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International Journal of Economics and Politics 2(1): 97-115, 2021

IJEP International Journal of Economics and Politics

DOI:10.29252/jep.2.1.97

Mechanisms to Handle Default Cases in Islamic Banking: The Malaysian Approach

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ARTICLE INFO

Article history:
Date of submission: 4-12-2020
Date of acceptance: 19-12-2020

JEL Classification:

G21
G24
G32

Keywords:
Islamic Banking
Islamic law
Shariah governance
Malaysia

ABSTRACT

This research investigates how Islamic banking institutions control default cases and the mechanisms they employ in handling such cases with reference to Malaysian Islamic banking regime. It was conducted on an exploratory design that employed doctrinal approach. Data were sourced from relevant statutes, regulatory guidelines, policy documents and established practices among Islamic banking institutions as well as academic texts that pertain to default cases. The data were examined with legal reasoning and qualitative analysis. The research finds that Islamic banks are prone to default cases and provide internal and external mechanisms to handle such cases in their operations. Though Islamic banks statutorily have wider scope than conventional ones, both banks are subject of the same framework in matter of credit risk regulations in Malaysia. The fusion of technology within procedures and governance mechanisms of dealing with default cases offers distinct benefits for Islamic banks in Malaysia. Analysis and reasoning in this research are restricted to the Malaysian Islamic banking regime only due to legal peculiarities among Islamic finance jurisdictions. Likewise, the research is confined to legal and regulatory perception of default cases only and could be furthered onto perceptions of other stakeholders in debt-recovery process. Again, subjective interpretation is inevitable in the analysis of some cases considered.This research contributes towards default cases literature in relation to Islamic banks and offers to fill research gaps therein. The research assists in understanding default control mechanisms employed by Islamic banks in Malaysia and stands to impart lessons to other jurisdictions thereon.

1. Introduction

Islamic banking system differs from its conventional counterpart. The Islamic banking system derives its principles from Islamic law or Shariah. However, some scholars like Ariff (2014) argued that Islamic banking is an

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imitation of conventional banking and still remains under its shadow. According to him, it is not just in term of products similarity between the two systems but also the fact that there is strong presence of the conventional banks as stakeholders in Islamic banking industry (Ariff, 2014). This might be true in some jurisdictions as different legal and regulatory frameworks are adopted for Islamic banking and as such, Islamic banks operating in various countries face obstacles peculiar to their jurisdiction across the globe. However, default is a common risk that faces both Islamic and conventional banks. Even though the way default occurs in Islamic bank may differ from conventional bank, it is nonetheless unavoidable in both. As such, adequate and effective mechanisms are required to handle them.

In Islamic banking, default occurs where a customer fail to meet due obligation under a financing facility that has been provided. However, in conventional banking default always arises out of a loan contract when the customer fails to repay the loan as agreed with simple or compound interest. The concept of default is broad in Islamic banking as the nature of Islamic banking products is different from those of conventional ones. Moreover, there are variety of products whose underlying contracts put the parties in various type of relationship which affects how default would be said to occur. Accordingly, default will be determined based on the product provided to the customer. For simplification purpose, it can be said that there are four main types of financing products that could be given to customers of Islamic banks. One is debt based products where products will be structured using debt based Shariah contracts such as *murabahah* (a trust sale where it is mandatory for the cost price of the asset and the profit to be disclosed to the customer), *bai' bithaman ajil* or BBA (instalment sale with defined instalment period and amount), *salam* (forward sale), *istisna'* (manufacturing contract), *'inah* (sale and buy-back sale) and *tawarruq* (monetization sale). Second is lease based products that could be structured based on *ijarah* (lease) while the third type is based on equity-based contracts such as *mudharabah* (money management partnership contract) and *musharakah* (joint venture). The final kind is a service-based contracts such as *wakalah* (agency) and *kafalah* (guarantee) where a fee can be charged for providing the service. Furthermore, these different Shari'ah contracts can also be combined to structure products as

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combination of contracts (*ijtima al-uqud)* is allowed within the limits imposed by shariah (Arbouna, 2007). In this vein, Islamic financial engineering provides two approaches that can be taken to come up with an Islamic financial product (Iqbal, 1999). The first approach, described as reverse engineering, involves considering of a prevailing instrument in the conventional system to assess its element with the objective of finding a closest substitute for Islamic finance from within the basic set of Islamic financial products or service. The second approach, which is innovation, entails invention of a new set of financial products that have distinctive risk-return profile (Iqbal, 1999, p. 547). Iqbal (1999) also believes that although in the long run the second approach may be better, it is more practicable to combine both in the short term.

