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Analysing Budget 2021: Islamic Finance Perspective

In tabling the Malaysian Budget 2021 on 6 November 2020, the Finance Minister announced several measures that may impact Islamic finance. Some of these measures are considered below, together with our comments.

(1) Further measures to assist bank customers/borrowers affected by COVID-19

The measures announced in Budget 2021 in this regard (described as “Targeted Loan Repayment Assistance”, or **TRA**) builds on previous government announcements earlier this year (see below) on moratorium and payment/repayment assistance for bank customers/borrowers affected by the COVID-19 pandemic.

Under Budget 2021, the earlier initiatives relating to moratorium and payment flexibility are further enhanced by the TRA measures as follows:

B40 and micro-enterprise customers/ borrowers — additional moratorium, reduced monthly instalment payments

Further assistance is granted under Budget 2021 to individual customers/borrowers in the B40 income group who are Bantuan Sara Hidup recipients, as well as to micro enterprise customers/borrowers with bank financing/loans of up to RM150,000.

For such customers/borrowers, they may request their banks to:

- (a) defer monthly instalment payments for three months; or
- (b) reduce their monthly instalment payments by 50% for six months.

Bank Negara Malaysia (**BNM**) has clarified that the above measures will be available to eligible customers/borrowers between 23 November 2020 and 30 June 2021, applicable to monthly instalments due in December 2020 onwards, and will take effect at the next instalment following a customer/borrower’s

request and confirmation.

M40 customers/ borrowers — self-declaration for reduced monthly instalment payments

This measure was announced in Budget 2021 and is further clarified by BNM.

For customers/borrowers in the M40 income group who are registered in the Bantuan Prihatin Nasional database and whose household incomes have been reduced due to the COVID-19 pandemic, BNM has stated that banks will accept requests from such customers/borrowers to reduce their monthly instalment payments.

The banks will process such requests based on the customers'/borrowers' self-declaration of reduced income and/or their household, to further expedite immediate relief. BNM further clarified that such banks will continue to engage with these customers/borrowers subsequently to review their financial circumstances.

Comment on the TRA measures

TRA complements previous moratorium and payment flexibility initiatives — the measures in Budget 2021 may be seen as a continuation of earlier moratorium and payment flexibility initiatives implemented by BNM this year, as follows:

- (a) initial blanket automatic six-month moratorium — covering all bank financing/loans to individuals for the period starting on 1 April 2020 and ending on 30 September 2020;
- (b) further targeted moratorium — for a further three-month period (i.e. 1 October 2020 to 31 December 2020) covering bank financing/loans to customers/borrowers who lost their jobs due to the COVID-19 pandemic;
- (c) reduced monthly instalment payment/repayment — for a period of at least six months (i.e. from 1 October 2020 onwards) covering bank financing/loans to customers/borrowers who had their salaries/income reduced due to the COVID-19 pandemic; and
- (d) payment flexibility measures — for other individual and SME customers/borrowers affected by the COVID-19 pandemic, depending on the circumstances: for example, banks may allow payment of only the profit/interest portion over a period of time, or banks may extend the overall period of the financing/loan to reduce the monthly instalment payments.

When TRA takes effect — The three-month targeted moratorium and the six-month reduced instalment payment measures apply

to monthly instalments due in December 2020 onwards. This will grant further relief, either in the form of a moratorium or reduced instalment payment, to eligible bank customers/borrowers who have been adversely affected by the COVID-19.

TRA may affect fixed rate Islamic financing — As noted by BNM, the targeted moratorium and reduced instalment payment measures may impact the *aqad* (contract) for existing fixed rate Islamic financing facilities, if banks impose additional profit for the period of the targeted moratorium/reduced instalment payment. A new *aqad* is required if banks charge additional profit on existing fixed rate Islamic financing facilities using Shariah concepts such as *Tawarruq* (multi-party sale transactions), *Murabahah* (cost plus sale), *Bai' Bithaman Ajil* (sale with deferred payment). However, if banks decide not to impose additional profit pursuant to the TRA, then no new *aqad* would be required.

TRA may affect Islamic hire purchase facilities — Any additional profit imposed by banks will not necessarily impact the *aqad* for existing Islamic hire purchase transactions from the Shariah perspective, because the Shariah concept of *Ijarah* (lease) used in Islamic hire purchase structures is sufficiently flexible to deal with this issue. However (as noted by BNM), a supplemental agreement is required to cover such additional profit due to the requirements of the Hire Purchase Act 1967. It may also be noted that unlike the case for the previous six-month blanket moratorium, the Finance Minister has not made any similar announcement that additional charges will not be imposed on Islamic hire purchase facilities that are subject to the targeted three-month moratorium.

