing agreement due to *Shariah* concerns, fearing that incorporation of the clause in the agreement may tantamount to uncertainty (*gharar*) in the selling price. In line with the aforesaid nature of *ibra'*, it can only be given by the banks' sole discretion without being inserted prior to the agreement. This means that in the event of default, the defaulter is obliged to pay the complete selling price should the bank refuse to grant him *ibra'*. The full payment of the bank's selling price may include unaccrued profit for the whole tenure of the financing facility. In contrast, under a conventional loan, the defaulter would only be obliged to pay the loan amount plus accrued interest and other related charges such as late payment interest. In order for Islamic banks to be competitive with their conventional counterparty, clause such as *ibra'* has to be inserted in their financing agreement.

Here comes the beauty of Islam as a way of life that has a comprehensive provision to provide *maslahah* (benefit) for its *ummah* (nation) under any circumstances. In the aforementioned situation, the disagreement among Islamic jurists concerning conditional *ibra'* (*ibra' mu'allaqah*) or outstanding debt (*da' wa ta'ajjal*) becomes a blessing whereby the opinion that permits conditional *ibra'* can be appropriately applied. However, the Shariah Advisory Council (SAC) of Bank Negara Malaysia (BNM) resolved that BNM, as the central bank, may require Islamic financial institutions to accord *ibra'* to their customer who wishes to settle their debt obligation arising from the sale-based contract, such as bay' *bithaman ajil* or *murabahah*, prior to the agreed settlement period. Bank Negara Malaysia may also require the terms and conditions on *ibra'* to be incorporated in the financing agreement to eliminate any uncertainty with respect to customer's entitlement to receive *ibra'* from Islamic financial institution (Shariah Resolutions in Islamic Finance 2010, p. 123).

The abovementioned BNM Shariah resolution reflects that *ibra'* may still be deemed unilateral and discretionary. It is also important to note that *ibra'* is actually obliged by BNM, in its capacity as authority, to regulate the operation of Islamic banking businesses and to secure the benefit (*maslahah*) of the customers.

Instead, the mandatory *ibra'*, either by way of bilateral *ibra'* or ruling passed by relevant government authority, is in line with the principle of justice, which is reflected in the element of time value of money (TVM) embedded in it. The element of TVM lies in deferred payment of debt arising from a deferred sale. A large majority of Shariah scholars agree that deferment earns a portion in price and hence, the deferred price is usually higher than the spot price. If the price of a commodity increases on account of deferment on deferred sale, it should be decreased due to acceleration of payment as in the case of waiving of outstanding debt with a condition of expediting settlement (*da' wa ta'ajjali*) or conditional *ibra'*. Some scholars argue that this type of *ibra'* consists of element of *riba* because the price is reduced due to time factor that lies in acceleration (*ta'jil*) of settlement. However, this can be counter argued based on the fact that *riba*, which means increase (*ziyadah*), has nothing to do with reduction in the amount of debt. The issue of bilateral *ibra'* can be understood for example, in the case of customer A obtains a financing facility from Bank X as illustrated in table (1) below:

Financing Amount	100 000
Profit rate	10% per year
Annual profit	10% X 100 000 = 10 000 per year
Financing Tenure	15 years
Total Payment for 15 years	100 000 + (15 X 10 000) = 250 000

Table 1 – *Details of Financing Facility Obtained by Customer A from Bank X*

Yr 1	Yr 2	Yr 3	Yr 4	Yr 5	Yr 6	Yr 7	Yr 8	Yr 9	Yr 10	Yr 11	Yr 12	Yr 13	Yr 14	Yr 15

Customer defaulted in year 2

Customer came to make early settlement of his debts in year 10

Table 2 – *Financing Tenures (15 Years)*

However, as shown in table (2), customer A defaulted in year two (2) of the financing tenure after paying the monthly installments for the period of two (2) years. As illustrated in table (2), he came to Bank X in year ten (10) to make full settlement of his outstanding debt. The issue raised in this regard is whether Bank X could claim the whole selling price [100 000 + (15 X 10 000) – (10 000 X 2yrs) = 230 000] or Bank X could only claim the selling price with exclusion of unaccrued profit [100 000 + (15 X 10 000) – (10 000 X 2yrs) – (10 000 X 5yrs) = 180 000]. The mandatory *ibra'* that is based on the acceptable concept of time value of money entails that Bank X could only claim the 180 000. This means that Bank X was not allowed to claim the unaccrued profit as this is considered profiting without counter-value which is a form of *riba al-fadl*.

