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Rebate in Islamic sale-based financing contracts: Bank Negara Malaysia guidelines on *ibrā'* versus conventional finance practice

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Abstract

Purpose – This paper aims to compare the rebate computation in Islamic sale-based financing contracts as proposed by Bank Negara Malaysia (BNM) in its guidelines on *ibrā'* (rebate) – with the rebate computation in conventional finance that is applicable to conventional loans, thus examining if there is a significant difference between the two approaches.

Design/methodology/approach – The paper employs the qualitative analysis method, involving review and discussion of relevant literature. Subsequently, a quantitative analysis is utilized to compare both rebate computations: the one proposed by BNM for Islamic sale-based financing contracts and the conventional finance computation that is utilized in conventional loans.

Findings – BNM's rebate computation for debts resulting from sale-based financing contracts does not differ from the conventional finance rebate computation applied to conventional loans; such similarity may raise the usury concerns that the conventional finance rebate computation raises.

Research limitations/implications – The paper focuses only on the fixed profit rate rebate computation proposed by BNM guidelines.

Practical implications – The results highlight the need for seeking another rebate computation to be applied in Islamic financial institutions in the case of mandatory bilateral rebate for sale-based financing contracts – a computation that differs from the practice utilized in conventional loans in order to avoid any usury implications associated with conventional finance computation.

Originality/value – The paper examines the rebate practice proposed by BNM for sale-based financing contracts. Forcing a predetermined rebate computation in sale-based financing contracts could be plausible as BNM requires; however, the suggested computation might be questionable because it resembles conventional finance computation.

Keywords *Bay' al murābaḥah*, *Da' wa ta'ajjal*, *Ibrā'*

Paper type Research paper

Introduction

Bay' al murābaḥah (cost-plus sale) is considered one of the major Islamic finance contracts that represents a significant percentage of transactions carried out by Islamic financial institutions (IFIs) (Gregory and Stuart, 2004). The sale-based financing contract employed in IFIs is a regular instalment sale that discloses the cost of the good sold to the buyer and then adds an agreed-upon profit mark-up on the cost (Hanif, 2016). Instalment sales are often conducted in conventional finance through instalment loans, whereby the cash loan corresponds to the cost of the good sold, and repayment instalments correspond to the deferred selling price.

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Conventional finance institutions do not consider the ramifications of *ribā* (usury) within their financing contracts, as the time value of money is accepted without any ethical limitations (Grant and Brue, 2007). As is known, *ribā* is an increase which in a loan transaction accrues to the lender over time without giving an equivalent counter-value or recompense in return to the borrower (Khan, 2003). On the other hand, Islamic finance principles distinguish the prohibited usury from the time value of money. The Islamic finance principles, in some instances, allow for the time value of money. However, acceptance of the time value of money in Islamic finance is limited to sale contracts only (Ghaith, 2010).

Some sort of similarity between both contracts – instalment loans made by conventional financial institutions and sale-based financing carried out by IFIs – used to raise the question about the viability of sale-based financing as a valid Islamic contract. However, this question has been eventually resolved by legalizing the sale-based financing contract as long as it is an actual trading or sale contract, not a charity or a loan (IIFA, 1992). Nevertheless, another discourse has been raised about sale-based financing contracts that centers on determining *ibrā'* (rebate) in the case of early settlement of debts resulting from such contracts. *Ibrā'* refers to an act by a person relinquishing his rights to collect payment due from another person (BNM, 2013).

In conventional finance, the rebate is calculated through the loan amortization schedule as defined in most elementary finance textbooks (Fabozzi, 2013, pp. 219–220; Ross *et al.*, 2016, pp. 117–118). The computation provided by conventional finance is a typical usury-based practice that deals with money as a commodity rented for a period of time. Yet, according to the conditional acceptance of the time value of money in Islamic laws and principles, the rebate issue is much complicated when discussed in Islamic finance. The rebate issue is addressed in Islamic finance through the *da'wa ta'ajjal* concept – a principle of credit trade in vogue among Arabs of the 6th century in which a debtor was given the option of getting a reduction in debt, provided he agreed to pay cash immediately (Khan, 2003).

Da'wa ta'ajjal used to be a controversial concept among early and contemporary Islamic scholars. Eventually, contemporary Islamic scholars inclined toward accepting rebate in Islamic sale-based financing contracts. Some scholars allowed rebate as a unilateral procedure left to the creditor's (seller's) discretion (IIFA, 1992). Others required the rebate to be bilateral as a conditional amount to be defined through a predetermined computation at the contract inception (BNM, 2013).

