Perbadanan Insurans Deposit Malaysia
Protecting Your Insurance And Deposits In Malaysia

NATIONAL RESOLUTION SYMPOSIUM 2024

23 - 24 September 2024

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SHARIAH MASTERCLASS:
Transfer mechanisms for Islamic banks

Moderator:

EZRY FAHMY BIN EDDY YUSOF

Head, Shariah Governance, Shariah Management, Maybank Group Islamic Banking

Panelist:

MUHAMMAD RIFQI

Research Specialist, Indonesia Deposit Insurance Corporation

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INDONESIA DEPOSIT INSURANCE CORPORATION

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Sharia Framework for Deposit Insurance & Bank Resolution in Indonesia

Muhammad Rifqi

Specialist, Research Group

Lembaga Penjamin Simpanan / LPS

(Indonesia Deposit Insurance Corporation)

(1) The Indonesian Banking Industry Overview

The Indonesian Banking Industry Overview

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Number of Banks in Deposit Insurance Program

The deposit insurance program is mandatory for **all banks** in Indonesia

Bank	2020	2021	2022	2023	Aug-24
Conventional Commercial Banks	95	95	93	92	**92***
Islamic Commercial Banks	14	12	13	13	**14**
Conventional Rural Banks (BPR)	1.506	1.468	1.441	1.403	**1.382**
Islamic Rural Banks (BPRS)	163	164	167	173	**173**
Total	1.778	1.739	1.714	1.681	**1.661**

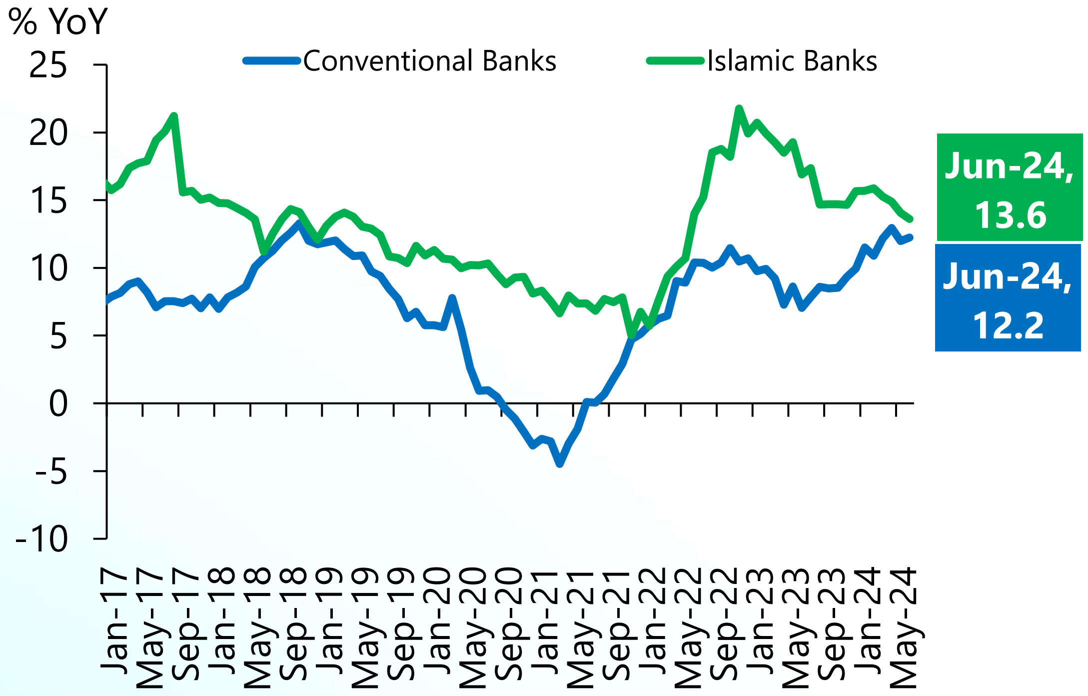
*) As of Aug 2024, there are 19 conventional commercial banks that have Islamic business units (UUS)

Source: FSA (OJK)