APPLICATION OF *IBRA'* IN RELATION TO COST OF FUND INCURRED BY THE BANK

In conventional banking, cost of fund refers to interest rate that the bank has to pay for the loan obtained from depositors, money market activities and investments. As for Islamic banking practice, a question has been raised as to whether the cost of fund incurred by the bank in the event of default can be compensated and recognized as income. A study on this issue has been conducted and found that the cost of fund cannot be compensated by the bank under the principle of *ta'widh* (compensation).

The study suggests the adjustment of *ibra'* formula as an alternative for the bank to cover the cost of fund in the event the customer defaults. In this regard, the bank can adopt a certain *ibra'* formula that leads to reduction of the amount of *ibra'* that the customer is entitled to in the event of default. As shown in the above table (2), Bank X can only demand the selling price after deducting *ibra'* amount on the settlement date in year ten (10) of the financing tenure and not the default date in year two (2). In this regard, the practice of *ibra'* remains unilateral and discretionary in nature. For example, instead of giving *ibra'* to its customer for the period of five (5) years (beginning from year 11 to year 15), Bank X may reduce its discretionary *ibra'* from five (5) years to three (3) years.

Hence, the amount that the customer has to pay is calculated as follows: [100 000 + (15 X 10 000) – (10 000 X 2yrs) – (10 000 X 3yrs) = 200 000]. In conclusion, the customer has to pay more to Bank X compared to the first scenario where the customer is entitled to *ibra'* for the period of five (5) years. In this case, Bank X is able to compensate 20 000 [*ibra'* amount for (5) five years (50 000) – *ibra'* amount for three (3) years (30 000)] for the cost of fund incurred. However, it is worth noting that adjustment of *ibra'* formula for the above purpose is only confined to sale-based financing facility such as *murabahah*, *ijarah* and *tawarruq* based financing facility. It is not applicable for financing facility structured based on partnership contract such as *shirkah*.

IBRA' IN BBA VARIABLE RATE

Based on this, *ibra'* is granted on monthly basis in order to correspond with the current profit rate in the market. *Ibra'* is granted based on the promise by the bank which makes the bank bound to fulfill the promise upon trigger event in the future. In the event the Effective Profit Rate is lower than the Ceiling Profit Rate, the monthly *ibra'* will be granted to the customer in order to match with the current market rate. However, it is argued that there is an issue of *gharar* in the form of two different selling prices in a sale contract embedded in this practice of giving *ibra'* . The first selling price is the ceiling price agreed upfront and the second selling price is the price after *ibra'* which is uncertain as it is benchmarked against interest rate. In this regard, the SAC of BNM in its 32nd meeting dated 27 February 2003, has resolved that monthly *ibra'* to match with the current market rate is permissible. The selling price with effective rate is based on the binding unilateral promise (*wa'd mulzim*) given by the bank; it is not premised upon the financing contract of the facility. In addition, the above resolution also allows the incorporation of *ibra'* clause and its method of calculation in the financing agreement to avoid uncertainty.

THE GIVING OF *IBRA'* IN THE EVENT THAT THE ACTUAL DISBURSED AMOUNT IS LESS THAN THE BANK'S PURCHASE PRICE

In commodity *murabahah* based financing facility, the bank upon receiving a purchase order from its customer buys a specified commodity from the commodity supplier at the bank's purchase price which is equivalent to the disbursed amount. The bank will then sell the commodity to the customer with mark up on deferred payment basis. Once the customer owned the commodity, he appoints the bank as agent to sell the commodity on spot basis at a price lower than the bank's selling price which is equivalent to the bank's purchased price. This means that the amount that the bank has to disburse to its customer should be equivalent to the bank's purchase price. In the event that the actual disbursed amount is lesser than the bank's purchase price due to certain reason or technical shortcoming, the bank has to opt for granting *ibra'* to the customer. However, the *ibra'* amount is not granted in cash but rather the bank may reduce the customer's monthly installment in proportion to the *ibra'* amount. In this case, it is obvious that the *ibra'* is significantly important to overcome any shortcoming in the execution of financial transaction like the commodity *murabahah* based financing facility.

CONCLUSION

It can be concluded that *ibra'* is a significant concept adopted in Islamic financing products for the purpose of making the product competitive and viable particularly when Islamic financial institutions are operating in a dual banking system. Instead, *ibra'* is also instrumental in avoiding dispute among the contracting parties particularly in the event of default where the bilateral *ibra'* can be adopted to oblige the bank to give rebate for early settlement done by the customer before maturity date. This approach also makes the Islamic financing products competitive with that offered by its conventional counterparty which is based on lending with interest. In fact, the practice of giving *ibra'* signifies that there is always the way out when Islamic bank encounters with the issue of competitiveness of its products compared to that of conventional. This is substantively manifested in the usage of *ibra'* in BBA variable rate and the mandatory *ibra'* in the case of early settlement by the customer.

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