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The Adverse Impact of COVID-19 on Islamic Banks in Malaysia

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Abstract
Purpose – This research aims to look into the adverse impact of COVID-19 on Malaysian Islamic banks.
Design/methodology/approach – For this work, literature review was undertaken to evaluate the impact of COVID-19 from selected countries.
Findings – This research is an attempt to add to the body of knowledge on the matter at hand and to provide a better understanding of the adverse effect of COVID-19 on Islamic banks in Malaysia in terms of capital, liquidity and provision. Increased risk including capital, liquidity and provision, which COVID-19 is thought to disrupt.
Research limitations – This study focuses on Islamic banks in Malaysia. Further research should look into the effect of COVID-19 on Islamic and conventional banks to see if there are any parallels or discrepancies with the results of this study.
Theoretical implications – Because this paper is conceptual, it will be valuable for Islamic banks' Shariah research function. The study also contributes to a review of the research on COVID-19 effect on Islamic banks in Malaysia
Originality/value – It is the authors' belief that this study is the first attempt of a conceptual examination of COVID-19's adverse impact on Malaysian Islamic banks.

Keywords: COVID-19, Islamic banks, Impact, Relief measures, Malaysia

1. Introduction

The COVID-19 pandemic has had an immediate and major impact on global economies. It has a significant impact on the business landscape as well as how and what customers buy. Businesses, particularly in the airline and tourism sectors, saw a substantial drop in demand and services during the lockdown. In Malaysia, it has been reported that from January 11 to March 16, 2020, hotels had experienced 170,084 booking cancellations, in which causing a revenue loss of RM68,190,364 (Foo et al., 2020). Growth in the gross domestic product (GDP), household spending, inflation, and unemployment rates have all been affected by the phenomena. Many small and medium-sized businesses (SMEs) are struggling to stay afloat. As a result, many employees have lost their jobs or had to accept pay cuts. The banking industry has been impacted by the Malaysian government's abrupt implementation of the Movement Control Order (MCO), which has put numerous economic sectors in jeopardy. MCO was launched by the Malaysian government on March 18, 2020, as part of its efforts to limit the spread of COVID-19 infection.

Due to the Covid-19 pandemic, consumers' buying patterns and behavior have changed. While most industries have seen a drop in demand, there are some that have benefited from the pandemic. Cloud computing, video conferencing, electronic payments, online meal delivery, and frozen foods and beverages (F&B) are all booming. Companies are being pushed to function in new ways more quickly as a result of the COVID-19, which is speeding digital transformation. Another effect of the epidemic is the disruption to the workforce. Working from home has become the new normal. The idea of working in the office from nine to five daily for five days weekly has instantaneously become irrelevant. Workers now have the option of not to be physically present at the office, which reduces traffic congestion. However, some firms are considering making working from home a permanent arrangement, which would have a huge impact on the office and commercial space market. The economy of Malaysia has been significantly affected by the Covid-19 pandemic. The partial lockdown undertaken in mid-March 2021 has slowed the nation's economic activities and harmed commodity, manufacturing, and intermediate products export revenues, as well as tourism income.

The amount of the decline in economic growth and public budgets, as well as the rate at which the epidemic will end, are both highly unknown. Recent political unrest might wreak havoc on governance standards, which nonetheless had saw steady improvement over the previous two years. With a liquidity coverage ratio of 149 percent, the banking industry is maintaining its loss absorption capital buffer, of which consisting common equity Tier 1 ratio of 14.3%. Malaysia's banking sector outlook, on the other hand, has been downgraded from stable to negative, highlighting the pandemic's detrimental impact on the profit and asset quality of banks. Related policies to counter the negative impact, such as interest rate reduction and moratorium of debt repayment would assist in alleviating credit stress. Nonetheless, these initiatives might also put pressure on the liquidity and interest margins of banks. The speed of economic recovery and the success of relief measures will determine the asset quality, profits, and capital levels of banks (Fitch Rating, 2020). According to Fitch Ratings, it is expected that the magnitude of Islamic financing will further improve due to the regulatory landscape that gives a balanced competitive environment, as well as the continuous promotion of Islamic banking instruments by banks. The COVID-19 pandemic puts the banks, especially Islamic banks' asset quality and growth at risk. Given a similar funding mix, we expect COVID-19 to have a comparable effect on the quality of assets of Islamic bank similar to conventional banks. Bank and government assistance measures, on the other hand, should assist in alleviating near-term impact.

Apart from prevailing competitiveness of the domestic market, the profitability of banks is expected to be negatively affected by the recent policy of rate reduction introduced by Bank

Negara Malaysia (BNM) and the easing of monetary policy undertaken by various APAC nations. Despite the fact that BNM might not in 2020 achieve its aim of a 40% Islamic financing mix, Fitch believes that in the medium-term Islamic financing will increase faster than conventional loans. In the short-term, Islamic banks' credit profiles should stay relatively stable. However, we foresee threats to the bank's profitability and asset quality should the COVID-19 pandemic continues. BNM's most recent steps in response to the COVID-19 pandemic are designed to help individuals and corporate borrowers; while ensuring that banks continue to have a significant function in the economy. With effect from April 1, 2020, BNM has imposed a six-month ban on the payment of personal loans and financing. It means that all banks will automatically postpone six-month financing payments, benefiting an approximate 70% of the overall funding of Islamic banking industry (RAM Rating, 2020).