Since different jurisdictions have different legal, regulatory and Shariah governance framework applicable to Islamic banking, it would be unfair to generalize how Islamic banks deal with default cases. Malaysia has been selected as the jurisdiction for this study because it has distinguished itself as a country a developed and sophisticated legal and regulatory framework for Islamic banking practice. Malaysia has been one jurisdiction in the world where it is statutorily provided for the country to have dual financial systems, so that Islamic finance system exists on its own distinctive legal regime as the conventional system. Section 27 of the Central Bank of Malaysia Act 2009 states that: "the financial system in Malaysia shall consist of the conventional financial system and the Islamic financial system". This proves the commitment of the government of Malaysia to sustain both Islamic banking and conventional banking in the country. Against this backdrop, this research examined and analysed legal and regulatory regimes for handling and managing default cases by Islamic banks in Malaysia.

Regardless of measures aimed at eliminating default, such as assured commitment to repayment capability, the issue of default in a banker/customer relationship remains as subsisting as the banking business itself (Moradi and Rafiei, 2019). A cursory appraisal of existing works points to the fact that both Islamic and conventional banks face similar challenge of default in settling obligations by customers (Muneeza, 2019; Ewanchuk and Frei, 2019; Hasan

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et al., 2017). However, careful scrutiny reveals that a case of default has more ramification on Islamic banks than conventional ones due the fact that Shariah has been less strict with respect to demand of repayment from a defaulter facing financial difficulties who, more often than not, solely defaults because of the said difficulties. In addition, Islamic banks cannot charge interest or any punitive fee for a default that is unintended and inevitable (Ali et al., 2019). In that situation, Islamic banks are obliged to, accordingly, grant respite. Authors such as Weill and Godlewski (2014), concluded that this unique feature of Islamic banking has made it more attractive to large firms for corporate lending. According to experts like Evans et al., (2019), default is not restricted to lending and granting of facilities by traditional banking business institutions. Modern lending avenues of p2p that are built and enabled by the revolutionary blockchain technology are, yet, prone to default notwithstanding all sophisticated algorithm employed to achieve automation (Gorajski et al., 2019; Chen et al., 2019; Yoon et al., 2019). In that instance, it is only for the system to initiate an automated action response appropriate for the default in question (Moradi and Rafiei, 2019). Meanwhile, the nature of default in Islamic banks makes it imperative for them to devise suitable mechanism to handle default cases (Ali et al., 2019) in their traditional and modern technology-driven operations.

This research paper consists of five sections. Section one comprises of this introduction; section two states the research methodology of the research; section three discusses perspective of the law on default in Islamic Banks; section four discusses practical perspective of dealing with default by Islamic Banks while section five, which is the conclusion of the paper, highlights the findings and recommendations of the research.

2. Research Methodology

This is an exploratory legal research and employs doctrinal methodology whereby relevant statutes and regulations, decided cases or case law, Bank Negara Malaysia Policy Documents in addition to regulatory guidelines are examined and analysed in a qualitative fashion. Secondary data from journal articles, textbooks and other published sources that are relevant to the research

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have been utilized in buttressing the examination and analyses presented in the work.

3. **Perspective of the Law on Default in Islamic Banks**

From the debtor or customer's perspective, a default may occur if a debtor is either unwilling or unable to pay his/her debt. There are many reasons why a customer defaults. Some of the common causes include lack of willingness to pay debt coupled with diversion of funds by borrowers, wilful negligence and improper appraisal by credit officers (Ali et al., 2019). Inadequate financial analysis of the customers made by the bank may be a contributing factor for default (Hasan et al., 2017). Though these are the general causes why a customer defaults in payment of debt, there can be number of other specific reasons which may differ from place to place, time to time and jurisdiction to jurisdiction.