Bank Negara Malaysia (BNM) followed its Shariah Advisory Council's (SAC) opinion that requires a bilateral rebate in sale-based financing contracts through a pre-specified rebate clause to be included in the contract at inception. Mandatory pre-specified rebate estimates, as BNM suggested, may be a reasonable and fair request. However, if conventional finance practices influence any computation provided to assess the rebate amount, it may bear the same usury concerns as conventional finance. Thus, this paper aims to investigate BNM's rebate computation as proposed in its guidelines on *ibrā'* to examine whether the proposed computation varies from conventional finance practice or not.

The rest of the paper is organized as follows: the next section discusses the literature on the rebate issue from both conventional finance and Islamic finance perspectives. Then, it elaborates on the problem and addresses the potential conventional finance influences on the BNM rebate computation method through an illustrative comparative case. It concludes with a summary of the discussion, recommendations and suggestions for further research.

Literature review

Rebate in conventional finance

Rebate is not a distinct issue in conventional finance literature; actually it may not be an issue at all. From the conventional finance perspective, a rebate is a spontaneous transaction

resulting from the early settlement of debts repaid through instalments, like mortgages and commodity-based debts. The instalment amount in such loans is derived from the annuity rule. As described in Gitman and Zutter (2015, p. 222), the ordinary annuity rule used in conventional finance is calculated as follows:

$$C = PV \frac{r}{1 - (1 + r)^{-n}} \tag{1}$$

where,

C – Instalment amount;

PV – Loan principal;

N – Financing periods;

r – The required rate of return.

The annuity rule adheres to conventional finance's typical logic, which states that any loan's present value equals its future value discounted at the required rate of return. Thus, if the loan is repaid through instalments, the loan's present value must be equated with the future instalments discounted at the required rate of return. Another interpretation of the annuity rule is: if both the loan's present value and the repayment instalments are reinvested on the same rate of return, the loan's future value must equal the repayment instalments' future value.

Consequently, in these kinds of loans, each instalment payment comprises two components: the first is the interest component, which is the required rate of return charged on the loan's beginning balance. The second component of the instalment represents the loan principal's repayment, which is termed "amortization." So, each payment made by the borrower is such that it provides the lender with the contractual interest (required rate of return) and repays part of the principal loan amount. As a result, when the final payment is made, the total instalments paid will be sufficient to fully repay the borrowed sum (Fabozzi, 2013).

The loan amortization process in conventional finance does not differentiate between instalments resulting from loan transactions or instalments resulting from sale-based financing transactions; the treatment is the same for both. To exemplify how the rebate amount is computed in conventional finance, assume a financing contract for a commodity worth US$1,000 in cash was converted to a sale-based financing agreement with five-year annual instalments based on a 10% interest rate. The annuity rule given in equation (1) is applied to determine the annual instalment value, which will be US$263.80. Then, the loan amortization schedule and the accompanied rebate amounts for each year will look as in Table 1.

When amortizing a loan in conventional finance, the credit interest (required rate of return) is applied to the loan beginning balance in order to compute the time value of money component in each instalment and the remainder of the instalment value is devoted to the loan repayment. This computation deals with money as a commodity rented for an agreed-upon rate per unit of time. Thus, when the borrowed amount of the commodity (money) increases, the rent paid (interest) increases; this treatment is considered usury according to Islamic laws and principles.

The rebate amount in any payment date is computed based on the amortization schedule as the difference between the outstanding instalments, which is the amount of the total remaining instalments (as per column (7) in Table 1) and the loan ending balance (as per column (6) in Table 1). The loan ending balance calculated in the amortization schedule has resulted from typical usury-based practice. Consequently, the rebate amount in conventional

Period (1)	Loan beginning balance (2)	Instalment amount (3)	Credit interest (4) = (2) × 10%	Loan amortization (5) = (3) – (4)	Loan ending balance (6) = (2) – (5)	Outstanding instalments (7)	Rebate amount (8) = (7) – (6)
1	1000.00	263.80	100.00	163.80	836.20	1055.20	219.00
2	836.20	263.80	83.62	180.18	656.02	791.40	135.38
3	656.02	263.80	65.60	198.20	457.82	527.60	69.78
4	457.83	263.80	45.78	218.01	239.81	263.80	23.99
5	239.81	263.80	23.98	239.81	0.00	0.00	0.00
Total		1319.00	319.00	1000.00			

Source(s): Author's own

Table 1. Conventional finance loan amortization schedule

finance is computed based on a usury-based practice that may cause an unfair deal to all contracting parties.