According to RAM Rating Services (2020), despite Islamic banks retaining a steady outlook, the spreading of COVID-19 pandemic is expected to weaken the demand for credit and impact Islamic banks' profitability this year. This is because there is intensified economic uncertainty. However, RAM Rating expects that in comparison of 8.3% in 2019, the year 2020 would see a reduction of lower than 5% in the nation's Islamic banking financing growth. Moreover, the rating agency warned that the indicators of Islamic banks' asset quality could deteriorate once BNM's financial assistance measures expire in six months. On the other hand, if borrowers' weaknesses last longer than the six-month moratorium, default provisioning needs may increase in 2021. According to asset quality metrics in reports, Islamic banks could remain manageable in 2020, with prevailing financial assistance given. However, the measures might not accurately reflect the Islamic banking system's credit quality. Despite the fact that the gross impaired financing ratio of Islamic banks increased to 1.4 percent at the end of 2019; i.e., from 1.3 percent in 2018 as a result of several problematic corporate accounts, the asset quality of Islamic banks remains healthy. This study aims to look at the repercussions of Covid-19 among Islamic banks in Malaysia. As a result, the research strategy will be of a conceptual approach, a beginning point, and a thorough literature review.

2. Literature review

2.1 Malaysian Islamic Banks

Islamic banking, in general, is the banking system that follows Islamic law, also recognized as Shariah law. Dissimilar to traditional banking, those Islamic banks are interest-free organizations. These banks will not conduct any banking or trade activities that have the elements of interest (Riba), gambling (Maisir), or speculative trading (Gharar). The Islamic banking is regulated by certain fundamental concepts; i.e., all involved parties will assume similar risks and share of profitability, every party is assured of fairness, and the business dealings are in accordance to underlying asset or economic activity. Islamic banking encourages Zakat (alms tax), prohibits monopoly, promotes collaboration for societal benefits, and supports the establishment of all Halal business components, and supports fair profit and loss sharing amongst parties concerned (Thambiah et al, 2011). Similar to conventional banking, Islamic banks are also providing numerous types of banking products and services. However, those products and services are Shariah-compliant.

The BNM and the Islamic Financial Service Act 2013 regulate the Islamic banks and financial businesses. The Shariah Advisory Council, Malaysia's highest-ranking authority in Islamic banking, finance, and Takaful was formed in 1997 to ensure the consistency of Shariah judgements in businesses. It is comprised of eminent Shariah academics, jurists, and legal experts. The special committee on Islamic finance, which was originally established in Budget 2019 is chaired by the deputy finance minister. It guides the development of Islamic Economics Blueprint, and its establishment was announced during the tabling of 2020 budget.

The current budget also contains outreach programs to develop a better knowledge of Shariah banking and finance. The Shariah Governance Framework (SGF), an upgraded version of the 2011 version that went into effect in April 2020, has been changed by BNM to focus on improving board members' understanding and execution of Shariah governance in their institutions. According to the Shariah governance policy document (SGPD), Islamic banks must have solid governance structure, processes and policies to support a complete Shariah adherence.

Malaysia has 12 and 16 Islamic windows and full-fledged Islamic banks, respectively. Based on the IFSB's Islamic Financial Services Sector Stability Report 2019, the country is the third-largest market for Islamic banking assets, accounting for 10.8% of the worldwide Islamic banking sector in the 2nd quarter of 2018, up from 9.1% the year before. Despite the fact that Islamic banking accounts for 26.5 percent of the country's commercial banking system, there had been a lot of talk about Islamic financial mergers and acquisitions in 2019. In 2019, the government announced the central bank's restructuring plan for the country's development financial institutions, specifically a new financial institution through the mergers of Bank Pembangu and Bank Pembangu. The planned acquisition of Malaysia Industrial Development Finance by Al Rajhi Malaysia was announced in 2019. The combined assets will worth RM13.43 billion (US$3.24 billion) after the merger. The government of Malaysia has introduced the PRIHATIN Economic Stimulus Package worth MYR250 billion to help economic recovery. Apart from the Overnight Policy Rate (OPR) reduction, the PRIHATIN package also outlines the aids provided by financial institutions where individuals and businesses are given financial assistance; i.e., emergency financing for SMEs, and flexible loan repayment. In Malaysia, the government's regulatory and supervisory actions enacted during the pandemic have had an impact on financial institutions, notably the banking sector; i.e., relation to earning liquidity, loan growth, and provisioning (Khoo, 2020).

Therefore, the purpose of this study is to analyze the major effect of COVID-19 pandemic on financial institutions, particularly those Islamic banks. This is because Malaysia stands as one of the centers for Islamic finance. To date, there are very few studies on the influence of Covid-19 pandemic on the banking industry, particularly from the aspect of Islamic banking. As a result, this paper contributes by addressing the lack of studies in this area in view that Covid-19 is a new research domain. COVID-19's spread is significant to Islamic finance framework including the Gulf nations, Iran and Malaysia. This is because the pandemic presents both setbacks and opportunities to this sector. The weekly market round-up issue of Islamic Finance News for 22nd to 28th February mentioned that the Saman Insurance and Iran Insurance are now covering coronavirus in their products. Most Malaysian banks, both Islamic and conventional banks have started offering their corporate and individual customers financial allowances for the temporary financial setbacks they are currently experiencing. Restructuring and rescheduling of debts, as well as temporary postponement of debt repayments, are among the relief packages. On the negative side, the scheduled global conferences during the year's first-half on Islamic finance had to be deferred. In addition, the pandemic has negatively impacted the halal industry, just as it has on other industries. Many have identified the halal economy as the future propelling axis of Islamic finance's growth, and the growth of Islamic finance will be affected should there is a negative effect on the halal economy. Malaysia's thriving Islamic banking and finance industry is largely due to the collaboration between the government, regulators, and industry actors. Malaysia's emergence as one of the world's largest Islamic finance marketplaces, and how the country is primed for growth.