(2) Proposed Consumer Credit Act — regulating consumer credit providers, impact on Islamic finance

The Finance Minister in Budget 2021 also proposed the enactment of a Consumer Credit Act, to encourage standardised “credit lending” activities and increase consumer protection. It was suggested that the proposed Act would provide a regulatory framework for activities related to the issuance of consumer credit and strengthen supervision of non-bank and non-supervised credit providers. It was also announced that BNM and the Securities Commission (**SC**) would lead the effort to formulate regulation for such consumer credit providers.

Comment on the Proposed Consumer Credit Act

Proposed Act has been announced in the past — The proposed Consumer Credit Act in Budget 2021 builds on earlier announcements made by the government previously (in particular, by the BNM governor and the previous Prime Minister), and therefore it is much welcomed that the government has decided to follow through on this initiative.

Proposed Act may affect existing law — Questions remain, though, on the scope and extent of the proposed Act: for example, what will happen to existing laws that also deal with consumer credit, such as the Moneylenders Act 1951, the Hire Purchase Act 1967, and the credit sale provisions in the Consumer Protection Act 1999. Would all these laws be repealed and subsumed under the new law? It would be good to see how these questions will be addressed in the proposed Act.

Proposed Act may affect Islamic finance — Will the proposed Act cover Islamic financing as well as conventional loans? In Budget 2021, the term “credit lending” was used by the Finance Minister in relation to the proposed Act, which seems to exclude Islamic financing. However, taking the cue from other consumer legislation, the position may be less clear. For example, the courts in the past have held that Islamic financing does not fall under the Moneylenders Act 1951, while Islamic hire purchase transactions have been held by the courts to be subject to the Hire Purchase Act 1967. It remains to be seen whether the proposed Act will apply to consumer credit using Islamic financing structures.

SC (together with BNM) may jointly regulate consumer credit — In Budget 2021, it was specifically mentioned that the SC (together with BNM) would jointly lead the effort to regulate consumer credit pursuant to the proposed Act. One would have thought that such a regulatory role would be left to BNM, in view of its position as regulator for banks and other non-bank institutions involved with Islamic financing. However, the inclusion of the SC may be appropriate particularly if such consumer credit products were to be offered electronically via digital platforms (which in the recent past has been regulated by both the SC and BNM).

(3) Sustainable and Responsible Investment (SRI) Sukuk — extending tax exemption on Sukuk grants

Budget 2021 also deals with income tax exemption on grants received by SRI *Sukuk* issuers from the SC, to finance the external review expenses incurred by an SRI *Sukuk* issuer up to a maximum amount of RM300,000. Previously, as earlier provided under Budget 2018, the income tax exemption applied only to grants given by the SC to Green Sustainable and Responsible Investments *Sukuk* (**Green SRI Sukuk**) issuers, and only for grant applications received by the SC from 1 January 2018 until the end of this year, i.e. 31 December 2020.

Under Budget 2021, the existing income tax exemption on Green SRI *Sukuk* grants is further enhanced as follows:

- (a) the tax exemption is expanded to all grants for SRI *Sukuk* and bonds which meet the ASEAN Green, Social and Sustainability Bond Standards, approved by

- the SC; and
- (b) the tax exemption on SRI *Sukuk* and bond grants is extended for an additional five years, i.e. to cover SRI *Sukuk* and bond grant applications received by the SC from 1 January 2021 to 31 December 2025.

Comment on the Tax Incentive for SRI Sukuk Grants

Present tax exemption is part of SRI tax incentives package — The tax exemption on SRI *Sukuk* grants announced in Budget 2021 is actually part of a series of tax incentives for SRI structures that have been announced in the past. In Budget 2016, the SRI tax incentive focused on income tax deduction on SRI *Sukuk* issuance costs; while in Budget 2018, the SRI tax incentives included income tax exemption on management fee income received by SRI fund managers (in addition to income tax exemption on Green SRI *Sukuk* grants as described above).

Other SRI tax incentives have already been extended — Last year, the other tax incentives (relating to income tax deduction on *Sukuk* issuance costs and tax exemption on management fee income) were extended until year of assessment 2023, following measures announced in Budget 2020. In contrast, under Budget 2021, the tax exemption on SRI *Sukuk* grants has been extended until the end of 2025. As such, it may be better if the various SRI tax incentives were streamlined to cover the same period.

Concluding remarks

It is appreciated that Budget 2021 is aimed at getting the Malaysian economy back on track in view of the COVID-19 pandemic. As such, specific incentives for Islamic finance may not be a priority at this time. In any event, it is hoped that the measures announced in Budget 2021 will help promote the development of the Malaysian economy generally (and the Islamic finance industry consequently) in the coming years.

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