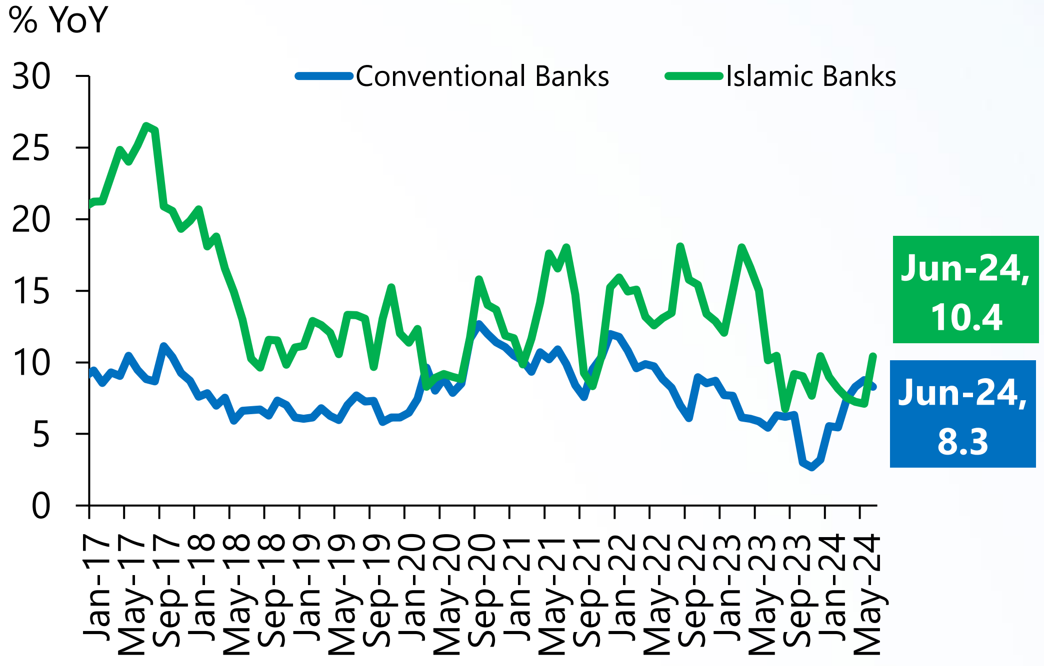
Intermediation Activities of Islamic Banks in Indonesia

"Islamic banks' financing grow faster (13.6% YoY, as of June 2024) compared to conventional banks credit (12.2% YoY, same period). Islamic banks' deposit growth have also picked up its pace lately, after being outgrown by conventional banks' deposit in April-May 2024."

Credit/Financing Growth



Deposit Growth*



*) Excluding interbank deposits

Source: FSA;

The Islamic Banking Landscape in Indonesia

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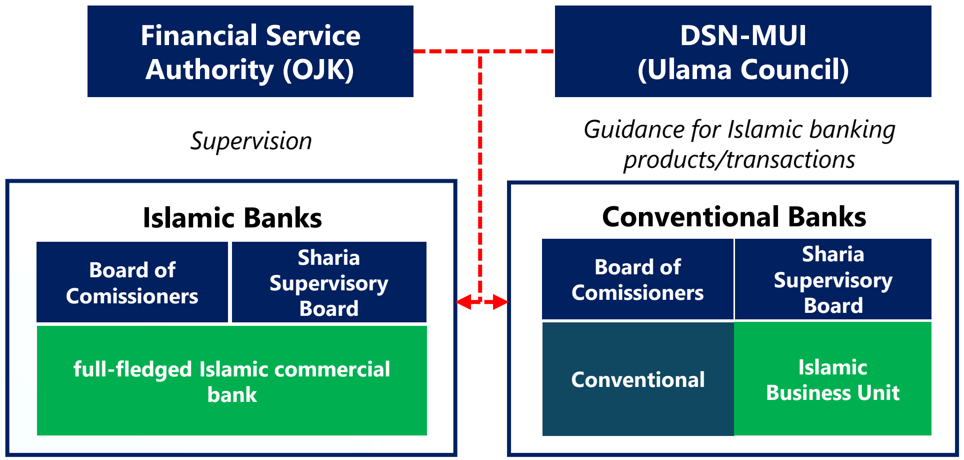
The Regulation Structure of Islamic Banks & Islamic Business Units



- There are two types of Islamic bank in Indonesia. **Islamic banks** which operate as full-fledged Islamic banks, and **Islamic business units** are specialized division or unit within a conventional bank that operates exclusively to provide Islamic financial products and services while being part of a larger conventional banking institution.
- In Indonesia, **DSN-MUI (National Sharia Council under the Indonesian Ulama Council)** provides specific guidelines for Islamic banking practices. Furthermore, each Islamic bank has its own **Sharia Supervisory Board**, responsible for monitoring and ensuring the compliance of the bank's products and services with Islamic principles.