2.2 Impact of COVID 19 for Islamic Banks

The nature of their operations has resulted in Islamic banks to be seen as more resilient to systemic financial crises than traditional banks (Miah et al., 2021, Hassan et al., 2020). They helped to lessen the impact of the global financial crisis in 2008 by prohibiting Riba transactions, Maysir, Gharar, speculators, and hazardous asset classes. According to studies by Ashraf et al. (2020), and Smolo and Mirakhor (2010), Islamic banks experienced less disruption from the 2008 financial crisis as compared to those conventional banks. It was discovered that the conventional banks are less stable than those Islamic banks when it comes to absorbing financial shocks (Brown, 2020). COVID-19, on the other hand, poses distinct hazards and has a greater impact, resulting in a global economic crisis never seen before. Others feel that the impact on Islamic banks will be significantly greater, notably in Africa and Asia. This is because the majority of them are financing the SMEs, retail loans/financing, merchant trading, and microfinance, as opposed to their conventional counterparts (Brown, 2020; Hassan et al., 2020; Miah et al., 2021).

During COVID-19, this is the most affected sector. Furthermore, Islamic banks are more sensitive to market liquidity as a result of COVID 19. The liquidity crisis was compounded by regulators' prohibitions in countries like Malaysia and Bangladesh, as well as Islamic banks' deferment of monthly instalments. Furthermore, the volatility in oil prices in Arab countries puts a substantial strain on the region's Islamic banks, which rely significantly on government spending (Hassan et al., 2020). The Covid -19 effects as well as the possible remedies to these difficulties are the focus of the literature on the subject. Hassan et al. (2020) looked at the challenges that Islamic finance and banking face, emphasizing on the substantial changes from the previous financial crisis. They proposed a variety of financial solutions, particularly Fintech as a viable solution to the difficulties. In the meantime, Chattha (2021) investigated the operations of financial regulators in 13 jurisdictions, focusing on Islamic institutions to lessen the COVID-19 impact. He also revealed that a number of authorities have taken steps to minimize the effects of COVID-19, including the introduction of a mandatory repayment moratorium, restructure and/or reschedule of financings, guarantee by government, capital buffer, capital allowance, provision of liquidity using numerous mechanisms, and ensure continuous financial accessibility.

Other research looked at the effect of COVID-19 on Islamic financing markets. The bulk of these studies found that the COVID-19's Islamic capital markets are less resilient than they were during the 2008 financial crisis. Gherbi and Alsedrah (2021), for example, looked into the short- and long-term consequences of COVID-19 on stock market growth and on Saudi Arabian economic woes. They discovered that the COVID-19 pandemic is substantially and significantly impacting the financial crisis indicator in the short-run, but not long run. Ryandono et al. (2021) discovered that shariah stocks react faster than conventional stocks and have a strong and favourable response to COVID-19. In contrast, Nurdany et al. (2021) discovered that positive and bad news have varying amounts of impact on the return volatility of the Indonesia Shariah Stock Index (ISSI). When compared to positive news, the COVID-19 epidemic had little impact on the ISSI's return volatility. The influence of the pandemic on both conventional and Islamic financial institutions in Gulf Cooperation Council (GCC) nations is studied by Akkas and Samman (2021). The research was divided into two phases: 2020 (phase 1) and 2021 (phase 2). Their findings contrasted those of the capital market, demonstrating that Islamic banks in Qatar, Bahrain, Saudi Arabia, UAE and Oman are resistant to COVID-19. Furthermore, during the initial outbreak of the COVID-19 epidemic, Islamic banks in Saudi Arabia and Bahrain were unaffected. As a result, they discovered that during the COVID-19, Islamic banks outperformed both conventional and Islamic window financial institutions. In a similar vein, Miah et al. (2021) examined COVID-19's potential impact on Bangladesh's

Islamic banking sector. Because Islamic banks are not permitted to conduct Riba transactions, they must engage in trading, which exposes them to true market risk. In view that majority of Islamic banks' transactions involve trading, they are more likely to be affected by the pandemic than their rivals. More than 75 percent of the investment and income of Islamic banks come from working capital and trade credit. Murabaha, Bai Muajjal, and Ijara are examples of Murabahah (cost-plus or mark-up) finance solutions. In addition, the study presents a few suggestions of how the government might assist Bangladesh's Islamic banks in dealing with the pandemic.

Seelye and Ziegler (2020) studied the primary impact of Covid-19 pandemic on American banking sector. The American government has undertaken numerous initiatives to boost the nation's economy in which include non-permanent and permanent alterations in directives issued by the regulator that impact banks directly. Malaysia is preparing for a time of recovery where the nation remains steadfast in managing the pandemic's repercussions. During this phase, the Islamic financial sector is presented with lots of potentials and there are heavy tasks ahead. The government's implementation of the moratorium period creates a number of concerns about liquidity risks, in which includes the impact on banks' cash inflows. This is because there will be delays in repayments as a result of loan restructuring or halt in payments. It is important to note that short-term liquidity risk can have an instant impact, while solvency risk can arise later. As a result, several considerations must be taken into account to support the banks' liquidity. Those measures include reduction in required reserve, reduced regulatory capital buffer, Sukuk/bond purchase program, and accessibility to central bank's credit (IsDB, 2021). The following Table 1 shows the impact of COVID-19 in Malaysia and Japan:

Table1: Impact of COVID-19

No.		Malaysia	Japan
1.	Loans, NPL, Provisioning	Deferment of all loan repayments for a period of 6 months, effective 1 April 2020, and credit card outstanding balances can be converted to a 3-year term loan with reduced interest rates.	Banks are advised to support the cash flow of corporate clients.
2.	Capital	Banks may drawdown on the capital conservation buffer of 2.5%.	Banks subjected to Basel international standards may use their capital buffer to absorb losses and maintain necessary funding.
3.	Liquidity	BNM to supply daily ringgit liquidity to banks, and banks may operate below the minimum Liquidity Coverage Ratio (LCR) of 100%.	Banks subjected to Basel international standards may use their liquidity buffer to absorb the liquidity shock.

