

## THE 261<sup>ST</sup> SHARIAH ADVISORY COUNCIL OF THE SECURITIES COMMISSION MALAYSIA MEETING (17 OCTOBER 2022)

### SHARIAH-COMPLIANT PREFERENCE SHARES

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#### INTRODUCTION

Issuance of preference shares (PS) is one of the methods for a company to raise capital and obtain funding. Based on the provision in Section 2(1) of the Companies Act 2016, preference shares are defined as follows:

*“a share by whatever name called, which does not entitle the holder to the right to vote on a resolution or to any right to participate beyond a specified amount in any distribution whether by way of dividend, or on redemption, in a winding up, or otherwise”.*

As an alternative to the existing conventional PS in the market, there are efforts by companies listed on Bursa Malaysia Securities Berhad (Bursa Malaysia) to issue PS that complies with the principles of Shariah.

In order to ensure that the PS that will be issued in the market complies with the principles of Shariah, the Shariah Advisory Council (SAC) of the Securities Commission Malaysia had comprehensively discussed the features of PS as well as issues related to PS from Shariah perspective. The resolutions made by the SAC also took into account the current practice of issuing PS in Malaysia and the relevant legal provisions in the Companies Act 2016.



If there are new proposals from the industry on Shariah-compliant PS based on other Shariah principles which are not prescribed in this resolution, the SAC will consider the suitability of such principle to be applied in Shariah-compliant PS.

## RESOLUTION

SAC in a series of meetings had discussed the features of PS and its related Shariah issues. In the 261<sup>st</sup> SAC meeting held on 17 October 2022, the SAC had resolved on the following resolutions on Shariah-compliant PS which are applicable for the issuance of Shariah-compliant PS by companies listed on Bursa Malaysia.

### **(A) Shariah Principle and Related Matters**

#### **1. Shariah Principle Applied in Shariah-compliant PS**

##### **(a) *Takyif Fiqhi* (Adaptation of *Fiqh*)**

The appropriate *takyif fiqhi* for Shariah-compliant PS is the principle of *musharakah*.

##### **(b) Contracting Parties in *Musharakah***

- (i) *Musharakah* in Shariah-compliant PS is between PS holders and ordinary shares (OS) holders where both parties contribute capital to the company.
- (ii) PS holders are treated as new *musharik* (partner) in the existing *musharakah* (i.e. *musharakah* among OS holders), whereby they invest in an existing *musharakah* venture (i.e. general business of the same company). PS holders are subject to different terms as compared to OS holders.



**(c) Execution of the *Musharakah* Contract**

The execution of the *musharakah* contract in PS is done through subscription of the PS by the PS holders after they have agreed to the terms and conditions in the relevant document of the PS.

**2. Entitlement of PS Holders to Dividend up to the Declared Profit**

From Shariah perspective, it is permissible for PS holders to receive dividend up to the declared profit by the company based on the concept of *taradhi* (mutual consent).

**3. Implementation of Waiver of Right in PS**


**(a) Waiver of Right by the OS holders to the PS holders**

Waiver of right by the OS holders to the PS holders may be implemented through several mechanisms in the following events:

(i) Distribution of Dividend

(aa) *Tanazul*

The OS holders waive their right to receive dividend after profit is realised by giving preference to the PS holders. *Tanazul* takes place via ratification by the Board of Directors of the company based on the mandate given by the OS holders.



(bb) *al-Wa`d bi al-Hibah*

The OS holders promise to waive their right through *hibah* to receive dividend after profit is realised by giving preference to the PS holders. *Hibah* contract takes place via ratification by the Board of Directors of the company based on the mandate given by the OS holders.

(ii) Dissolution or Winding-up of Company

(aa) *Tanazul*

The OS holders waive their right to receive any amount pursuant to the dissolution or winding-up of the company by giving preference to the PS holders. *Tanazul* takes place via ratification by the Board of Directors of the company based on the mandate given by the OS holders.

(bb) *al-Wa`d bi al-Hibah*

The OS holders promise to waive their right through *hibah* to receive any amount pursuant to the dissolution or winding-up of the company by giving preference to the PS holders. *Hibah* contract takes place via ratification by the Board of Directors of the company based on the mandate given by the OS holders.