Source: FSA (OJK), LPS

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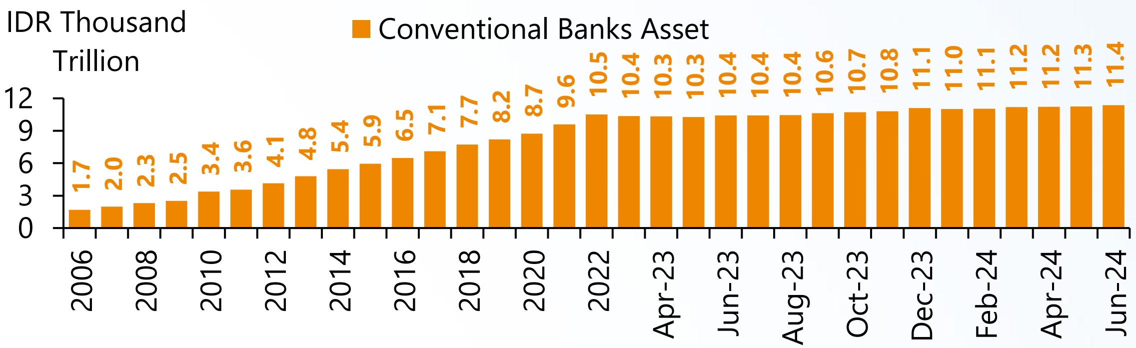
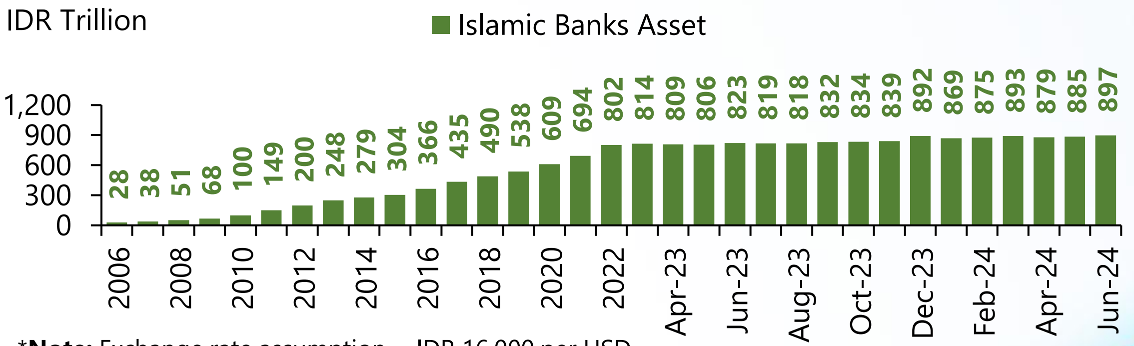
Total Assets of Conventional and Islamic Banks

Total asset of conventional banks per Jun-24 was IDR 11,370 trillion or USD710.6 billion.*



Total asset of Islamic banks per Jun-24 was IDR 897 trillion or USD56.1 billion.*



*__Note:__ Exchange rate assumption = IDR 16,000 per USD.

7.31% Market share of Islamic banks, (based on total assets, as of Jun 2024)

The Deposit Insurance Coverage Ratio:
LPS Fully Covers More Than 99% of Bank Accounts in Indonesia

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DID YOU KNOW?

The Deposit Insurance Coverage ratio is the number of accounts fully covered under the deposit insurance system **as a percentage of total accounts in the industry**

Commercial Banks Coverage

Conventional Banks
Number of Accounts that are Fully Insured
544.84 Million Accounts
(99.94% of total accounts)
(per Aug-24)

Islamic Banks
Number of Accounts that are Fully Insured
47.94 Million Accounts
(99.96% of total accounts)
(per Aug-24)

Rural Banks Coverage

BPR/BPRS
Number of Accounts that are Fully Insured
15.72 Million Accounts
(99.98% of total accounts)
(per Jul-24)

The coverage amount has been higher than the LPS Law **target of at least 90% of total depositors,** and the rule of thumb from the International Association of Deposit Insurers (IADI) of **at least covering 80% of total depositors**.