To exemplify how the conventional finance rebate computation is implemented, the loan beginning balance in the first year is the total loan amount, which is US$1,000, and the credit interest is applied to the loan beginning balance to compute the interest portion from the instalment, which is (1,000 × 10% = 100) as shown in column (4) in Table 1. Then, the remaining amount of the instalment is devoted to loan amortization as a direct reduction from the beginning balance to derive the loan ending balance (1,000 – 163.8 = 836.20), as shown in column (6) in Table 1. Thus, if the borrower decides to prepay and settle the loan at the end of the first year after paying the first instalment, the total remaining instalments will be (263.80 × 4 = 1055.20) as shown in column (7) in Table 1, and the rebate amount will be (1055.20 –836.20 = 219.00) as shown in column (8) in Table 1.

The aforementioned usury-based practice in computing rebate brings significant injustice to the borrower. The conventional finance loan amortization practice guarantees a fixed credit interest for the creditor on the outstanding loan balance. This implies that if the borrower decides to settle the loan earlier than its maturity, the interest that the borrower would waive through prepayment will be comparatively less than the interest he had already paid. This is because if the borrower decides to repay the debt earlier than at maturity, the loan amortization technique applies the credit interest on the loan balance to compute the interest portion of each instalment, while the remainder of the instalment is allocated to the loan amortization. Because the loan balance is higher in the early periods of the loan maturity, the interest portion in instalments will also be higher in those periods. According to the illustrative data in Table 1, the interest charge is US$100 in the first year, whereas it is only US$23.98 in the last year, as shown in column 4 in Table 1, which results in a lower amount allocated to loan amortization and a higher settlement value for the borrower in the early periods of the debt's life.

Rebate in Islamic finance

Islamic finance has to address the rebate issue differently since Islamic finance denies any time value of money in charitable transactions such as loans. At the same time, it accepts it in some sale transactions such as instalment or deferred sales. Therefore, adopting the rebate without considering the distinction between charitable and sale transactions may raise some usury concerns in such an arrangement. Thus, a clear distinction between rebate treatments in both contracts would contribute to alleviating these concerns. The following section discusses the rebate issue in charitable and sale contracts.

Rebate for debts resulting from charitable contracts (unilateral rebate): Most of the early scholars in Islamic jurisprudence did not accept the *da' wa ta'ajjal* concept and thus did not allow rebate compensations for early settlement of debts, without differentiating between debts resulting from deferred sales and debts resulting from loans. Such a prohibition was justified by the argument that rebate compensations were equivalent to accepting the time value of money on loan transactions, which is equivalent to the prohibited usury. Prohibition used to be the opinion of most primary Islamic juristic schools, claiming that rebate is the same as usury; in both cases, the debt amount varies with time. In the case of usury, when time increases, the debt amount increases. In the case of a rebate, when time decreases, the debt amount decreases (Ibn Rushd, 2004, pp. 2/170–171; Abdul Khir, 2016).

A minority of early scholars pioneered by Ibn Taymiyyah and Ibn Qayyim al-Jawziyyah allowed rebate, in general, claiming that rebate does not fall under the regular usurious transactions. While regular *ribā* transactions harm the debtor for the benefit of the creditor, *da' wa ta'ajjal* benefits both parties, including debtors and creditors (Ibn Qayyim al-Jawziyyah, 2006, pp. 3/260–261; Abdul Khir, 2016).

Contemporary scholars inclined toward rebate acceptance. The acceptance stabilized in the Islamic finance literature through resolution 64 (7/2) of the International Islamic Fiqh Academy (IIFA), which legalized rebate in the fourth clause of the resolution. However, this legalization was restrained by the following terms:

(1) No prior agreement compels the rebate or defines its amount;

(2) The relationship between creditors and debtors are mutual; and

(3) No third-party intervention is allowed (IIFA, 1992; Saiman and Salleh, 2016).

Although the IIFA resolution mainly addressed instalment sales, the rebate treatment involved therein is considered a unilateral one that left the provision of the rebate to the creditor's discretion, which might be more suitable for charitable, not sale contracts.