It is an established fact that the risks of Islamic banks depend on the nature of products used in the transactions, either deposit or financing (Muneeza, 2019). Accordingly, Islamic banks will face greater challenges in classifying and managing risk than conventional banks, depending on the complications arising and the nature of the risk of each contract (Weill and Godlewski, 2014) in addition to profit-loss sharing concept of certain financing product (Sundararajan & Errico, 2002; Venardos, 2006). Also, the nature of risk faced by the capital owners in an Islamic bank differs according to the types of financial instruments it uses, the people it employs to manage the bank and its degree of transparency (Rosly & Zaini, 2008 and Hassan & Dicle, 2005).

It is essential to state that credit risk is the main risk faced by Islamic banks like its conventional counterparts (Sulaiman et al. 2018). Islamic Financial Services Board (2005) defines credit risk as potential that a counterparty fails to meet its obligations in accordance with agreed terms. This includes for example managing financial exposure in *murabahah* (cost-plus profit disclosed trust sale), *musharakah mutanaqisah* (diminishing partnership) and *ijarah* (lease) contracts for the receivables and leases and managing working capital financing transactions or project in *salam* (forward sale), *istisna'* (manufacturing sale) and *mudarabah* (money management partnership)

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contracts. Credit risk management in Islamic banks is more complicated due to nature of the contracts and additional factors such as due to the fact that Islamic banks cannot charge a penalty due to default in payment by the customer as conventional banks can charge penalty or overdue interest. There is a possibility that this limitation can be misused by the customer and they may intentionally default in payment as they are aware of the fact that Islamic banks will not charge anything extra to them like the conventional banks. This is an additional issue faced by Islamic banks in credit risk management (Khan, 2003).

There are many mechanisms followed by financial institutions to mitigate the risk of default like pledging of collateral, third-party credit guarantee, use of credit rating, appointment of independent collection agencies and following strict credit evaluation policies by ensuring that the financing facilities are given to only customers who are likely to be able to repay, and who are unlikely to become insolvent (Ahmad et al., 2018; Sheila, 201; Kohansal & Mansoori, 2009; Aballey, 2009). The credit evaluation process of customers made by Islamic banks must be done taking into consideration the circumstance of the location where the bank operates (Ali et al., 2019).

In Malaysia, mechanisms to handle default case does not start from the point where customer defaults. Bank Negara has established frameworks to be followed by Islamic banks to avoid default in the first place as prevention is better than cure. On 22nd January 2018, the Bank Negara Malaysia released the "Policy Document on Credit Risk for banking institutions, insurers and takaful operators, and financial holding companies." It is a revised standard culminating in Bank Negara Malaysia's comprehensive review of the existing regulatory framework, "Best Practices for the Management of Credit Risk Guidelines." The revised standard aims to further elevate credit risk management practices across the industry, taking into account developments in the size and diversity of product offerings, greater internationalisation of the financial system and the growing role of domestic capital markets (Bank Negara Malaysia, 2018A). The policy document took effect beginning 1 July 2018 for banks on an entity basis and 1 July 2019 on a consolidated basis (Bank Negara Malaysia, 2018A). This policy document has been issued

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pursuant to sections 47(1) and 266 of the FSA 2013 and sections 57(1) and 277 of IFSA 2013.

The Credit Risk policy document of Bank Negara Malaysia defines Credit risk (including counterparty credit risk) as "the risk of a counterparty failing to perform its obligations" (paragraph 1.1, Bank Negara Malaysia, 2018B). There are total 17 paragraphs with an appendix in this policy document which are also applicable to Islamic banks. According to this policy document, the Board of the financial institution will have to promote a sound credit risk management environment and will have to annually approve the credit risk strategy of the respective financial institution. In addition to this, a robust internal system and an infrastructure must be established for inter alia to for timely detection and escalation of issues related to credit risk management. This policy document deals with credit approval, credit risk assessment, credit risk measurement, exceptional credits, credit risk monitoring, problem credits, credit risk reporting, credit concentration risk, credit risk reporting, independent credit review and specific requirements for banking institutions: rescheduling and restructuring of loan/financing facilities.