Source: LPS

The Deposit Insurance Schemes:
3T - Eligibility Criteria for Deposit Claim Reimbursement

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Eligible deposits are deposits (both conventional and Islamic) that comply to the deposit insurance scheme's requirements.

The maximum deposit insurance coverage:

IDR 2 billion (USD 125,000)* **per depositor per bank**

*__Note:__ The Exchange rate assumption = IDR 16,000 per USD.

Source: LPS

"3T" Requirements

T1 — ***Tercatat dalam pembukuan bank***

The deposit is recorded in the bank's book

T2 — ***Tingkat bunga simpanan yang diterima tidak melebihi tingkat bunga penjaminan LPS***

Interest rate of the deposit is not higher that LPS deposit insurance rate (this criteria is for conventional banks only)

T3 — ***Tidak terindikasi melakukan fraud dan/atau terbukti melakukan fraud (tindak pidana di bidang perbankan)***

The depositor is free from any indication of fraud or other crimes that contributes to the bank loss or endangers the bank's business continuity

(2) The Sharia Framework for Deposit Insurance and Bank Resolution in LPS

Deposit Insurance and Resolution of Islamic Banks:
Ulama (DSN-MUI) Fatwas Related to LPS

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Sharia Principles in Deposit Insurance

(According to the Fatwa 118/DSN-MUI/II/2018)

- Deposit insurance for Islamic banks is carried out using *Kafalah* principle
- Contributions and premiums originating from Islamic banks must be managed based on sharia principles.
- LPS assets originating from Islamic Bank contributions and premiums must be invested in Islamic financial instruments.
- In the event that the depositor has deposits both in the parent bank and its Islamic business unit that is greater than the maximum deposit insurance limit, LPS pays the deposit insurance claim proportionally.
- Payment of deposit insurance claims for sharia portion of the bank must be made through Islamic Banks, except for the areas that have not been covered by Islamic Bank's operational services.
- In the event of shortage of Islamic deposit insurance funds, LPS shall cover the shortfall temporarily by using funds from other sources.

DSN-MUI = National Sharia Board – Indonesian Ulama Council

Deposit Insurance and Resolution of Islamic Banks:
Ulama (DSN-MUI) Fatwas Related to LPS

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Sharia Principles in Bank Resolution

(According to the Fatwa 130/DSN-MUI/X/2019)

- Implementation of resolution of Islamic banks experiencing solvency problems cannot violate sharia rules.
- LPS transfers liabilities (of the Islamic banks with solvency problems) to recipient banks or bridge banks (banks must be Islamic banks) using *hawalah* structure
- • Asset valuation for the Receivables or the principle and profit sharing in financing; from the customer receiving the financing facility is carried out in accordance with the characteristics of the financing contract scheme used
- Asset Sales for Fixed asset, equipment, and yield-based financing assets are carried out using buy and sell mechanism (*al-Bai'*), while for receivables-based financing assets are carried out using transfers in which the payment of the price (*tsaman*) is in the form of goods ('*ain*)
- Dispute resolution must be carried out in accordance with sharia principles and applicable laws and regulations

DSN-MUI = National Sharia Board – Indonesian Ulama Council

(3) More Focus: Transfer Mechanism of Islamic Banks' Asset During Resolution

Islamic Bank Resolution:
The Resolution Methods

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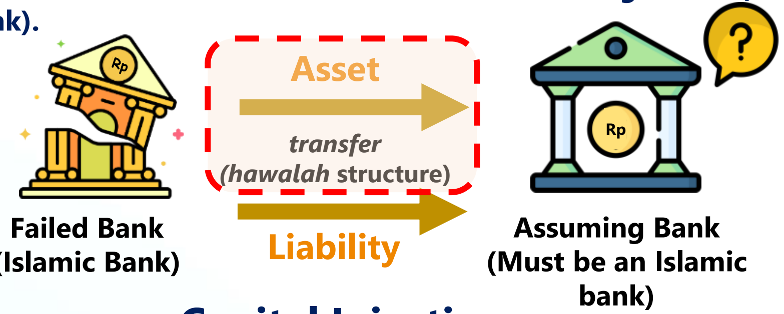
Bank Resolution Methods

- ❑ LPS has 4 methods to conduct bank resolution.
- ❑ LPS will calculate the whole resolution cost of each method and will choose the method with lowest cost.

DID YOU KNOW?