Rebate for debts resulting from sale contracts (bilateral rebate): Bilateral rebate assumes two distinctive features that make it different from a unilateral rebate. First, it is binding on the seller in the event of default and early settlement. Second, it involves the exchange of time for money embedded in the deferment (*ajal*) or Grace period of payment (Abdul Khir, 2016). Hence, the rebate is not left to the creditor's (seller's) discretion to determine the amount granted unilaterally. The bilateral rebate practice is rational in sale-based financing contracts, as the time value plays a significant role in determining the price in instalment sales. It is established and computed by the seller at the contract's inception; and merely represents the difference between the cash price and the instalment price (Saleem, 2016). Therefore, as the time value of money is permitted and calculated at the contract's inception in sale transactions, it is argued that it must be permitted and measured at any other time of the contract's life as a reasonable practice to safeguard all contract parties' interests and eliminate any ignorance from the contract (Saiman and Salleh, 2016).

Ibn Qayyim al-Jawziyyah (2001) accepted the rebate, in general, arguing that rebate secures the mutual interest of both transacting parties. Despite this opinion of accepting rebate in all types of contracts, Ibn Qayyim mentioned that it might be rational to distinguish between debts resulting from loan contracts and debts resulting from deferred (instalment) sale contracts when addressing the rebate issue (Ibn Qayyim al-Jawziyyah, 2001).

This distinction introduced by Ibn Qayyim could be one of the first attempts to distinguish between unilateral and bilateral rebates. On the other hand, the distinction mentioned above implies a typical conception of the time value of money. In a *qarḍ* (loan) transaction, which is a charitable transaction, no time value of money is included in the loan amount as no *ribā* is

allowed; it would thus be meaningless to charge a time value of money as a forced rebate in debts' early settlement. However, in the case of a deferred or instalment sale, the time value of money is included in the amount of the instalments, so it would be plausible to reclaim a rebate in the early settlement of debts.

The SAC of BNM followed the opinion of legalizing a mandatory bilateral rebate in the case of early settlement of debts resulting from sale-based financing arrangements. At its 24th meeting, the SAC decided that Islamic banking institutions must incorporate a clause to provide *ibrā'* to their clients who make an early settlement in the Islamic financing agreement (Shah *et al.*, 2016). BNM also introduced a demonstration of rebate computation in different cases; the demonstration was annexed to the *ibrā'* guidelines for sales-based financing issued by the bank (BNM, 2013).

Some contemporary scholars also distinguish between loan transactions and sale transactions when dealing with the rebate issue. Saleem (2016) recommended the distinction between loan debts and sale-based debts when dealing with the rebate issue; the study recommended bilateral rebate in sale-based debts. Abdul Khir (2016) supported BNM's suggestion, advocating bilateral rebate in sale-based debts instead of the unilateral rebate. He considered it the best and fairest Islamic mechanism to overcome injustice in several events that may impact on the bank's liquidity, such as the early settlement of debt facilities and early withdrawal of term deposits. In that sense, the interest of both transacting parties would be equally secured. However, the study introduced an illustrative case that was much influenced by the conventional finance rebate computation supported by the conventional loan amortization practice, as if there are no Sharī'ah concerns related to this practice. Ishak (2019), however, suggested that some of the influences of conventional finance on BNM's rebate computation could be attributed to the structure of Islamic financial products themselves; such products have been greatly influenced by the interest rate employed in conventional finance contracts.

The research argument

Accordingly, it could be argued that the literature recommends a bilateral rebate computation for sale-based financing contracts, supporting BNM in introducing the rebate as predetermined in a separate clause of the contract. This is reasonable in debts resulting from sale-based transactions and is fairer than the unilateral rebate. Nevertheless, the literature shows some influences from conventional finance on Islamic finance when applying the rebate practice; the influence was found in Abdul Khir's (2016) illustration and was hinted at in Ishak's (2019) conclusion.

This research examines the degree of conventional finance influence on the *ibrā'* practice as applied by IFIs, as the theoretical argument of this research concluded that the rebate practice applied to conventional loans is a usury-based practice that is not consistent with Islamic laws and principles. Thus, the paper examines the rebate practice used by BNM as one of the most notable of the Islamic institutions that allow mandatory bilateral rebate. Accordingly, the paper tests the following hypotheses:

H0. There is no significant difference between the rebate amount proposed by BNM's guidelines on *ibrā'* and the rebate amount resulting from the loan amortization practice utilized in conventional finance.