4. Practical Perspective of Dealing with Default by Islamic Banks

To understand how Islamic banks deal with default cases in practice, it is imperative to see how they deal with default in four aspects. Firstly, at the governance level; secondly in dispute resolution stage; thirdly at internal level leveraging on technology and finally externally by relying on other institutions. For illustration purposes, information extracted from different Islamic banks operating in Malaysia will be referred.

(a) Governance Level

To mitigate credit risk, Islamic banks have put in place mechanisms within the institution. Bank Islam Malaysia Berhad (2013) states that collection tools and approaches of Islamic banks can include collection system, reminder letters, auto dialer, short messaging system, email reminder, outsourcing to external agency, legal action, internal reschedule and restructure and external arrangements such as Agensi

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Kaunseling dan Pengurusan Kredit (Credit Counselling and Debt Management Agency).

Guiding principles of risk management for institutions (other than insurance institutions) offering only Islamic financial services published by Islamic Financial Services Board (2005), states that credit risk is one of the risks faced by Islamic banks. It is stated there that Islamic banks shall have in place a strategy for financing, using various instruments, in compliance with Shariah, whereby it recognizes the potential credit exposures that may arise at different stages of the various financing agreements and it shall also carry out a due diligence review in respect of counterparties prior to deciding on the choice of an appropriate Islamic financing instrument. Furthermore, Islamic bank must also have in place appropriate methodologies for measuring and reporting the credit risk exposures arising under each Islamic financing instrument and must have in place Shariah compliant credit risk mitigating techniques appropriate for each Islamic financing instrument. Therefore, within Islamic banks, underwriting standards, risk control and credit recovery mechanisms must be put in place to deal adequately and effectively with credit risk.

The organizational structure of Bank Islam Malaysia Bhd, the first Islamic bank in Malaysia illustrates that there is a recovery and rehabilitation department within the bank. Also, at the board level, it has established a Board Risk Committee and at management level there is a Management Risk and Control Committee that consists of Recovery Management Committee and Operational Risk Control Committee. The main function of the Board Risk Committee is to oversee the Bank's activities in managing credit risk, market risk, liquidity risk, operational risk, legal risk, Shariah-compliance risk, compliance risk and any other relevant risks and to ensure that the risk management process is in place and functioning (Bank Islamic Malaysia Berhad, 2017, p.138). The function of the Management Risk Control Committee is a sub-committee of Board Risk Committee and the highest risk committee at Management level (Bank Islamic Malaysia Berhad, 2017, p.138). It is responsible to perform the oversight functions and to ensure effective management of

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key issues relating to the overall risk management of the Bank. Operational Risk Control Committee is a subcommittee of Management Risk Control Committee (MRCC) which is responsible to provide the oversight function on facilitate the function and objective of MRCC in the management of key issues on operational risk (Bank Islamic Malaysia Berhad, 2017, p.138). Recovery Management Committee is a subcommittee of Management Risk Control Committee and responsible to provide the oversight function on recovery issues and related operational strategies on recovery in the Bank. This structure is in line with the Credit Risk concept paper of Bank Negara Malaysia that was discussed earlier (Bank Islamic Malaysia Berhad, 2017, p.138).

(b) Dispute Resolution Stage

Islamic banks in case of default prior to the dispute being taken to the court also takes some actions and using case law this can be illustrated. The case selected to discuss is the most recent reported case law found in the Malaysian Lexisnexis website, which is *Sigur Ros Sdn Bhd & Anor v Maybank Islamic Bhd & Anor* [2018] MLJU 244. The reason why this case is chosen is to illustrate the latest practice of the Islamic banking industry in this regard.