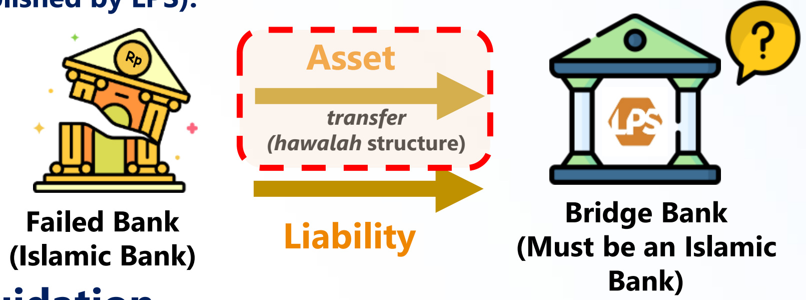
1 Purchase and Assumption (P&A)

The resolution method by transferring some or all of the troubled bank's assets and/or liabilities to the assuming bank (healthy bank).



2 Bridge Bank

The resolution method by transferring some or all of the troubled bank's assets and/or liabilities to a bridge bank (a temporary bank established by LPS).

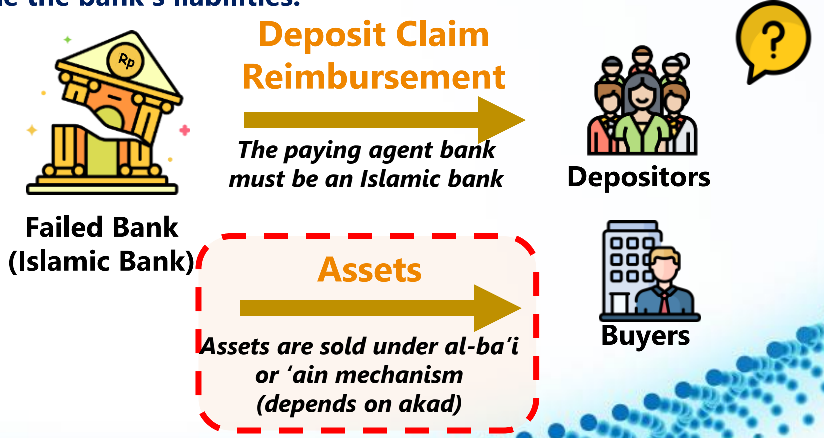


3 Temporary Capital Injection

The resolution method by providing temporary additional capital to the troubled bank with the aim of rescuing it (usually a bank with a systemic impact).

4 Liquidation

The resolution method by selling the troubled bank's assets to settle the bank's liabilities.



Source: LPS

Islamic Bank's Asset Sale During Liquidation

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The liquidation of Islamic bank asset is conducted based on Fatwa DSN-MUI No. 130/DSN-MUI/X/2019 and LPS Regulation (PLPS) No. 1/2020 about Islamic Bank Insurance dan Resolution Implementation.

Islamic Bank Asset Selling Mechanism

A. Property Plan and Equipment

Able to be transferred using the sale and purchase mechanism (*al-bai'*)

B. Financing Asset

Able to be transferred using the sale and purchase mechanism (*al-bai'*)

C. Receivable Asset

Able to be transferred using the mechanism of sale and purchase through form of goods (*'ain*) of equal price (*tsaman*).

Combined Selling Mechanism

- The assets are able to be transferred using the sale and purchase mechanism (*al-bai'*) if the valuation of assets as described in A and B above is at least 51% of the total valuation of assets (A+B+C).
- If the A+B assets valuation is less than 51%, AND the criteria of *dharurat/hajiyat* is fulfilled, the liquidation team could ask for the opinion of the Sharia commitee to conduct the sale using *al-bai'* mechanism.

Dharurat/Hajiyat Criteria

Remaining Duration for Liquidation is Less Than 6 Months

The transaction cannot be fulfilled under sharia principle due to commodity availability (gold, bonds, etc.) constraints

Challenges of Islamic Bank's Asset Sale During Liquidation

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Common Challenges

1) Limited availability of intermediary commodity to use as *'ain* object.

2) Considerable spread between buying & selling price of gold in the physical market.

3) Unwillingness of potential buyer to conduct transaction using *'ain* mechanism or to pay in gold (they usually prefers cash).