A study by Hasan on COVID-19 impact on Islamic banking in Indonesia can be broken down into three probable hazards, including financing risks, asset impairment, and a tightening of the profit-sharing structure. The study found that Islamic banking is more resilient than the conventional banking when the economy is hit by the COVID-19 pandemic. Based on the concerns posed by the COVID-19 epidemic, Islamic banks have seized possibilities to enhance their market share by surviving these threats. Increased digital marketing in Islamic banking operations is one of the strategies. The internet has become an indispensable mechanism for

them to remain connected and undertake activities related to social, business and educational pursuits. The Covid-19 impact on the dynamics of Islamic banks such as profitability, stability, non-performing financing, and size was anticipated by Mansour, Ajmi, and Saci (2021) throughout the period 2019Q4 to 2021Q4. Bahrain, Brunei, Indonesia, Kuwait, Malaysia, Pakistan, Saudi Arabia, Turkey, and the United Arab Emirates were among the nine jurisdictions chosen for the study. According to their findings, the Islamic banks in Saudi Arabia, Kuwait and the United Arab Emirates could possibly be less affected, whereas Bahrain, Brunei, Malaysia, Pakistan, and Turkey are anticipated to be impacted, especially in relation to growth.

In terms of profitability, as assessed by return on assets, Bahrain, Brunei, Indonesia, Malaysia, and Turkey were anticipated to have a steep fall during the initial quarters of the projected timeframe. It will then stabilize and improve in the final quarters. Their research of the impact on non-performing loans in Turkey, Malaysia, Pakistan, Indonesia, and Bahrain predicted a rising trend in the first few quarters until they reached their maximum value. In every nation, except Indonesia and Malaysia, the impact of COVID-19 is anticipated to not surpass the predicted nonperforming financing above historical values. This information suggests that, as opposed to the Middle Eastern countries, the Southeast Asian countries except Brunei are highly sensitive to the worsening of NPF. This is because their anticipated NPFs outperformed past performance greatly. In terms of stability, they used the capital adequacy ratio as a metric and discovered that all of the countries under consideration are projected to meet the requirement outlined by Basel Committee on Banking Supervision on capital adequacy.

Table 2: Summary of Relevant Studies on COVID -19 and Islamic Financial Markets worldwide

S/N	Author/ Year	Country/ Region	Issues on COVID-19	Objectives	Methodology	Findings
1	Hassan et al. (2020)	Global	COVID-19 Challenges and role of Fintech	To analyze the challenges posed by COVID- 19 to the Islamic finance	Review Paper	The disruptive technological innovation called Fintech can be utilized to address COVID-19 challenges for IFIs.
2	Chatta (2020)	Global	Supervisory implications for Islamic Banks	To review the supervisory actions aimed at containing the impact of the outbreak and compares them across a sample of 13 jurisdictions	Review Paper	During the outbreak of the COVID-19 pandemic, the authorities have taken various measures, include: announcing a mandatory moratorium on repayments, restructuring and/or rescheduling of financing, providing

						government guarantees, using capital buffers and granting capital relief, providing liquidity facilities through various tools, and ensuring uninterrupted access to financial services for the general public.
3	Gherbi and Alsedrah (2021)	Saudi Arabia	Impact on stock market	To investigates the short- and long-term effect of COVID-19 pandemic period and the largest Islamic stock market development (SMD) on financial crises (FC).	Quantitative. Secondary data. (ARDL)	The short-term result implies that the FC indicator had significant positively affected by the COVID-19 pandemic. However, the long-run model result shows that market size indicator leads to a major FC, while market trade value indicator has negative impact on FC indicator.
4	Ryandono et al. (2021)	Indonesia	Impact on stock market	To explore the reaction of sharia stock in the Indonesian capital mark et to the global COVID-19 pandemic.	Quantitative. Secondary data (Market Adjusted Model)	This study indicates that the sharia stocks in the capital mark et in Indonesia can respond quickly to the COVID-19.
5	Nurdany et al. (2021)	Indonesia	Impact on stock market	To identify the existence of asymmetric volatility in the Islamic capital market during the COVID-19 pandemic.	Quantitative. Secondary data. GARCH	Good news and bad news do not have the same level of impact on the volatility of Indonesia Sharia Stock Index (ISSI) return.
6	Akkas and Samman (2021)	GCC countries	The impact of stock prices of IFIs during COVID-19	To investigate the impact of the COVID-19 outbreak on Islamic and conventional financial institutions and Islamic windows in the	Quantitative. Secondary data (panel data)	The results show that Islamic financial institutions are less exposed to the repercussions of

				Gulf Cooperation Council (GCC) countries.		the COVID-19 outbreak than the conventional and Islamic window financial institutions in Bahrain, Oman, Qatar, Saudi Arabia and UAE. Moreover, the Islamic financial institutions in Saudi Arabia and Oman have not been affected by the COVID-19 outbreak.
7	Miah et. al (2021)	Bangladesh	Impact on Islamic banks	To assess the probable impact of COVID-19 on the Islamic banking system in Bangladesh. More specifically, it attempts to test the hypothesis that Islamic banks are exposed to increased risk because of their role as a provider of "merchant capital" including financing for trade, commerce and working capital, which are believed to be severely disrupted by the COVID-19.	Quantitative. Secondary data	The research supports the hypothesis that the investment pattern of Islamic banks is skewed toward the trade and merchant's financing. More than two-third of Islamic banks' investment, and income thereof, is concentrated on working capital and trade finance. As these sectors are largely vulnerable to the economic shock resulting from COVID-19, Islamic banks in Bangladesh are likely to be affected through this channel.