In the case of *Sigur Ros Sdn Bhd & Anor v Maybank Islamic Bhd & Anor* [2018] MLJU 244, it is said that when the default was triggered, the first plaintiff asked for extension of time and the first defendant did accept this proposal by offering to restructure the financing. The main reason why the first defendant in this case offered to restructure the financing facility taken by the first defendant was due to the fact that first plaintiff was facing difficulty in making the payments on time and merely granting more time will not help the first plaintiff to fulfil the obligation to pay. It is known from the facts of this case that the first defendant has given plaintiff a bullet repayment deadline and granted at least 4 extensions of time. However, the first plaintiff was unable to settle the payment owing to the first defendant even though multiple extension of time was given. Finally a letter of demand was sent to settle the payment within 14 days with the notice that if this is not complied, the matter will

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be taken to litigation. When this letter of demand was sent by the first defendant to the first plaintiff, again the first plaintiff requested for extension of time via a letter.

It is imperative to note that the Islamic banks do take adequate measurements in cases of default before the matter is taken to the court. This is evident from the above case. From the above case analysis, it is understood that the Islamic bank involved in the case tried to resolve the issue amicably out of court. This proves that Islamic banks do not straight away go to the court when a default occurs and there are certain internal mechanisms put in place in the Islamic banks, just like the conventional banks in this regard.

(c) Leveraging on Technology

In the Bank Muamalat Malaysia Berhad's Annual Report (2016) it is stated that it has started using technology to improve processes on delinquent and impaired financing accounts with the launching of new collection module known as Juris Collect which is a software equipped with artificial intelligence to extract customer's information for purpose of managing delinquencies allocation of cases to collection agents and managing effectiveness of collection agents performance. The purpose of this is to help the genuine customers facing potential problem in their repayment for workout solution to prevent their account turning delinquent. It must be noted that simultaneously, the bank also use a proactive step to detect early warning sign of potential problem accounts (Bank Muamalat Malaysia Berhad, 2016).

It is also stated in Bank Muamalat Malaysia Berhad's Annual Report (2016) of the bank that in July 2015, the bank has successfully implemented a web-based online Financing Document System ("FDS") for Home Financing. FDS is a collaborative application solution between the Bank and designated solicitors that undertake financing documentation for the bank and this application is an automated tracking system to monitor the progress of financing and security documentation from the issue of letter of instruction to the solicitors until the perfection of all financing and return of security documents from the solicitors

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(Bank Muamalat Malaysia Berhad, 2016). Another function of FSD is that provides an incorporates automated straight through processing on settlement of Bank's legal documentation fees and charges to the solicitor's accounts by improving efficiency and facilitates faster turnaround time in the perfection of home financing documentation which results in faster disbursement of funds (Bank Muamalat Malaysia Berhad, 2016).

Juris Collect software provides an end to end debt collection system with different collection strategies that is required by their customers (Juristech, N/A). They offer modules for managing each stage of delinquency with functionalities encompassing collection, recovery, agency management, legal recovery and write-off. In the collection stage, the bank can strategize contact channels using predictive behavioural scoring using Artificial Intelligence (AI) and in the recovery stage, the bank can manage late stage accounts using pro-active recovery strategies. In the agency management stage, the bank is able to place hard to collect accounts in a fully collaborative framework and in the legal recovery stage, the bank is able to recover debt by pursuing legal action including bankruptcy and winding up. The final state of write-off will enables the bank to write-off accounts that have exhausted all avenues through interface to host and general ledger.

In the official website of Juristech, Bank Rakyat has been presented as a case study to illustrate their success story. It is stated that to tighten and consolidate its collection and recovery processes, Bank Rakyat engaged Juris Technologies in 2006 to deploy Juris Collect. Juris Collect was deployed and a rollout in early 2008 and successfully integrated all parties, including internal collectors, Credit Management Department, Core Banking System, external collectors and law firms into one seamless collection process. A review done in 2009 had shown that during the first nine months of 2009 (January to September 2009), the rate of non-performing loans was brought down to 1.2 per cent from 1.9 per cent.