THANK YOU

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TRANSFER MECHANISM FOR ISLAMIC BANKS

Potential Solutions

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Senior Manager, Shariah

Perbadanan Insurance Deposit Malaysia

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1. Shariah Framework in Islamic Resolution

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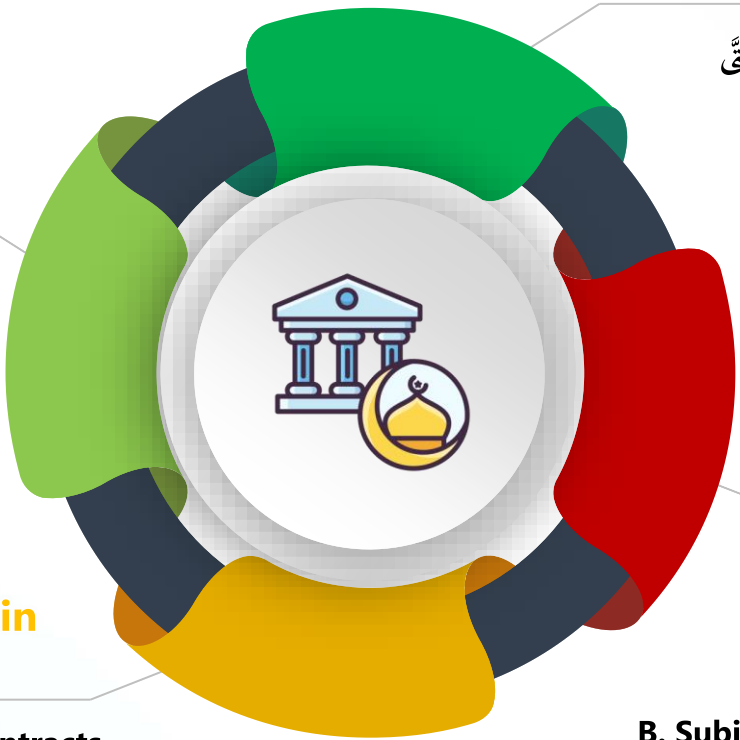


General Rule

الْأَصْلُ فِي الْأَشْيَاءِ الْإِبَاحَةُ حَتَّى
يَدُلَّ الدَّلِيلُ عَلَى التَّحْرِيمِ

"The status of all matters (other than rituals) is permissible; until an evidence is given that a certain matter is prohibited."

General Islamic value

i. Justice and Fair Dealings
ii. Upholding the necessity of human being
iii. Conformity with the *Maqasid Syariah* (objectives of Syariah)

Avoidance of prohibited elements

A. Contractual based (Interest (*Riba*), Excessive uncertainty (*Gharar*), Gambling (*Maysir*), Speculation)

B. Subject Matter of the transaction (e.g liquor and liquor-related activities; non-halal food and beverages; Shariah non-compliant entertainment; tobacco and tobacco-related activities; Anything that can be harmful to human being)

C. Ethical based (e.g deceit (*najash*), monopoly (*ihtikar*), defraud (*gubn*), misguidance (*taghrir*) vague (*talabbus*)

