Repayment moratorium in Malaysian Islamic banks

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The COVID-19 outbreak has led to the implementation of the Movement Control Order (MCO) in Malaysia since the 18th March 2020. The MCO has mandated the closure of all government and private premises — except those involved in essential services. This measure has impacted the cash flow of both the general public and SMEs, affecting their capability to fulfill bank obligations. DR MOHAMMAD MAHBUBI ALI and SITI FARIHA ADILAH ISMAIL write.

In view of the aforementioned, the government on the 25th March 2020 announced a six-month moratorium on loan/financing repayments starting the 1st April 2020. According to Bank Negara Malaysia (BNM), this moratorium is expected to ease the cash flow of SMEs and individuals that are mostly affected by COVID-19. This brief article sheds critical light on the repayment moratorium from the perspective of Shariah.

In Islam, the creation of indebtedness — within the capability to repay it, be it resulting from a benevolent loan or deferred sale contracts, is permissible. However, a debtor is responsible for paying his obligation in a timely manner or as demanded by the creditor. Failure to fulfill a timely payment by a solvent debtor is deemed a breach of other rights and may be subject to punishment.

However, if a debtor is facing genuine difficulty in paying his obligation in due time, the creditor should grant the debtor a time extension for payment. According to the Quran: "And if someone is in hardship, then [let there be] postponement until [a time of] ease (2:280)."

Muslim jurists agree that a creditor is obliged to provide a postponement of payment to an insolvent debtor until he is financially capable of paying it.

They also prohibit any increase over and above the outstanding amount of the obligation as a result of the given postponement of payment, for this will trigger the issue of Riba Jahiliyah or Nasiah.

The BNM's new release on the 1st May 2020, however, allowed the recognition of accrued profit over the deferment period for hire purchase and fixed-rate Islamic financing. This has invoked various contentions and criticisms on how BNM communicates its policy. Nevertheless, this position was later reversed by the minister of finance on the 6th May 2020, which affirms that the moratorium will not invoke any extra charges, including modification loss.

On the whole, a debtor in Islam is classified into two types: a solvent debtor and an insolvent debtor. A solvent debtor is compelled to fulfill his timely obligation, thus is not entitled for an extension of payment. The debtor's refusal to make a timely payment, while being able to pay it, might be subject to punishment. In some incidents, the forced selling of collateral and court action are necessary to recover the creditor's outstanding debt. On the other hand, an insolvent debtor shall be given a sufficient extension of time to settle his obligation until he is financially capable of paying.

The moratorium policy should, therefore, take into consideration the status of bank customers and apply only to insolvent customers, with the exclusion of solvent customers. The banks are, therefore, granted the authority to identify their customers' eligibility for a moratorium. This approach is line with the ultimate objectives of the Shariah on the protection of both life and legally-owned property of customers.

For Islamic banks, the approach on the selective moratorium policy will ensure their financial liquidity and business sustainability amid this extraordinarily challenging time. Applying an automatic moratorium for all customers, irrespective of their financial capabilities, would deepen further the fall in Islamic banking revenues.

This is particularly true since Islamic banks in Malaysia have already suffered from low margins resulting from the slashing of BNM's base rate to 2.5%, low fee-based income due to lesser demand for certain banking services, slow growth in financing amid COVID-19, lower oil prices and a drop in investment avenues due to a capital market slump.

COVID-19 have exposed Islamic banks to an increase in non-performing financing or credit default risk due to a high number of business closures and increase in unemployment.

Currently, thousands of consumers are being placed under quarantine as part of the Enhanced MCO. As a result, these consumers might lose their ability to pay installments, particularly of mortgages. The closure of businesses would lead to cash flow problems, which in turn will affect their capability to fulfill the bank installments.

The pandemic might also bring liquidity risk to Islamic banks because new depositors have an increasing preference for short-term safe assets and safe haven investment portfolios such as gold. On the other hand, as indicated earlier, credit risk will increase significantly due to the rise in the number of business shutdowns and the unemployment rate. Consequently, demand for liquidity arises. Even existing depositors have now started withdrawing their savings for their daily spending, to sustain their life and livelihood.