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(d) Relying on External Institutions

In April 2006, Bank Negara Malaysia set up an agency called Credit Counselling and Debt Management Agency, or commonly known as Agensi Kaunseling dan Pengurusan Kredit (AKPK) with the main objective of assisting individuals in managing their financial situation. The services provided by this agency includes financial education, financial counselling and debt management program services are provided by the Agency. AKPK provides financial counselling prior the debtor getting defaulted by making them aware of the consequences of being defaulted. Even after being defaulted, the debtor can seek help from AKPK to get assistance to get relief or an adequate amicable solution that could be workable to settle the debt. Online debt management service is also provided by AKPK and the website of AKPK provides information required for financial literacy and other matters to provide relief in settling a debt.

In providing debt management service, AKPK negotiates on behalf of their customer (debtor) with the banks to restructure or reschedule the facilities taken. The success stories of AKPK are numerous and they are being made publicly made available for others to take a lesson from them. In one of the success stories mentioned, there was a person who came to AKPK after struggling for 3 years to settle a debt owing to a financial institution and he had no clue on how he could manage his financial affairs to settle off the debt. What happened to him was when he returned after living in another country for 15 years to Malaysia, he had a shocking discovery that due to his credit cards, he owe a debt of RM 66,000 to his banks. He discovered that this debt did not arise as a result of him neglecting to pay off his debt but due to the reason that he forgot to cancel the credit cards owing to two different banks. Both the banks levied finance charges on membership fees and the amount ridiculously ballooned in a matter of years. He tried his best for 3 years to negotiate with the banks to retract or reduce the amount he owed to them, but did not succeed. When he heard about AKPK, he decided to approach AKPK and AKPK negotiated with the two banks on his behalf on the matter.

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AKPK was able to secure a 10 year tenure for him to pay his debt to the banks.

The analysis of the above case indicates that the role the Authority plays in the debt management is that of a mediator based on the shariah concept of *Sulh*. *Sulh* comprises of mediation, negotiation or conciliation as well as compromise of action which fits within the definition of Alternate Dispute Resolution (ADR) (Islam, 2012; p.31). This model is indeed feasible and can be adopted in other countries to ensure that burden of debt does not prevent people from going about their normal life. In this model, the approach taken is self-help assistance seeking mechanism and the assistance provided is effective enough to change the situation of the worried debtor. The fact that the involvement of the Central Bank of Malaysia in this initiative make the Authority's function effective and enforceable.

The Islamic Corporation for the Development of the Private Sector (ICD), the private sector arm of Islamic Development Bank (IDB) Group is in the process of testing a model called "Biniog Sathi" banking model. Biniog Sathi", meaning "Friend in Investment" in Bangla, is a new generation banking model developed by ICD to address problem of credit default in the banking industry with the help of Zakat and Sadaqa. The model is based on Islamic finance principles and it will make the Islamic Banking more competitive. The idea was first conceptualized in 2006, however, it was not made public until 2012 when it was first publicized through "ICD Maze" competition. Eventually two seminars were held in IDB and IRTI. Primarily, the Biniog Sathi Model will be used for individual and micro debtors only. These may include farmers, small businessmen, women, students, working class people, etc.

Under this model, each Islamic bank will have a contractual relationship with an independent Zakat and Charity Fund. The Islamic bank will conduct its financing operations as usual via shariah compliant sale contract and if default occurs, the customer who is the debtor will be provided with an option to receive assistance from the Zakat and Charity Fund with which the Islamic bank has a contractual relationship with.

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The advantage of this model is that it creates an option where the bank will not have to forgo the principal amount given to the customer who defaulted and the customer via Zakat and Charity Fund will be able to pay off his debt to the bank without hardship.

If an Islamic bank were to adopt this model, it must enter into a long-term agreement with Biniog Sathi Limited (BSL). BSL is an entity which will be formed in the future with the capital injection from multilateral banks, such as, ICD. For time being, an ICD team carries out the responsibilities on behalf of BSL till the entity is formally incorporated. The Islamic bank will then enter into a long term agreement with a Zakat and Charity Fund and then the implementation of the model can be carried out.