Fulfillment of requirement in Shariah contract/concept

A. Essential Elements (Pillars) of Contracts

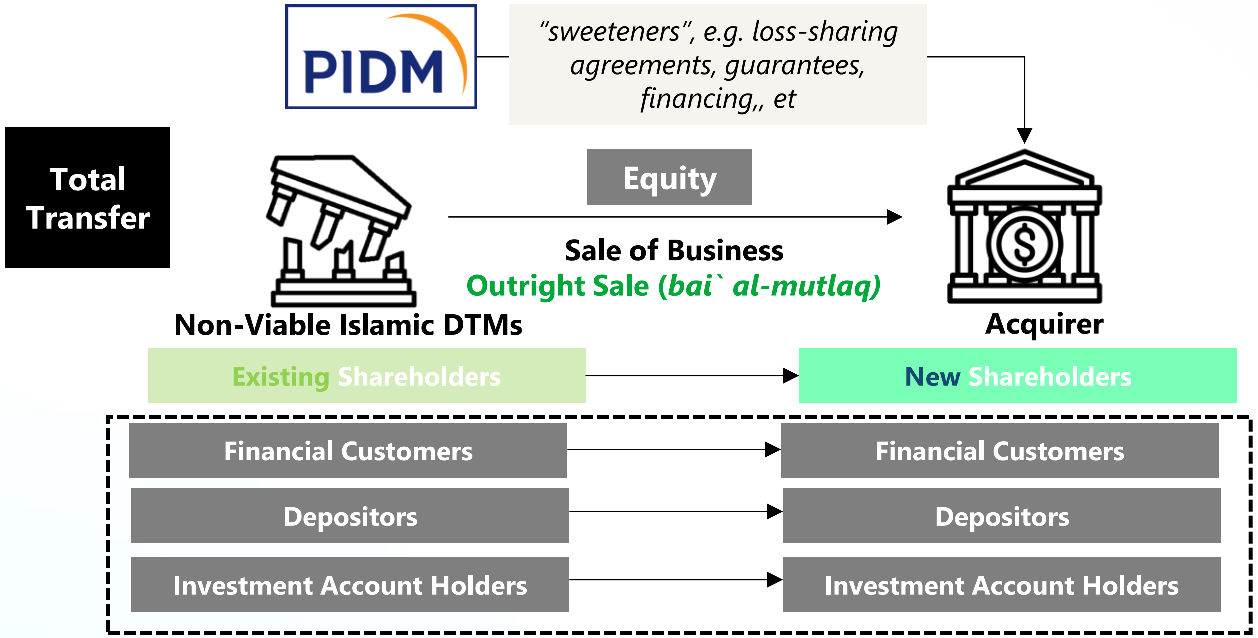
i. Contracting parties Eg. Buyer and Seller (for sale contract)
ii. Form of contracts Eg: Offer and acceptance
iii. Subject matter of contracts Eg. Purchase item

B. Inherent Nature of Contracts

Areas of Concerns

1. Do specific Shariah requirements i.e. prohibited elements and Shariah contracts requirements, need to be observed when the purpose is Shariah compliant?
2. To what extend the dharurah basis can give exception to the specific Shariah requirements?
3. Are masalahah and maqasid Shariah sufficient to become the basis of executing resolution actions?

2. Sale of Business- Potential Shariah concept – Full Transfer



Uniqueness of Islamic DTMs balance sheet

Assets	Financing	Debt-based : *tawarruq, murabahah, bai`-day, bai` `inah, qard* Partnership-based : *musharakah, mudarabah,* Exchange based (usufruct) : *ijarah*
Liabilities	Deposit	Debt-based : *tawarruq, qard*
Off-balance sheet	Investment Account	Agency-based : *wakalah* Partnership-based : *mudarabah*

Potential Solutions

Outright Sale (*bai` al-mutlaq)*

Under the outright sale, methods that can be used in sale is the **bidding and auction process** (*muzayadah* or *munaqasah*).

Under resolution, *bai` al-mudthar* (sale under distress situation) and *bai` al-mukrah* (forced sale to the seller) may also be considered.

Areas of Concerns

1. Force share transfer in Shariah point of view
2. Whether changing of terms/rights in the force share transfer is Shariah compliant or what are the possible effects?
3. Does consent of customers still required in the sale?
4. Whether selling of conventional business with Islamic business requires differentiation of Shariah compliant treatment for the Islamic business?

2. Sale of Business- Potential Shariah concept – Partial Transfer

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Partial Transfer

Non-Viable Islamic DTMs

PIDM → *"sweeteners", e.g. loss-sharing agreements, guarantees, financing,, et* → Acquirer A

Financial Customers (Retail) → **Acquirer A**

Debt-based : *tawarruq, murabahah, bai`-day, bai` `inah, qard*

Financial Customers (Corporate) → **Acquirer B**

Exchange based (usufruct) : *ijarah*

Depositors → **Acquirer C**

Debt-based : *tawarruq, qard*

Investment Account Holders → **Acquirer D**

Agency-based : *wakalah*

Areas of Concerns

1. For selling based on portfolio basis (mixed debt and non-debt based asset), does the composition of debt and non-debt based asset/liabilities need to be observed.
2. What are the Shariah compliant mechanism for the partial transfer of the failed Islamic bank for each of the line item in the balance sheet of IFIs
3. *Bai` al-dayn* (Sale of debt) – features that applicable to all IFIs
4. *Bai` al-dayn bi sila'* (Sale of debt with commodities) - features that applicable to all IFIs