**(b) Waiver of Right by the PS holders to the OS holders**

Waiver of right by the PS holders to the OS holders may be implemented through *tanazul* principle in the following situations:

(i) Dividend Declared by the Company in Excess of the Expected Dividend Rate

The PS holders waive their right to receive dividend in excess of the expected rate once the profit is realised.

(ii) Partially-participating PS

The PS holders waive their right to participate entirely in the excess profit on a pro-rata basis and will only be entitled to receive the dividend up to the rate stipulated in the terms of the PS issuance.

(iii) Zero dividend PS

The PS holders waive their right to receive dividend during the tenure of the PS issuance.

**(B) Features of PS**

**1. Voting Right**

PS holders are not entitled to the voting right as provided under the Companies Act 2016. From Shariah perspective, it is permissible since PS holders have agreed to such arrangement during subscription of PS.



## 2. Dividend

### (a) Types of Dividend Distribution

The company will offer certain dividend rate that will be received by the PS holders every year. Such rate is known as expected preferential dividend rate. However, the rate is indicative and can only be declared out of available profits of the company on condition that the company is solvent<sup>1</sup> as provided under the Companies Act 2016. The dividend distribution shall be made based on the approval given by the Board of Directors of the company.

In general, there are three (3) types of dividend distribution or payment that are permissible from Shariah perspective as follows:


#### (i) Cumulative Dividend

PS with cumulative dividend feature refers to PS where its dividend rate (partly or wholly) will be carried forward to the following years and accumulated until its maturity date or as long as the PS is not redeemed. This happens when the company could not or did not declare the dividend on the specified dividend distribution date. The rate that can be accumulated and carried forward is as follows:

(aa) Up to the expected preferential dividend rate; or

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<sup>1</sup> Section 132 (3) of the Companies Act 2016 provides that a company is regarded as solvent if the company is able to pay its debts as and when the debts become due within twelve months immediately after the distribution is made.



(bb) Difference between dividend paid and expected preferential dividend rate.

However, the amount of dividend to be paid is subject to the availability of profit and declared by the company on the financial year of the dividend payment. If there is no available profit on the maturity or redemption date of PS, the company will not declare any dividend and will not pay such accumulated dividends to PS holders.

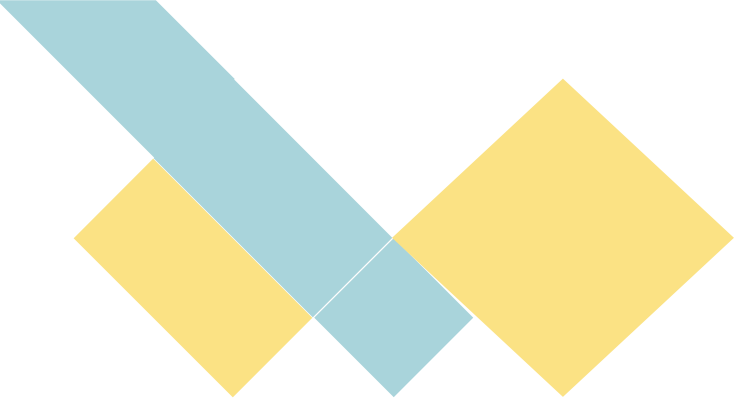
**(ii) Non-cumulative Dividend**

PS with non-cumulative dividend feature refers to PS where its undeclared dividend rate are not accumulated or carried forward. The company is only required to pay the dividend declared in the current year to PS holders.

**(iii) Zero Dividend**

PS with zero dividend feature refers to PS that do not distribute any dividend to its holders. Nevertheless, usually for issuance of this type of PS, the company will offer certain incentives to attract investors to subscribe such PS.

From Shariah perspective, as long as such incentives do not have the element of capital and/ or profit guarantee by the contracting parties, it is permissible. Among the incentives allowed include but not limited to the following:

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- (aa) Determination of certain redemption method that is subject to the SAC resolution in relation to redemption of PS;
  - (bb) Determination of certain conversion method that is subject to the SAC resolution in relation to conversion of PS;
  - (cc) Offering of discount on the issue price of the PS; and
  - (dd) Offering of detachable company warrants.


**(b) Distribution of Dividend at a Lower Rate than the Available Profit**

In the event that the available profit earned by the company is lower than the expected dividend rate, the distribution of dividend to PS holders at a lower rate than the available profit earned is permissible based on the terms and conditions of the PS that has been agreed upon the subscription of PS.

