

## THE 272<sup>ND</sup> SHARIAH ADVISORY COUNCIL OF THE SECURITIES COMMISSION MALAYSIA MEETING (14 SEPTEMBER 2023)

### ISSUANCE OF SHARIAH-COMPLIANT PREFERENCE SHARES VIA BONUS ISSUE BY A LISTED COMPANY

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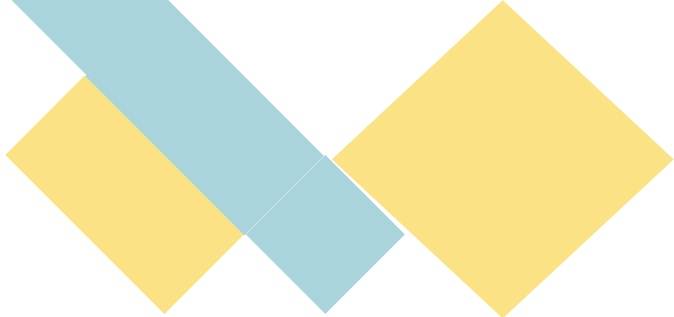
#### INTRODUCTION

An industry proposal relating to the issuance of Shariah-compliant redeemable preference shares (RPS-i) via bonus issue<sup>1</sup> by a listed company, whose securities are classified as Shariah-compliant was presented to the Shariah Advisory Council (SAC).

Since the RPS-i is based on the *musharakah* principle, among the Shariah issues discussed in such proposal were as follows:

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<sup>1</sup> Bonus issue refers to an issue of new shares to members in proportion to their existing holdings (also known as a scrip issue or capitalisation issue), typically carried out to turn accumulated reserves into new shares, which proportionally reduces the value at which each and every share trades. <https://www.lexisnexis.co.uk/legal/glossary/bonus-issue>



**(1) Retained Earnings<sup>2</sup> as a *Musharakah* Capital Contribution by the Preference Shareholders in the Existing *Musharakah***

Whether the *musharakah* capital contribution by the preference shareholders in the existing *musharakah* through retained earnings is acceptable from Shariah perspective?

**(2) Application of Principle of *Ibra'* to Reflect the Waiver of Rights for Preferential Dividends (which was declared but is unpaid or cannot be paid) in Shariah-Compliant Preference Shares**

Whether the principle of *ibra'* may be considered as an appropriate Shariah principle to reflect the waiver of rights for preferential dividends which was declared but is unpaid or cannot be paid to the preference shareholders?

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<sup>2</sup> Retained earnings represent the earned capital of the reporting entity. Earned capital is the capital that develops and builds up over time from profitable operations. It consists of all undistributed income that remains invested in the reporting entity. [https://viewpoint.pwc.com/dt/us/en/pwc/accounting\\_guides/financial\\_statement/financial\\_statement\\_18\\_US/chapter\\_5\\_stockholde\\_US/58\\_retained\\_earnings\\_US.html#pwc-topic.dita\\_1955185401180140](https://viewpoint.pwc.com/dt/us/en/pwc/accounting_guides/financial_statement/financial_statement_18_US/chapter_5_stockholde_US/58_retained_earnings_US.html#pwc-topic.dita_1955185401180140)



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## RESOLUTION

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In the 272<sup>nd</sup> meeting held on 14 September 2023, the SAC had resolved several issues in relation to the issuance of Shariah-compliant preference shares via bonus issue as follows:

**(1) Retained Earnings as a *Musharakah* Capital Contribution by the Preference Shareholders in the Existing *Musharakah***

According to accounting perspective, retained earnings comprise of cash and in-kind. Therefore, according to the Shariah perspective, retained earnings is acceptable as the *musharakah* capital contribution for issuance of preference shares by the existing shareholders.

**(2) Application of Principle of *Ibra'* to Reflect the Waiver of Rights for Preferential Dividends (which was declared but is unpaid or cannot be paid) in Shariah-Compliant Preference Shares**

The principle of *ibra'* is the appropriate Shariah principle to reflect the waiver of preference shareholders' rights to receive any remaining preferential dividends declared but is unpaid or cannot be paid if the available amount of proceeds from the liquidation of the assets of the company is insufficient to pay in full the preferential dividends that have been declared but remains unpaid.



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## SHARIAH JUSTIFICATION

Shariah justifications for the SAC resolution above are as follows:

**(1) Retained Earnings as a *Musharakah* Capital Contribution by Shariah-compliant Preference Shareholders in the Existing *Musharakah***

- (i) The Shariah principle used for the issuance of the Shariah-compliant preference shares via bonus issue is *musharakah*. For the issuance of Shariah-compliant preference shares via bonus issue, the listed company (ListCo) will set free for distribution the retained earnings of the company with the consent of the ordinary shareholders, which will be satisfied in the form of fully paid Shariah-compliant preference shares issued to the ordinary shareholders instead of a dividend pay-out in cash. Since the distribution of retained earnings to ordinary shareholders and capital contribution via subscription of the ListCo Shariah-compliant preference shares occur simultaneously, there will be no cash proceeds from the ordinary shareholders and there is no requirement to reflect the individual transactions via accounting entry.