2.3 The Need for Rescheduling or Restructuring

As a result of the COVID-19 problem, Islamic banks have undertaken certain steps to restructure Islamic financing facilities. The BNM's Shariah Advisory Council (SAC) had held a special meeting to discuss the subject, and the SAC issued a verdict on the practices (BNM, 2020). The first attempt is to restructure the Islamic financing facility using Shariah-compliant contracts. This could be accomplished by including an additional provision that refers to the terms of the existing contract. However there is an exception when a different contract of

Shariah is employed, for example a change to Ijarah from Musharakah, or various financings using different Shahriah contracts consolidated into a new single contract; then a new contract will be needed. The second measure is the conversion of a conventional loan into an Islamic loan, which is permitted by Islamic banks. The practice of going backwards is, however, prohibited. It is beyond the Islamic banks' obligation and control if a client demands that his/her financing be converted to conventional lending. The treatment of compounding profit on restructuring is the final step. Any accruing gains from the prior loan cannot be included in the new principal sum of the restructured credit. The accrued profit could only be transferred and computed in the total debt amount; it must not be considered in the calculation of new profit. This is to prevent debt profit charges from being double-counted.

According to the Ministry of Finance, numerous special aids, restructuring, loan/financing facilities, and 6-month moratorium have been offered to enterprises, SMEs, and individuals. With these initiatives, the activities of SMEs could be sustained, employment be preserved, and local investments be encouraged (The Star, 20 March 2020). From the banks' point of view, the restructuring or rescheduling of financings would result in reduced non-performing accounts, immediate write-backs of certain provisions, and optimal debt recovery. As for the customers, the restructuring or rescheduling of debts will assist them in managing cash-flow, sustaining businesses and avoiding legal implication. Customers can defer payment instalments to banks without incurring any fees or penalties by requesting a moratorium. Moratorium is one of the efforts taken by financial institutions to provide relief to clients affected by COVID-19. In reference to BNM 2019's Credit Risk Policy Document ("Policy Document"), Appendix 1 (paragraph 3) clearly states that the rescheduling and restructuring of debt may include the granting of a moratorium on repayments as a result of certain and exceptional situation (in which COVID-19 is considered). BNM stipulates that the banking institutions must provide clear criteria for the suspension of loan/financing repayments. According to Appendix 1 (paragraph 4) of the Policy Document, whenever a Bank granted a debt repayment moratorium, the deferment must not be more than 6 months from the moratorium's application date.

The term "rescheduling exercise" is the reference to the changes made to the terms of loan/financing where there are no significant alterations to the loan/financing contract's key conditions and terms. Typically, rescheduling entails extending or lengthening the duration of the loan/financing and revising repayments. "Rescheduling exercise" also signifies that there are changes made to the loan/financing agreement's main terms and conditions, whereby there are alterations to the debt structure, or other significant changes to the agreement's provisions. The kind or form of the financing/loan may be restructured or converted, for example, to term financing/loan from overdraft, or to non-revolving loan/financing from revolving loan/financing. This activity's goal is to help consumers increase their cash flow and get out of debt. Therefore, the current COVID-19 pandemic has resulted in the balance sheets of Islamic bank to be more flexible in the event of changes in revenue sharing due to changes in revenues. Dissimilar to conventional banking, should the banks' interest income reduce, there will be no reduction in the customers' interest. This scenario is posing a considerable challenge to the conventional financial system.

2.4 Capital

Islamic banks' capital comprises of both shareholders' debt and equity. The major sources of debt are current and investment accounts. The debt, which makes up the majority of the capital is the foremost element that impacts capital structure. Islamic banks receive monies from depositors and use expert investment management to invest the funds with realistic profits and risks. Capital structure is regarded as one of the most important characteristics, as it imposes

important restraints on Islamic banks. To deal with potential shocks, Islamic banks typically retain greater capital than the minimum required under capital standards. Saving and currents accounts through Qard and Wadiah, and fixed deposits through Tawarruq or Murabahah, are the major financial sources of the debt (Noor Mahinar, Norhashimah & Ng, 2019). Investment accounts allow shareholders of Islamic banks to partake in the loss and profit of investments. This means that the low leverage could motivate banks to produce higher returns for reduced risk of bankruptcy. Toumi et al. (2012) observed that through the measurement of equity ratio, capital structure and profitability are positively related, which supports this viewpoint. According to Islamic principles, profitability and debt must have an inverse proportion (Kusasi, 2013). Various proxies, including as, return on assets (ROA), return on equity (ROE), earnings per share and Tubin Q, have been employed in past research to quantify profitability (EPS). Similar to past studies, ROA has been employed by this research as profitability proxy. Banks that use more equity as a source of funding, on the other hand, have a lower chance of insolvency and are more sustainable (Choudhury, Hossain & Mohammad, 2019). Investors will endure any losses from investments. As a result, a proper capital structure protects corporations from collapsing. Debt/leverage illustrates the capital structure consideration of this study.