**3. Participating PS**

PS with participating feature refers to the right of PS holders to participate in the surplus profit of the company after the distribution of dividend is made. This type of PS is divided into three (3) categories as follows:





(a) Non-participating

In general, PS is considered as non-participating unless otherwise stated clearly in the terms of issuance of PS. Non-participating PS holders are not entitled to participate in the surplus profit earned by the company.

(b) Partially-participating

PS holders and OS holders will participate in the surplus profit earned by the company after the distribution of dividend is made between them. However, the participation of PS holders in the surplus profit is only limited to a rate that has been set out in the terms and conditions of the PS issuance.

(c) Fully-participating

PS holders and OS holders will participate in the surplus profits earned by the company on a pro-rata basis after the distribution of dividend is made between them.

From Shariah perspective, all three (3) categories of PS as stated above are permissible.



#### 4. Conversion

##### (a) Convertible PS

This type of PS entitles its holders the right or option to convert the PS to OS. From Shariah perspective, this type of PS is permissible based on the concept of *istibdal* (substitution).

Among the conversion methods which are permissible include but not limited to the following:

- (i) Conversion ratio;
- (ii) Conversion ratio and conversion price; and
- (iii) Cash paid for the difference between the PS surrendered and the conversion ratio.

Conversion method used must be agreed by the contracting parties and has no element of capital guarantee by the company to PS holders, such as the price of OS to be received must be subjected to the market value at the point of conversion.

##### (b) Non-Convertible PS

This type of PS cannot be converted to OS. From Shariah perspective, this type of PS is permissible.



## 5. Redemption


### (a) Redeemable PS

This type of PS can be redeemed by the company or PS holders at a specified date. This type of PS entitles its holders and the company the right or option to determine the redemption method (either partly or wholly). The same would be applicable in determining the parties that can opt to redeem the PS (either PS holders or company).

From Shariah perspective, this type of PS is permissible based on the terms and conditions of the PS which have been agreed upon during subscription of PS. The redemption of PS can be executed through purchase and sale undertakings as long as it does not guarantee the capital and/ or profit of PS holders.

For sale undertaking, any redemption method can be determined based on the agreement by the contracting parties. Meanwhile for purchase undertaking, the redemption method that can be implemented is limited to the following:

- (i) Redemption of PS based on the market value of PS on the redemption date;
- (ii) Redemption of PS based on the current performance of the company; or
- (iii) Redemption of PS through ratification by the Board of Director of the company.



For PS with cumulative dividend feature, the redemption price of PS can only take into account the available profit made by the company at the time when the redemption is made and the dividend rate that has been declared but unpaid to PS holders.

**(b) Non-Redeemable PS**

This type of PS cannot be redeemed by the company or PS holders either before or on the maturity date of such PS. From Shariah perspective, this type of PS is permissible.

**6. Dissolution or winding-up of the company**

PS holders will get preference as compared to OS holders in the distribution of company's asset or any amount upon the occurrence of dissolution or winding-up of the company based on the mechanism of waiver of rights as resolved by the SAC in item (A)(3) above.

The determination of the company's dissolution or winding-up formula which have been agreed upon the subscription of PS through disclosure in the terms and conditions of the PS is permissible.

**(C) Other Related Matters**

**1. Shariah Status of PS where its underlying shares are Shariah-compliant**

The underlying shares of PS must be classified as Shariah-compliant securities.



## **2. Utilisation of PS Proceeds**

Proceeds from PS issuance must be utilised for Shariah-compliant purposes only.

## **3. Change of Shariah-compliant Status for Securities of Company related to PS**

If the securities of a company are re-classified as Shariah non-compliant by the SAC, the status of PS for such company is also classified as Shariah non-compliant.

Therefore, the PS holders of the company are entitled to dispose such PS or OS (after the conversion to OS is made) by following the guide on the timing for the disposal of securities that have been classified as Shariah non-compliant securities by the SAC.

In the event of redemption, PS holders may also request the company to redeem such PS that has changed status to Shariah non-compliant subject to the SAC resolution in relation to redemption of PS.

## **4. SAC Endorsement on Shariah-compliant Status of PS**

For PS issuers that would like to obtain the status of Shariah-compliant PS, such PS must obtain the endorsement from the SAC.