H1. There is a significant difference between the rebate amount proposed by BNM's guidelines on *ibrā'* and the rebate amount resulting from the loan amortization practice utilized in conventional finance.

Methodology

The paper adopts quantitative analysis to compare the rebate computation proposed by BNM for Islamic sale-based financing contracts and the conventional finance computation by using a paired sample *t*-test for gauging the difference between the two means. The first sample consists of rebate amounts provided by the BNM guidelines on *ibrā'*. The second sample consists of the conventional finance rebate amounts that are computed using the same BNM dataset after being reprocessed by the conventional finance rules.

Data collection

The research's data comprise the 25 different rebate amounts presented in the *bay' bi thaman ājil* (BBA) fixed-rate home financing illustrative case mentioned in the BNM guidelines on *ibrā'*. The illustrative case data presented in the BNM guidelines' annex will be used as the BNM practice sample to determine the rebate amount. The same dataset will then be processed using the conventional finance rules to construct a paired sample for the conventional finance rebate.

Data results and analysis

The following data were extracted from the illustrative case provided by BNM (2013) as a demonstration of the application of *ibrā'* utilizing a fixed contracted profit rate in BBA home financing. The financing terms were as follows:

Selling price	RM365136.00
Contracted profit rate (CPR)	9%
Financing periods	180 months (15 years)
Cost of purchase/principal (COP)	RM200000.00
Instalment mode	Monthly
Instalment amount	RM2028.53

BNM has not mentioned the formula utilized to compute the instalment amount in the annexed illustration. However, it can be inferred from the figures mentioned above that BNM has employed the typical ordinary annuity rule to derive the instalment after rephrasing some terms as follows:

$$C = PV\frac{r}{1-(1+r)^{-n}} \tag{2}$$

where,

C – Instalment amount;

PV – Loan principal (rephrased as cost of purchase/principal);

N – Financing periods;

r – The required rate of return (rephrased as contracted profit rate).

BNM's customized payment and its accompanied rebate

BNM introduced the customized payment schedule under an ideal situation together with the application of *ibrā'* and the settlement amount formula, where the rebate is computed as the

difference between the outstanding selling price and the outstanding COP. A summarized version of the schedule is presented in Table 2. The full schedule as annexed in BNM's illustration case is shown in Appendix.

Conventional finance loan amortization correlated rebate

The conventional finance loan amortization will use the same dataset from BNM's illustrative case. However, BNM's monthly profit rate (9%/12 = 0.75%) is applied as the credit interest in conventional finance loan amortization. Also, BNM's outstanding COP is utilized as the outstanding loan balance in the conventional finance loan amortization. Finally, BNM's outstanding selling price is employed as the outstanding instalments in the conventional finance loan amortization. The rebate amount is the loan's interest portion, which is the outstanding instalments minus the outstanding loan balance. The credit interest is applied to the outstanding loan balance to compute the interest portion of each instalment, while the remainder is deducted from the outstanding loan balance to reach the new balance.

Accordingly, the loan amortization schedule and its accompanying rebate using conventional finance premises for BNM's case data can be computed as described in Table 3.

Comparing the rebate in fixed-rate BBA and in conventional finance loan

Table 4 presents a comparison of the two rebate amounts: the one proposed by BNM and the other computed using the conventional finance loan amortization practice for the 25 chosen dates.

Just as the instalment amount determined by BNM resembles the ordinary annuity estimate, the loan amortization schedule prepared according to conventional finance's

Period	Payment date	Instalment	Profit payment	COP payment	Outstanding selling price	Outstanding COP	Deferred profit (Rebate)
0	30-06-2009	–	–	–	365135.97	200000.00	165135.97
1	31-07-2009	2028.53	1500.00	528.53	363107.44	199471.47	163635.97
2	31-08-2009	2028.53	1496.04	532.50	361078.91	198938.97	162139.93
...	...	...	...	...	...	...	...
48	30-06-2013	2028.53	1277.62	750.91	267766.53	169598.40	98167.98
...	...	...	...	...	...	...	...
180	30-06-2024	2028.53	15.10	2013.43	0.57	0.00	0.00

Source(s): BNM (2013)