2.5 Liquidity

The recent financial crisis has slowed the effect of liquidity creation on economic growth in developing markets. Interbank market, deposits, central banks, and market are the four sources of liquidity. A bank could evade experiencing liquidity crisis through central banks, interbank market and the market (Al harbi, A., 2017). Because of the restrictions on liquid assets and the competition from conventional banks, Islamic banks have a large quantity of liquid assets. Less developed financial markets and market processes are the key restrictions to Islamic banks' liquidity. To address liquidity risk, Islamic banks rely on Murabahah commodities, interbank placement finance on Wakalah, Ijarah, Mudarabah, as well as other instruments. For the philosophy of Islamic finance, this circumstance necessitates the establishment of correct regulations, mechanisms, and procedures for liquidity management that is effective and efficient. Cash and cash equivalents, liquid quoted investments and short-term placements with banks or financial institutions, are all examples of liquid assets. Islamic banks can take advantage of favorable possibilities that arise in regional marketplaces due to their strong liquidity position. Based on Islamic theory, in the event of a financial crisis, a highly-liquid bank could improve its capital structure by lessening the liquidity risk, whereas loan demand must fall. In addition, banks that possess good level of current assets would generate more cash internally, which they could use to fund their operations and new investments. Researchers have employed a variety of proxies to estimate liquidity in the literature of capital structure. The liquid assets against deposits; total funding portion of cash and cash equivalents against total assets, and current assets against current liabilities are all examples of these metrics. Assets that are liquid, i.e., cash and cash equivalents were used as Islamic banks' liquidity proxy in this study (Akhtar et al., 2011; Igbal, 2012).

If the liquidity ratio is high, this means the assets are highly liquid and the smaller the profit margin. Islamic banks' liquid assets are linked to their solvency and are used to meet withdrawal requests. In principle, a bank that has sufficient liquidity could sustain and fulfil payment and asset financing commitment. Should a bank does not have enough liquidity in meeting the demand from creditors and depositors, it will be forced to close.

2.6 Provision

To have a stable net income, the LLP (loan loss provision) will be increased should the pre-LLP income is good, and the LLP will be decreased should the pre-LLP income is poor (Curcio

& Hasan, 2015). Financing loss provisions are known as financing loss provisions in Islamic banks (FLP). Both the income statement and the balance sheet contain this information. Based on this argument, Islamic banks should conduct more research into the employment of financing loss provisions for income smoothing, and Islamic banks should pay greater attention to Islamic business ethics in earnings management methods. However, no research comparing income smoothing utilizing FLP has been conducted in Malaysia. Once the rescheduling or restructuring exercise has been approved, the Islamic bank will send the customer a letter stating the amendment, or a supplemental offer letter outlining the exercise's condition and circumstances. The BNM's Shariah Advisory Council ("SAC") mentions that when an Islamic financing is rescheduled or restructured, a new legal instrument is necessary to incorporate any variations of terms and conditions. This is because Islamic finance places a premium on contractual parties' mutual consent. Before closing the new agreement in a sale-based financing that incorporates a sale agreement, the prior sale has to be ended (fasakh). To avoid paying stamp duty twice on the financing agreements, the BNM SAC enables cross-referencing between the new agreement and the existing agreement if the new arrangement is undertaken subsequent to the termination of the original contract (BNM SAC 26th meeting on 26 June 2002).

Based on the current and foregoing practices, for any restructuring of sale-based financings, a new agreement supplementing the facility agreement needs to be signed by the customer and the financial institution. Additionally, a new 'aqad contract has to be executed in accordance to the Shahriah law for the facilitation of the financing's restructuring. The BNM SAC has decided that the period of financing could be lengthen where a new contract on mutual agreement is not needed, provided, among other things, that the original sale price is not exceeded (BNM SAC 32nd meeting on 27th February 2009). In terms of the legal documentation, the parties will, similar to a conventional loan, execute an agreement supplementary to all original legal documents. This is to signify the rescheduled or restructured financing. Prevailing legal agreements will continue to be legal and are enforced as unceasing security for debt repayment under the Islamic financing arrangement.

3. Relief Measures

Numerous research has found that COVID-19 has impeded the expansion and stability of Islamic financial institutions. Many countries have launched a variety of steps to assist Islamic banks in dealing with COVID-19's challenges. Many countries' regulators have aided the public by postponing loan and financing payments for bank customers from 6 to 12 months, including Malaysia (Please refer Table 2). The decision of the authorities will result in almost no capital inflows in the next six months, impacting banks' profitability and liquidity (Chattha, 2021; Hassan et al., 2020). On the plus side, pandemic has the ability to highlight market dynamics and open doors for social financing, crowdfunding, Fintech, and digitalization (Brown, 2020; Hassan et al., 2020). Islamic finance social tools such as Social Sukuk, Qardh-Al-Hasan, Waqf and Zakat can be used by Islamic banks to support affected individuals, SMEs, and businesses during and after COVID-19 pandemic (Haider et. al., 2020). Fintech will enable the provision of Islamic financial services like Waqf, Crowdfunding, and Zakat through Blockchain and Artificial Intelligence (AI) where they are more transparent, efficient, innovative, appealing, and user-friendly (Todorof, 2018). BIMB Invest, a subsidiary wholly-owned by Bank Islam Malaysia Berhad (BIMB), has just lately begun to use big-data analytics and AI in its strategies for the elimination of any prejudices or instincts while making decisions (IFNFinTech, 2017a, 2017b). Furthermore, the Investment Account Platform (IAP), a network of Islamic banks that act as financial intermediaries to give money to eligible SMEs, was founded (Oseni and Ali, 2019).