## SHARIAH JUSTIFICATION

### (1) Shariah Principle based on *Musharakah*

The acceptable Shariah principle to be applied in Shariah-compliant PS is *musharakah*.<sup>2</sup> This principle is in line with the legal point of view where PS is categorised as share capital of a company.

*Musharakah* refers to the partnership contract between two or more parties to finance a project. All partners will contribute capital either in the form of cash, in-kind or combination of both. Any profit derived from the partnership will be distributed based on a pre-agreed profit-sharing ratio. Meanwhile, any loss will be borne together based on the respective parties' capital contribution.<sup>3</sup>

Among the justifications on the permissibility of *musharakah* are based on the following texts:


قَالَ لَقَدْ ظَلَمَكَ بِسُؤَالِ نَعَجْتِكَ إِلَىٰ نِعَاجِهِ وَإِنَّ كَثِيرًا مِّنَ الْخُلَطَاءِ لِيَبْغِيَ بَعْضُهُمْ  
عَلَىٰ بَعْضٍ إِلَّا الَّذِينَ ءَامَنُوا وَعَمِلُوا الصَّالِحَاتِ وَقَلِيلٌ مَّا هُمْ

Meaning: Daud A.S. eventually ruled, he has definitely wronged you in demanding to add your sheep to his. And certainly many partners wrong each other, except those who believe and do good but how few are they!

(Surah Sad: 24)

<sup>2</sup> Based on the discussion between scholars, *sharikah* can be divided into several types. In the context of PS, it can be seen from the perspective of *sharikah al-`inan*.

<sup>3</sup> Wahbah al-Zuhaili, *al-Fiqh al-Islami Wa Adillatuh*, Dar al-Fikr, 1997, v. 5, p. 3890-3893, Ibn Qudamah, *al-Mughni*, Maktabah al-Qaherah, v. 5, p. 13-14 and p. 27-28.



In a hadith *qudsi* narrated by Abu Hurairah R.A., Allah S.W.T. said:

أنا ثالث الشريكين ما لم يخن أحدهما صاحبه، فإذا خانه خرجت من بينهما

Meaning: I am the third (partner) of two partners as long as one of them does not cheat his companion. Then, if he cheats (his partner) I depart from them.

(Reported by Abu Daud)

Ibn Raslan when explaining the meaning of this hadith said that a partner should be trustworthy towards the other partners. Al-Rafi`e further explained that if there is betrayal between partners, then the blessings on their property will be lost.<sup>4</sup>

It can be understood from the hadith that the principle of *musharakah* is permissible due to the blessing in it.


## (2) ***Muqtadha al-`Aqd in Musharakah***

*Muqtadha al-`aqd* (objective of the contract) in *musharakah* refers to *hukm aslī* of *musharakah* which is profit and loss sharing among *musharik* (partners). *Muqtadha al-`aqd* (in the context of *hukm aslī*) is determined and specified by *Syara`* and not by the contracting parties. Therefore, the contracting parties cannot alter *hukm aslī* which has been determined by *Syara`*. Fuqaha' also allow the imposition of conditions in a particular contract as long as it does not contravene

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<sup>4</sup> Ibn Raslan, *Syarh Sunan Abi Daud*, v. 14, p. 168.

<sup>5</sup> *Hukm aslī* refers to a certain effect on the contract or the main objective of the contract is stipulated.



*hukm asli* of a particular contract and it does not lead to anything prohibited by *Syara`*.

In order to ensure that PS fulfil the requirements of Shariah as stated above, the features of PS must preserve the *hukm asli* for the *musharakah* contract.

### **(3) Capital and Profit Guarantees in *Musharakah***

Islamic scholars agree that *musharakah* is a trust-based contract. Therefore, capital and profit guarantees by a *musharik* to other *musharik* is not permissible. However, it is permissible to stipulate a condition that the concerned *musharik* should guarantee the realised profit and the capital loss of other *musharik* in the event of misconduct (*ta`addi*), negligence (*taqsir*) or breach of terms (*mukhalafah al-syurut*) agreed in the contract during the management of *musharakah* venture.<sup>6</sup>

Besides that, the capital and profit guarantees by the contracting parties do not occur since there is probability risk of earning profit or otherwise in a *musharakah* venture. This is in line with the following hadith in which Rasulullah SAW said:

الخراج بالضمنان


Meaning: Any profit goes to the one who bears responsibility.