Table 2. Illustrative customized payment schedule for fixed-rate BBA

Period	Payment date	Instalment	Credit interest	Loan amortization	Outstanding instalments	Outstanding loan balance	Interest amount (Rebate)
0	30-06-2009	–	–	–	365135.97	200000.00	165135.97
1	31-07-2009	2028.53	1500.00	528.53	363107.44	199471.47	163635.97
2	31-08-2009	2028.53	1496.04	532.50	361078.91	198938.97	162139.93
...	...	...	...	...	...	...	...
48	30-06-2013	2028.53	1277.62	750.91	267766.53	169598.40	98167.98
...	...	...	...	...	...	...	...
180	30-06-2024	2028.53	15.10	2013.43	0.57	0.00	0.00

Source(s): Author's own

Table 3. Loan amortization schedule in conventional finance

Period	Deferred profit as calculated in BNM's case of fixed-rate BBA (last column in Table 2)	Interest amount as calculated in the conventional finance's case (last column in Table 3)	Difference
0	165135.97	165135.97	0.00
1	163635.97	163635.97	0.00
2	162139.93	162139.93	0.00
3	160647.89	160647.89	0.00
...	...	...	...
48	98167.98	98167.98	0.00
49	96895.99	96895.99	0.00
50	95629.68	95629.68	0.00
...	...	...	...
170	812.28	812.28	0.00
171	666.23	666.23	0.00
172	534.30	534.30	0.00
...	...	...	...
178	45.21	45.21	0.00
179	15.12	15.12	0.00
180	0.00	0.00	0.00

Source(s): Author's own

Table 4. Comparison of the two rebates

premises is also quite similar to the illustrative customized payment schedule introduced by BNM. Hence, both methods lead to an identical rebate amount on any payment date.

Accordingly, and with no need for the statistical test, the rebate amounts will not differ for both methods because it seems that the computation premises are the same for both practices. This result supports the null hypothesis, suggesting no significant difference between the rebate computation employed by conventional finance and the rebate computation proposed by BNM.

The results suggest that the *ibrā'* practice, as determined by BNM, may be influenced by the conventional finance practice of loan amortization, which may have its unique Sharī'ah concerns without reference to the annuity rule. Following the annuity rule in determining instalments, although not recommended, is still not a violation of Islamic laws and principles. However, following the conventional finance practice of loan amortization accompanied by the annuity rule to amortize the debt resulting from the sale-based financing and to determine the rebate amount is considered a usury-based transaction that may violate Islamic laws and principles.

Employing the annuity rule when determining the instalment value could be justified in Islamic financial contracts when replacing the denied interest rate with the accepted required rate of return, i.e. the profit rate. There is nothing wrong with seeking the same profit from two different sale forms: cash versus instalments. Likewise, there is no harm in utilizing the conventional finance ordinary annuity formula to yield the same future value regardless of the chosen paths, cash or instalments.

The previous reasoning does not contradict Islamic finance principles. Instead, it represents a stipulation of trying to obtain the same future benefits from cash sales and instalment sales. Such a stipulation has its theoretical background in Islamic finance. Otherwise, any type of instalment sales would not be accepted under any terms or conditions as an Islamic financial contract.

Nevertheless, the loan amortization technique used to determine the loan beginning balance and the rebate amount in conventional finance is a usury-based transaction. The loan amortization transaction stipulates a credit interest to be charged on the loan balance in each

instalment payment to determine the portion allocated as a required rate of return, and the remainder is devoted to amortize the loan balance; this is a typical usury-based transaction. Therefore, if IFIs, while following the annuity rule to determine the instalment amount, simulate the conventional loan amortization practice, they would make a direct violation of Islamic laws and principles.

Hence, from the Islamic perspective, the loan amortization practice applied in conventional finance should not be treated equally with the annuity computation. The annuity computation could be justified from the Islamic finance perspective; however, the loan amortization practice accompanied by the annuity rule is considered a usury-based transaction that cannot be justified. This is because the loan amortization practice deals with money as a commodity rented for an agreed-upon rate per time unit. Thus, when the borrowed amount of the commodity (money) increases, the rent paid (interest) increases, which is a typical usury case that harms one of the contracted parties (the borrower) and may represent a direct violation of Islamic laws and principles.

Conclusion

The concept of rebate or *ibrā'* has long been an issue of debate in Islamic finance. Eventually, the rebate ended up being recognized in most of the contemporary literature on Islamic finance. However, rebate acceptance has taken two different directions: the first is accepting rebate as a unilateral practice without a predetermined computation; and the second direction is to allow a bilateral rebate by specifying a predetermined rebate computation in the contract to be employed in the early settlement of the debt.