The role of BSL is crucial in this model. The BSL will formulate a Biniog Sathi Protocol that will specify the steps to be undertaken by the Islamic ban in order to investigate a defaulted borrower to determine whether the default is a genuine one. This protocol will include procedure like checking the bank accounts, assessing his/her lifestyle, checking the wealth of his relatives, checking the employment record of the debtor. This protocol must be agreed and acknowledged by the Zakat and Charity Fund providers. To maintain the confidence of the Zakat and Charity Fund providers, an annual protocol compliance audit will be conducted by BSL and if the Islamic banks properly follow the protocol, a compliance certificate will be issued. On the other hand, if BSL finds out that the Islamic bank has not complied with the protocol, the information will be shared with the Zakat and Charity Fund providers. The success and sustainability of this model is yet to be tested. However, since initial target is to implement the model to microfinance only, the suitability of it to commercial Islamic banks might not be known yet.

In Malaysia, financial service providers can outsource some of the services approved by Bank Negara Malaysia such as debt recovery. This is in line with the outsource concept paper of Bank Negara Malaysia issued on 28th December 2018. However, even the outsourced service provider shall follow the rules enacted by Bank Negara Malaysia including the prohibited business conduct concept paper issued on 17th

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November 2014. Paragraph 9.3 of this concept paper states that financial service providers are not prohibited from taking actions to collect debt or advising consumers on the consequences of not repaying debt. However, financial service providers must not threaten to take actions that are not legally possible in order to coerce the financial consumer to repay their debt. In this regard, financial service providers should be guided by the Bank Negara Malaysia's expectations as set out in the Fair Debt Collection Practices.

5. Conclusion

This research has proved that in Malaysia, the mechanisms to handle default cases by Islamic banks are same as for conventional banks. This is due to the fact that same legal and regulatory framework applies to both types of banking in this matter. However, from statutory viewpoint, the scope of Islamic banking is much wider than that conventional banking as understood from the statutory definition of both under the IFSA and FSA respectively.

Credit risk is common to Islamic and conventional banks and Bank Negara Malaysia accordingly requires both banks to follow the Credit Risk Policy Document in dealing with default cases. Obviously, Islamic banks do not have a special requirement in this regard despite their peculiarities. Moreover, the governance requirements of Islamic banks are same as the conventional banks in dealing with default cases. Nonetheless, Islamic banks have different mechanisms in place to deal with default cases in practice and these mechanisms are classified in this research into those used by the Islamic banks at the governance level; dispute resolution stage; internal level leveraging on technology and externally by relying on other institutions.

This research also reveals that the governance structure of Islamic banks do have measures to deal with credit risk and the case of Bank Islamic Malaysia Berhad has been used to illustrate the use of such measures. Through analysis of a recently reported case, the study has also illustrated the actions Islamic banks take in the dispute resolution stage to deal with default which

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not only includes dealing with litigation straight away but also considering a way the dispute could be settled out of court using alternative dispute resolution mechanisms such as *sulh* (reconciliation).

The research also finds that Islamic banks do leverage on technology to deal with default cases and the cases of Bank Muamalat and Bank Rakyat has been discussed to illustrate the point. In this current era of technology with industry 4.0, adoption of technology such as AI is desired and this study has revealed that Islamic banks also do employ technology to mitigate credit risk. This proves that Islamic banks are not backward in terms of using technological advancements. Finally, this study also presents the success story of AKPK as an external body setup in Malaysia to assist customers who are in default to overcome their personal difficulties while at the same time protecting the right of the bank to recover the defaulted amount. Biniog Sathi model is a potential model that could be used in Malaysia. It is also found that in recovery, Bank Negara Malaysia has allowed Islamic banks to outsource but with strict adherence guidelines for fair debt collection. Conventional banks too in Malaysia follow the same yardstick

This study concludes that Islamic banks in Malaysia use similar mechanisms to handle default cases as conventional banks; that Islamic banks do exercise duty of care towards their investment account holders and shareholders to ensure balancing the rights of the customers in case of default. It is anticipated that this research will assist in understanding the mechanisms followed by Islamic banks in Malaysia to deal with default cases and that other jurisdictions could learn and implement lessons from Malaysia in that regard.

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