Value-based Intermediation (VBI), one of BNM's efforts, is becoming more visible in the current new COVID-19 economic recovery, and it gives a huge chance for Islamic finance to become recognized as a significant part of the global mainstream financial system. On March 25, 2020, BNM announced a series of supervisory and regulatory initiatives as an assistance to banking institutions' efforts of aiding SMEs, individuals and companies in coping with the COVID-19 pandemic. The item in question is a six-month loan or financing repayment moratorium offered by banks to their customers. Another example of VBI is Maybank's product for Islamic fixed deposit customers. This product is for those who had their earnings impacted by the COVID-19 epidemic to establish a fixed deposit (New Straits Times, 2020). The feasibility and extend of Islamic finance played during the recovery phase, i.e. post-Covid 19 will primarily be ascertained by the using of Fintech in months to come (Haider et al., 2020).

Fintech and financial service delivery by Islamic financial institutions are complementary. This is as a result of the changes occurring in society's infrastructure, behavior, and technicality. During the pandemic, the government of Malaysia has introduced large stimulus packages as well as provided numerous assistance programs to help the nation's economic recovery. The examples of the initiatives undertaken are management of financial flow, tackle the supply and demand issues as well as sustain workers' employment. A total of 321,000 and 2.63 million of companies and employees, respectively had received the assistance from the wage subsidy program (Ghaffour, 2021). Borrowers and clients were also helped by the financial industry, which included Islamic institutions. The first six months of 2020 saw a disbursement totaling RM120 billion in financing/loans to SMEs, whereby the number of businesses benefitting from this effort exceeded the previous years. The financial institutions' capital buffer had also been reduced by BNM. This is to facilitate the rescheduling and moratorium of accounts impacted by the Covid-19 pandemic. The financial institutions' required statutory reserve had been lessen to 2% from 3%, in which leading to liquidity injection of an approximately RM30 billion into the banking industry. BNM also allows the banks to also tap into a 2.5 percent capital conservation buffer, lowering their liquidity coverage ratio below 100 percent, and use accrued regulatory reserves. Meanwhile, the Bank of New Zealand reduced the overnight policy rate to provide extra policy stimulus and speed up economic recovery.

BNM's Monetary Policy Committee had recently decreased the overnight policy rate (OPR) to 1.75 percent (reduction of 25 basis points) as one of the initiatives to aid the nation's economic recovery. Up to September 2020, the OPR rate was maintained at 1.75%, in which the floor and ceiling rates reduced to 1.5% and 2%, respectively (The Star, 2020). The drop in OPR has a number of consequences for both the public and the banks. Local banks would change their base financing rate (BFR) and base lending rate (BLR) if the OPR is lowered. This will have an indirect effect on the interest rate, lowering the expenses of borrowing, or refinancing of outstanding loans. As a result, financial institutions will reduce their interest rate on existing loans that are floating-rate based, leading to lower periodic payments or instalments. Consequently, the new loans would also follow the present low interest rate~~s~~. However, a decreased OPR means that interest rates on savings accounts and fixed deposit accounts would be lowered as well. Therefore, the investors will receive a smaller return on their bank investments than they did previously. According to BNM, in the 2nd quarter of the year, Malaysia's economic activities are beginning to revive and grow rapidly. This is due to the cautious and gradual re-opening of the nation's economy. As such, the reduced OPR has provided an additional push in boosting the nation's economic recovery (BNM, 2020). Table 3 indicates all the Malaysian Islamic banks' base rate (post- OPR reduction) as of August 6, 2020.

Table 2: Base Rates, Base Financing Rates and Indicative Effective Lending Rates of Islamic Banks in Malaysia as at 6 August 2020.

No.	Islamic Financial Institution	Base Rate (%)	Base Financing Rate (%)	Indicative Effective Lending Rate (%)
1.	Affin Islamic Bank Berhad	2.70	5.56	3.30
2.	Al Rajhi Banking & Investment Corporation (Malaysia) Berhad	2.85	5.75	4.20
3.	Alliance Islamic Bank Berhad	2.57	5.42	3.11
4.	AmBank Islamic Berhad	2.60	5.45	3.25
5.	Bank Islam Malaysia Berhad	2.52	5.47	3.25
6.	Bank Muamalat Malaysia Berhad	2.56	5.56	3.56
7.	CIMB Islamic Bank Berhad	2.75	5.60	3.50
8.	Hong Leong Islamic Bank Berhad	2.63	5.64	3.35
9.	HSBC Amanah Malaysia Berhad	2.39	5.49	3.50
10.	Kuwait Finance House (Malaysia) Berhad	2.25	6.14	3.30
11.	Maybank Islamic Berhad	1.75	5.40	3.25
12.	MBSB Bank Berhad	2.65	5.50	3.20
13.	OCBC Al-Amin Bank Berhad	2.58	5.52	3.45
14.	Public Islamic Bank Berhad	2.27	5.47	3.10
15.	RHB Islamic Bank Berhad	2.50	5.45	3.50
16.	Standard Chartered Saadiq Berhad	2.27	5.45	3.50

Source: Bank Negara Malaysia

The government of Malaysia has introduced a moratorium on debt repayments for a period of six months, i.e., from 1st April to 30th September 2020. After this moratorium period expires, the financial institutions could restructure the debt or allow payment deferment to their customers impacted by the pandemic. The pandemic has not only shifted the nation's finances, economy, and administration, it also introduced 'new norms' for the people's continued daily activities (Ali, et al., 2021). Most businesses, including SMEs have experienced a significant economic downturn due to the COVID-19 pandemic. The banks are the SMEs' main financier, with total funding exceeding 90% (BNM, 2020). As a result, the Malaysian government, through BNM has taken steps to ensure the SMEs' survival during these trying times and to mitigate the outbreak's cascading effects; particularly given the inability to continue operating during the MCO, which lasted months. Interested SMEs might request for financial assistance that worth billions of ringgit through development financial institutions, as well as conventional and Islamic commercial banks. To guarantee the financing, the financial institutions could obtain a guarantee issued by SJPP (Syarikat Jaminan Pembiayaan Perniagaan) or CGC (Credit Guarantee Corporation).