(Narrated by Ibn Hibban (4928))

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<sup>6</sup> Dr. Ali Jum`ah, *Mausu`ah al-Iqtisad al-Islami fi al-Masarif wa al-Nuqud wa al-Aswaq al-Maliyah al-Islamiyah*, Dar al-Salam, Cairo, 2009, vol. 5, p. 262.





And also Islamic legal maxim which explains that any gain or profit realised are based on the risk borne by the contracting parties:<sup>7</sup>

الغنم بالغرم

Meaning: Liability is (undertaken in equivalent) with reward.

Therefore, *musharakah* contract is to ensure that risk is calculated fairly and any form of capital and profit guarantee by the contracting parties contradicts *muqtadha` aqd al-musharakah*.

In the context of Shariah-compliant PS, there is no capital and/ or profit guarantee by the company to the PS holders. This is because the dividend rate determined in the terms and conditions of the PS (whether cumulative or non-cumulative) is only indicative. The dividend rate is also not considered as debt by the company to the PS holders because the dividend declaration to be distributed to the PS holders is subject to the availability of profit of the company, in line with Section 131 of the Companies Act 2016.

The permitted methods in the redemption and conversion does not make PS holders free from any risks such as uncertainty of the market value of the shares and performance of the company. Therefore, there is no guarantee that PS holders will receive their investment capital in full in the situation of redemption and conversion.

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<sup>7</sup> al-Zuhaili, *al-Qawaid al-Fiqhiyyah wa Tatbiqatuha fi al-Mazahib al-Arba`ah*, Dar al-Fikr, 2006, vol. 1, p. 543.



#### (4) *Tanazul* Principle

*Tanazul* in general refers to waiver of rights by its holders (صاحب الحق) or its agent in relation to the following:

- (i) Rights which are determined (*mu`ayyan*) or not determined which exist in a person's liability; or
- (ii) Transfer of ownership or its equivalent, whether related to *haq maliy* (financial rights) or *haq ghair maliy* (non-financial rights), in whole or in part, with *`iwadh* (consideration) or without *`iwadh*.<sup>8</sup>

Among the justifications on the permissibility of *tanazul* principle is based on the following verses :


وَإِنْ كَانَ دُوْ عُسْرَةً فَنَظِرَةٌ إِلَىٰ مَيْسَرَةٍ وَأَنْ تَصَدَّقُوا خَيْرٌ لَّكُمْ إِنْ كُنْتُمْ تَعْلَمُونَ

Meaning: If it is difficult for someone to repay a debt, postpone it until a time of ease. And if you waive it as an act of charity, it will be better for you, if only you knew.

(Surah al-Baqarah: 280)

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<sup>8</sup> Dr Muhammad Ya`aqub al-Dahlawi, *Huquq al-Mar'ah al-Zaujiyyah wa al-tanazul`anha, Dar al-Fadhilah li al-Nasyr wa al-Tauzi`*, 2002, p. 75.



Ibn Kathir when interpreting such verse stated that creditors who waive their right to receive payment of debt from debtor is a form of charity.<sup>9</sup>

This is supported by hadith narrated by Abu Hurairah R.A. that Rasulullah S.A.W. said:

كان تاجر يداين الناس، فإذا رأى معسرا قال لفتيانه : تجاوزوا عنه، لعل الله أن يتجاوز عنا، فتجاوز الله عنه

Meaning: There was a merchant who used to lend the people, and whenever his debtor was in straitened circumstances, he would say to his employees, 'Forgive him so that Allah may forgive us.' So, Allah forgave him.

(Reported by al-Bukhari and Muslim)

Al-Asqalani explained that the hadith is stating that the creditor's action to provide deferment of debt to debtor or lessen the amount of debt is considered as charity if it is performed sincerely. Such action will also be rewarded by Allah S.W.T.<sup>10</sup>

Based on the justifications and Islamic scholars' views as stated above, the application of *tanazul* principle is permissible. In the context of PS, *tanazul* principle can be applied in certain situation as long as it does not contravene the *hukm asli* of *musharakah*.

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<sup>9</sup> Ibn Kathir, *Tafsir Ibn Kathir*, Dar al-Kutub al-Ilmiah, vol. 1, p. 55.

<sup>10</sup> al-`Asqalani, *Fath al-Bari*, Dar Ibn al-Jauzi, vol. 4, p. 309.