Growing Cs for Islamic financing facilities

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TYPICALLY, Islamic banks consider 5Cs in approving a consumer's financing application for vehicle, mortgage and personal use. 5Cs stand for character, capacity, capital, collateral and condition. The banks usually will approve the financing applications if these Cs are met to safeguard the continuity of financing repayment and a consumer's financial well-being.

In this week, I intend to write on 5Cs customarily used by both Islamic and conventional banks to approve financing applications by consumers at large. Three issues are addressed. Issue #1 - What are attributes of the 5Cs? Issue #2 - Why are 5Cs imperative to Islamic banks? Issue #3 - Do 5Cs have new forms?

For the first issue, some points of view are brought forward to understand the attributes of each C. Most Islamic banks use 5Cs to determine the financing approval. In more details, I define character as a quality of the person. The bank approves the financing if one has good quality and rejects when the latter does promote poor quality. This refers to one's willingness to pay a debt, which is associated with his moral quality termed as a human risk. This C also refers to excellent character built based upon individual's proper maintenance of his credit history. The bank considers people with excellent character to extend the financing out of the fact that people with an ideal character are the most likely to repay the financing facility. Will the bank approve a mortgage application from a young graduate who just got a contract lecturer? A question to ponder.

Of the 5Cs, character is firstly ranked by the banks when approving the financing facilities. It is the hardest part to judge by the banks out of asymmetric information. The second C, capacity means a consumer's ability to meet a debt obligation when it is due. This refers to young folks' income level. The high the extent of the income, the high is the likelihood to repay. The bank tends to approve the financing when the consumer has ability to absorb debts. Capacity is closely related to capital, but provides extra financial measures to provide a better picture of the applicant's financials. The third C, capital refers to the money, property and any valuable items that mutually represent the wealth of a consumer of the bank. The bank tends to approve the financing when the consumer has a positive financial worth that is what your own is greater than what you owe. The high the extent of financial worth, the better is the financing application approval. The fourth C, collateral means properties or assets are provided by consumers to lenders. It secures a financing or other line of credit in terms of financing repayment. A good piece of collateral to secure for the house financing would be the house itself, which is in good shape and insured. Yet, this also deals with one's possession of real estate and third party guarantees. The fifth C, condition means a situation that may impact a consumer's ability to obtain credit where human capital matters. The consumer who has an excellent condition has a high tendency to get approved by the bank. Indeed, the consumer has ability to repay regardless the economic conditions.

With respect to the second issue, three reasons provided on "why are 5Cs important?" but are not confined to: **Continuity of repayment (1st C) -** Islamic banks impose 5Cs to consumers to ensure their continuity in servicing monthly instalment. *Character* enables the banks to match the financing facility to the right client for better likelihood of debt repayment. The client has good credit report. *Capacity* enables the banks to extend the facility to the client who has sufficient income /cash inflow for better repayment. *Capital* enables the banks to give the financing for those who have collective amount of wealth. *Collateral* enables the banks to take back their money via consumers' property in case the latter declines to pay after three times. *Conditions* enable the banks to award the financing to clients who are stable should economic headwind occurs. **Creditworthiness of individual (2nd C) -** In the modern society, taking debt is normal for Gen-Y to possess properties (i.e. car, house and gold) out of lack of savings at a young age. The banks will consider a client who has a low *debt to income ratio*, implying the latter's financial freedom that becomes a shield should an economic downturn is of occurrence. **Compliancy to *Shariah* (3rd C) -** In this regard, the banks typically will assess the purpose of consumers' financing application should capture *maqasid* where basic needs come first before basic wants follow. The purpose of doing so is to ensure the banks can provide financing to right persons to meet new basic needs covering car and house, inter alia.

Concerning the third issue, there exists four growing Cs, which also affect one's credit evaluation by Islamic banks but are not limited to: **Consumption in moderation (1st C) -** This refers to one's ability to allocate his income-expense properly to maximise his utilities, covering himself and his family. He approaches a bank for financing when there is a need only. He spends money not for vacation and luxury goods. **Consumer well-being (2nd C) -** This means that any decisions to take up new financing facilities will not affect one's existing quality of life. He maintains and enhances the quality of life after taking up the financing facility. **Commitment in repayment (3rd C) -** This refers to individuals' ability to pay monthly instalment consistently without arrears. This is related to God-fearing from being indebted, in which taking debts is a trust, which need to return back by a debtor to a creditor. The high the extent of God-fearing, the high the extent one's commitment to pay debts on time and consistent. **Central Credit Reference Information System (4th C) -** In Malaysia, the CCRIS is a public entity established by Bank Negara Malaysia (BNM) in 2001 to provide "creditworthiness of individuals" to banks for financing approval. The CCRIS is not aimed to black list individuals but provides credit information on individuals to banks. This measure is beyond "Character" out of the fact it reflects one's identity of trend in debt repayment, demonstrating a disciplined attitude is rewarded with a good report by the CCRIS. Beyond the CCRIS is CTOS, stands for Credit Tip-Off Service, a private company that provides credit reporting used by banks to approve customers' financing application since 1990.

To cut a long story short, this article provides new Cs beyond traditional 5Cs used by banks to approve financing applications. With the proposed growing Cs covering, Consumption in moderation, Consumer well-being and Commitment in repayment, Islamic banks' extrapolation on giving financing facilities to consumers will precise and reliable. Unlike CCRIS, these Cs need new attributes to help banks in measuring one's financing application, which warrant further empirical investigations to contribute to new knowledge in this area where new indexes are brought into play, at least.

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