The Special Assistance Fund is the most noteworthy BNM assistance effort offered to Malaysian SMEs affected by COVID-19 (SRF). The goal of this fund is to assist SMEs overcoming short-term cash flow challenges; allowing them to stay in business while protecting the employees' jobs (BNM, 2020). The government has agreed to provide lending totaling RM5 billion at a favorable rate of 3.5%. The lending will be for 5 and half years where 6-month moratorium of repayment allowed. Those financial institutions, including Islamic FIs would continue processing the applications up to 31st December 2020. However, due to

constrains caused by the MCO, the processing and disbursing of financing could not be done in a timely manner (BNM, 2020).

Additional measures

1. Financing/loan repayments are automatically given a moratorium
2. For the purposes of accounting and regulatory categorization, the moratorium period is not considered in the overdue period.
3. CCRIS would not consider those financing/loan accounts with moratorium of this nature as R&R
4. CCRIS would not classify those R&R debts as credit impaired
5. Liberalization of financing/lending limit
6. Reduction in prudential buffers
7. The requirement for MFRS 9 and financial reports
8. Financial institutions must include Covid-19 impact in calculating ECL
9. There must not be a change in stage when there are overdue repayments during the moratorium timeline.

The Malaysian Accounting Standards Board published an advice on the disclosure of expected credit loss for reporting businesses that provide loans and financing on March 25, 2020. According to MFRS 9 Financial Instruments , most loan and financing receivables are calculated at amortized cost, which will eventually be subjected to impairment testing. MFRS 9 (paragraph 9.5.5.5) states that during the initial recognition, a loss allowance of 12-month estimated credit losses is recognized for financing and loan receivables, representing the next 12 months' risk of loss. Should the financing/loan receivables' credit risk escalated at future date of reporting, the allowance of loss would be equal to the lifetime of expected credit loss, i.e., loss risk over the receivables' projected remaining lifespan (MFRS 9.5.5.3).

As a result of Covid-19 pandemic, Islamic banks must decide if they have enough reasonable and supportable data to make economic forecasts in the future. Under the current exceptional conditions, judgement must be formed based on the available information, which is regarded to be limited. As a result, Islamic banks may need to alter the data they already have on possible situations involving a general worsening of credit risks. Given the inherent level of uncertainty and sensitivity of judgments and estimates, adequate disclosures of the key assumptions employed, as well as the judgments made in predicting projected credit losses, are especially critical in Islamic banks' financial statements.

Because SMEs receive the majority of Islamic bank lending, they must assess the effects of government actions on relief to SMEs when developing predictions to measure projected credit losses. Furthermore, when Islamic banks make modifications or reschedule a financing account, credit risk rises significantly, necessitating the recognition of loss allowances for lifetime predicted credit losses. However, in the current context, where regulatory action may be driving payment moratoriums, it may not be prudent to assume that rescheduling or restructuring will result in lifetime projected credit losses for all receivables. Furthermore, Islamic banks should assess if payment moratoriums will allow financing clients affected by the COVID-19 outbreak to resume regular payments in the near future. As a result, there is a chance that over the estimated remaining lifespan of the financing receivables, there would not be a considerable increase in credit risk.

4. Conclusion and Recommendations

The unfavorable effect caused by Covid-19 on Islamic banks in Malaysia is the subject of this study. It is obvious that the Covid-10 outbreak has wreaked havoc on practically every aspect of global economic activity. There is no exception in the Islamic finance sector. However, this pandemic is considered to be disruptive to the Islamic banks at an increasing rate. A study of the literature reveals the limited number of studies on the negative effect of COVID-19 on Malaysian Islamic banks. As a result, this study contributes to a deeper understanding of the repercussion of COVID-19 on Islamic banks in Malaysia in terms of capital, liquidity, and provision by providing more literature on the matter. Increased risk, including capital, liquidity, and provision, which COVID-19 is thought to be disruptive. As a result, it is also proposed that Islamic banks are least effective in dealing with the impact of COVID-19 as the repercussion is greater on them. Further research should look into the influence of COVID-19 on Islamic and traditional banks to see if there are any parallels or discrepancies with the findings of the current study.

Furthermore, during this pandemic, Islamic banks should use the chance to develop unique Islamic financial solutions. As a solution to mitigate COVID-19 repercussions, Islamic finance must continue to produce new guidelines under Maqasid Shariah. However, for the mitigation of COVID-19 impact, all techniques and new rulings have to be Shariah compliant. There must be absence of attributes such as Maysir, Riba, Gharar and other prohibited elements. The new guidelines must address the interests of all the parties involved, including depositors, fund users, banks, regulators, and the general public. In comparison to their conventional rivals, this is a fantastic chance for Islamic banks to demonstrate that the ideal form of living is the Islamic manner, especially in economic and money matters.

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