2. Sale of Business- Potential Shariah concept – Partial Transfer

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Partial Transfer

Non-Viable Islamic DTMs

Financial Customers (Retail) → **Acquirer A**

Debt-based : *tawarruq, murabahah, bai`-day, bai` `inah, qard*

Financial Customers (Corporate) → **Acquirer B**

Exchange based (usufruct) : *ijarah*
Equity based ; *musharakah*

Potential Solutions

Transfer of assets

- ***Bai` al-Dayn*** (sale of debt)
- ***Bai` al-Dayn bi sila`*** (sale of debt with commodities)
- ***Hawalah al-haq*** (transfer of rights)

- **Outright Sale** (*bai' Mutlaq* –can be in the form of *bai` muzayadah* and *bai` munaqasah)*

Areas of Concerns

1. Does consent of customers still required in the sale?
2. Are current offering of product transferrable?

If the settlement/payment is in deferred, other structure might be taken into consideration, but challenge might arise if the transfer is on standalone portfolio (asset only/liability only).

Possible options (on-going research):

1. ***Hawalah* with sale**
2. ***Hawalah* and tawarruq**
3. ***Hibah* and tawarruq**

potential Shariah issues →

1. The combination of contracts may result in the contracts being **contingent upon each other.** There is a potential issue of dependency of the contracts despite both being executed separately.
2. The combination of contracts **may lead to the element of *riba***, where there is a potential issue of giving gift for consideration (*hibah bi al-thawab*).
3. The combination of contracts may invoke the potential issue of **fictitious contracts** being employed to legalise the transfer.

3. Transfer of Liabilties

Partial Transfer

Non-Viable Islamic DTMs

Depositors → **Acquirer C**

Debt-based : *tawarruq, qard*

Potential Solutions

Transfer of Liabilities

- ***Hawalah al-dayn*** (transfer of debt)

Areas of Concerns

1. Transfer of deposit may attract challenges in standalone transfer (without any other portfolios), but whether it is practically can be done, will need further assessment.
2. Does consent of customers still required in the transfer?

4. IA and other off balance sheet items

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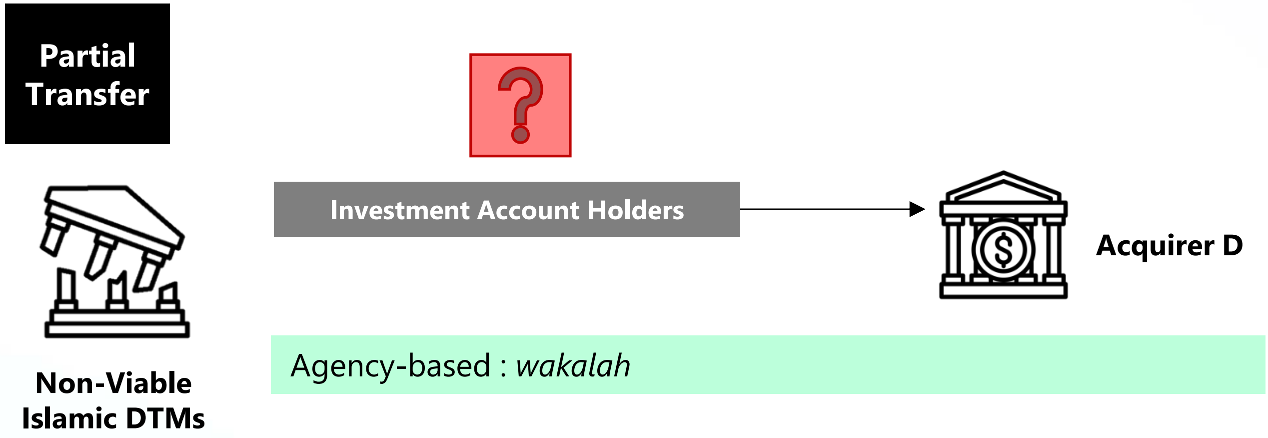

Areas of Concerns

1. What are the status of transactional capacity of the non viable Islamic DTMs in the off-balance sheet item upon NVT
2. What are the suitable Shariah mechanism transfer for other than debt and equity-based products, i.e. off-balance sheet items, investment accounts, services, social finance products, gold-based products, late payment charges.

Consideration

1. IA reflect different relations of failed MI to the assets tagged to the investment
2. NVT status may carry different effect to failed MI due to its inability to continue the business
3. Assessment on the subject matter of transfer may be required to propose suitable Shariah compliant mechanism on the transfer

Other item that may require further assessment

banking subsidiaries, services, social finance products, gold-based products, late payment charges, financial services entities (i.e. asset management, nominees), overseas branches.

THANK YOU