The SAC of BNM has supported the second direction. Nevertheless, the predetermined estimate proposed by BNM was greatly influenced by the pattern of loan amortization practice implemented in conventional finance. This considerable effect resulted from employing the ordinary annuity formula in determining the instalment amount at the contract's inception. Although using the ordinary annuity formula may not violate Islamic laws and principles, the conventional loan amortization practice connected to ordinary annuity represents a direct violation of Islamic laws and principles, as an apparent usury-based transaction. The COP is viewed as a balance whereby the profit rate is charged on it, which resembles the loan amortization practiced in conventional finance when charging the credit interest on the loan balance; this is a typical financing transaction with credit interest (*ribā*).

This paper suggests that part of the aforementioned problem may arise because of simulating the ordinary annuity rule when determining the instalment value in sale-based financing contracts. While the use of the ordinary annuity formula may not be forbidden or prohibited by itself, its ramifications related to the loan amortization would violate Islamic laws and principles. In order to avoid this problem, the paper recommends that IFIs should diverge away from conventional finance techniques when determining the instalment value in sale-based financing contracts. The paper also suggests that another rebate computation should be sought in the case of an early settlement of debts resulting from sale-based financing contracts – regardless of the instalment computation criterion.

This paper only examined the fixed profit rate rebate computation proposed by the BNM guidelines. It is recommended to discuss the variable profit rate rebate in further research.

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Appendix

	No.	Payment date	Installment	Profit payment	COP payment	Outstanding Selling Price	Outstanding COP	Deferred Profit
	0	30-06-2009	-	-	-	365,135.97	200,000.00	165,135.97
	1	31-07-2009	2,028.53	1,500.00	528.53	363,107.44	199,471.47	163,635.97
Year 1	2	31-08-2009	2,028.53	1,496.04	532.50	361,078.91	198,938.97	162,139.93
	3	30-09-2009	2,028.53	1,492.04	536.49	359,050.38	198,402.48	160,647.89
	4	31-10-2009	2,028.53	1,488.02	540.51	357,021.85	197,861.96	159,159.87
	5	30-11-2009	2,028.53	1,483.96	544.57	354,993.32	197,317.40	157,675.91
	6	31-12-2009	2,028.53	1,479.88	548.65	352,964.79	196,768.74	156,196.03
	7	31-01-2010	2,028.53	1,475.77	552.77	350,936.26	196,215.98	154,720.26
	48	30-06-2013	2,028.53	1,277.62	750.91	267,766.53	169,598.40	98,167.98
	49	31-07-2013	2,028.53	1,271.99	756.55	265,738.00	168,841.85	96,895.99
	50	31-08-2013	2,028.53	1,266.31	762.22	263,709.47	168,079.63	95,629.68
	51	30-09-2013	2,028.53	1,260.60	767.94	261,680.94	167,311.70	94,369.08
	52	31-10-2013	2,028.53	1,254.84	773.70	259,652.41	166,538.00	93,114.24
	53	30-11-2013	2,028.53	1,249.04	779.50	257,623.88	165,758.50	91,865.20
	170	31-08-2023	2,028.53	160.06	1,868.47	20,285.87	19,473.07	812.28
	171	30-09-2023	2,028.53	146.05	1,882.49	18,257.34	17,590.58	666.23
	172	31-10-2023	2,028.53	131.93	1,896.60	16,228.81	15,693.98	534.30
	173	30-11-2023	2,028.53	117.70	1,910.83	14,200.28	13,783.15	416.60
	174	31-12-2023	2,028.53	103.37	1,925.16	12,171.75	11,857.99	313.23
	175	31-01-2024	2,028.53	88.93	1,939.60	10,143.22	9,918.39	224.30
Year 15	176	29-02-2024	2,028.53	74.39	1,954.15	8,114.69	7,964.25	149.91
	177	31-03-2024	2,028.53	59.73	1,968.80	6,086.16	5,995.44	90.18
	178	30-04-2024	2,028.53	44.97	1,983.57	4,057.63	4,011.88	45.21
	179	31-05-2024	2,028.53	30.09	1,998.44	2,029.10	2,013.43	15.12
	180	30-06-2024	2,028.53	15.10	2,013.43	0.57	0.00	0.00

*COP: Cost of Purchase/Principal

Table A1. Customized payment schedule presented by BNM (2013)

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