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- (ii) The capital contribution in *musharakah* by *musharik* (partner) in the form of cash and/or in-kind is permissible. However, the capital contribution in-kind must be valued based on the market price<sup>3</sup> or a mutually agreed price. Such capital contribution must be valued in monetary value at the time of the execution of *musharakah* contract. The said valuation needs to be conducted to ensure that the value of capital contribution from the contracting parties is clearly determined at the time of the execution of such contract.

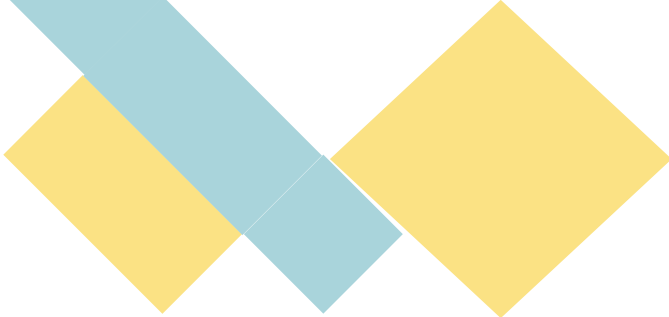
The bonus issue of preference shares is a form of *musharakah* whereby the retained earnings will be utilised and treated as capital contribution for the subscription of the said preference shares. Since retained earnings consist of cash and in-kind expressed in monetary value, it fulfils the requirement of *musharakah* capital contribution.

- (iii) Capital contribution provided by *musharik* into a *musharakah* venture must be readily available, identifiable and accessible at the time of execution of the *musharakah* contract. Therefore, debt is not permissible to be used as capital contribution in the *musharakah*.<sup>4</sup>

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<sup>3</sup> Imam Malik's view and some Islamic scholars from Hanbali's *mazhab*, please refer; al-Dusuki, *al-Syarh al-Kabir li al-Syarh al-Dardir wa Hasyiyyah al-Dusuki*, Dar al-Fikr, n.d., vol. 3, p. 349, Ibn Qudamah, *al-Mughni*, Maktabah al-Qaherah, 1968, vol. 5, p. 13, Wahbah al-Zuhaili, *al-Fiqh al-Islami Wa Adillatuh*, Dar al-Fikr, Dimasyq, 1997, vol. 5, p. 3893.

<sup>4</sup> Wahbah al-Zuhaili, *al-Fiqh al-Islami Wa Adillatuh*, op.cit., p. 3890-3893.



**(2) Application of Principle of *Ibra'* to Reflect the Waiver of Rights for Preferential Dividends (which was Declared but is Unpaid or cannot be Paid) in Shariah-Compliant Preference Shares**

*Ibra'* is an appropriate Shariah principle to be applied because once the preferential dividends are declared by the Board of Directors of the company, they are considered as established debt owed to the preference shareholders which shall be paid unless the preference shareholders waive their rights to the debt via *ibra'*.

According to Shariah perspective, the application of principle of *ibra'* is acceptable as long as the arrangement is agreed between the contracting parties based on the following legal maxim:<sup>5</sup>


"الأصل في العقد رضى المتعاقدين ونتيجته هي ما التزموا به بالتعاقد"

"The original rule of a contract is the mutual consent or agreement by both contracting parties and the consequence of the contract is based on (rights and responsibilities) agreed in the contract."

The preference shareholders have agreed to the terms and conditions in the relevant document of the Shariah-compliant preference shares during the subscription of such preference shares. Therefore, the act of granting *ibra'* either by themselves or via ratification by the Board at

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<sup>5</sup> Ahmad al-Zarqa', *Syarah al-Qawa'id al-Fiqhiyyah*, Dar al-Qalam, 1989, p. 482.



the time of waiver on their behalf (whichever is applicable), is binding upon them. This is in-line with the following hadith of the Prophet Muhammad (peace be upon him):<sup>6</sup>

"المسلمون على شروطهم إلا شرطا أحل حراما أو حرم حلالا"

"Muslims are bound by the conditions in which they agreed upon, except for the one that permits the haram (forbidden acts) or forbids the halal (permissible)."

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<sup>6</sup> Abu Daud, *Sunan Abi Daud*, Bait al-Afkar al-Dawliyyah, 1999, p. 398, hadis No. 3594.