Mudarabah
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PART A OVERVIEW

1. Introduction

1.1 Compliance with Shariah requirement is a prerequisite in ensuring the legitimacy and integrity of Islamic financial products and services. In meeting this expectation, it is essential for an Islamic financial institution (IFI) to establish the necessary operational framework and infrastructure to ensure that the conduct of Islamic financial transactions is consistent with Shariah.

1.2 The Shariah contract-based regulatory policy is intended to promote transparency and consistency of Shariah contract application which would enhance the contracts’ certainty and strengthen Shariah compliance by IFIs.

1.3 The Shariah contract-based regulatory policy consists of two components, namely the Shariah and the operational requirements. The Shariah requirements highlight the salient features and essential conditions of a specific contract. The latter outlines the core principles underpinning good governance and oversight, proper product structuring, effective risk management, sound financial disclosure and fair business and market conduct. The operational requirements aim to complement and promote sound application of the Shariah principles.

1.4 Mudarabah is a contract based on a fiduciary relationship between a capital provider (rabbul mal) and an entrepreneur (mudarib). Under a mudarabah, any profit generated from the capital is shared while financial losses are borne by the rabbul mal.
2. **Policy objectives**

2.1 This policy document aims to:

(a) provide reference on the Shariah rulings associated with *mudarabah*;
(b) set out key operational requirements with regard to the implementation of *mudarabah*; and
(c) promote end-to-end compliance with Shariah requirements which include adherence to sound banking practices and safeguarding customers’ interest.

3. **Scope of policy document**

3.1 Part B provides mandatory Shariah requirements to ensure the validity of *mudarabah* and its optional practices.

3.2 Parts C and D provide operational requirements on governance and oversight, structuring, risk management, financial reporting and business and market conduct. Part C provides the operational requirements on the *mudarabah* where the IFI is a *mudarib* and/or the *rabbul mal* of the *mudarabah* venture, while Part D provides specific operational requirements where the IFI is the *rabbul mal*.

4. **Applicability**

4.1 This policy document is applicable to:

(a) all IFIs as defined in paragraph 7.2. Notwithstanding this, licensed takaful operators under the Islamic Financial Services Act 2013 (IFSA) shall only apply Part B of this policy document.

(b) all financial products and services structured on *mudarabah*, except for:

(i) sukuk, collective investment schemes and equities; and

(ii) interbank investments\(^1\), which are excluded from Part D.

\(^1\) Islamic Negotiable Instruments (INIs) based on *mudarabah* are also excluded.

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5. **Legal provisions**

5.1 The requirements in this policy document are:

(a) specified pursuant to sections 29(1) and (2), 57(1), 135(1) and 277 of the Islamic Financial Services Act 2013 (IFSA); and

(b) specified pursuant to sections 41(1) and 126 and issued as a direction pursuant to section 129(3) of the Development Financial Institutions Act 2002 (DFIA).

6. **Effective date**

6.1 This policy document comes into effect as follows:

(a) Part B, immediately upon issuance of this policy document; and

(b) Part C and D, on 1 June 2016.

7. **Interpretation**

7.1 The terms and expressions used in this policy document shall have the same meanings as assigned under the Financial Services Act 2013 (FSA), IFSA and DFIA, as the case may be, unless otherwise defined in this policy document.

7.2 For the purpose of this policy document:

“S” denotes a standard, requirement or specification that must be complied with. Failure to comply may result in one or more enforcement actions;

“G” denotes guidance which consist information, advice or recommendation intended to promote common understanding and sound industry practices which are encouraged to be adopted;

“Islamic financial institution” or “IFI” means:

(a) a licensed Islamic bank under the IFSA;

(b) a licensed takaful operator under the IFSA;

(c) a licensed bank and licensed investment bank under the FSA approved under section 15(1)(a) of the FSA to carry on Islamic banking business;

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and
(d) a prescribed institution under the DFIA approved under section 129(1) of the DFIA to carry on Islamic banking business or Islamic financial business.

7.3 A glossary of terms used in the policy document is set out in Appendix 2.

8. Related Shariah rulings and policy documents

8.1 This policy document must be read together with but not limited to such Shariah rulings and policy documents as specified in Appendix 3.

9. Policy documents superseded

9.1 This policy document supersedes the requirements for mudarabah in the:
(a) Guidelines on Musharakah and Mudarabah contracts for Islamic Banking Institutions issued on 15 September 2007 as at the effective date of part C and D of this policy document; and
(b) Shariah Standard on Mudarabah issued on 22 October 2012.
PART B  SHARIAH REQUIREMENTS AND OPTIONAL PRACTICES

10. Definition

S 10.1 Mudarabah\(^2\) is a contract between a capital provider (rabbul mal) and an entrepreneur (mudarib) under which the rabbul mal provides capital to be managed by the mudarib and any profit generated from the capital is shared between the rabbul mal and the mudarib according to a mutually agreed profit sharing ratio (PSR) whilst financial losses are borne by the rabbul mal provided that such losses are not due to the mudarib’s misconduct (ta`addi), negligence (taqsir) or breach of specified terms (mukhalafah al-shurut).

11. Nature

S 11.1 Mudarabah is a contract based on a fiduciary relationship (aqd al-amanah). Under this principle, a mudarib manages the mudarabah asset in trust and is not liable for the impairment of the asset except for impairment which is a result of the mudarib’s misconduct (ta`addi), negligence (taqsir) or breach of specified terms (mukhalafah al-shurut).

S 11.2 Any of the contracting parties has the right to terminate the contract unilaterally except in the following conditions:
(a) the mudarib has commenced the work relating to the management of the capital of the rabbul mal; or
(b) the contracting parties have agreed to enter into a mudarabah contract for a specified time; or
(c) the contracting parties have agreed not to terminate the mudarabah contract within a specified time.

\(^2\) The terms muqaradah and qirad are synonymous to mudarabah.
G 11.3 A mudarabah is categorized into two types:
   (a) Unrestricted Mudarabah (Mudarabah Mutlaqah).
       An unrestricted mudarabah is a contract in which the rabbul mal
       permits the mudarib to manage the mudarabah capital without any
       specific restriction.
   (b) Restricted Mudarabah (Mudarabah Muqayyadah)
       A restricted mudarabah is a contract in which the rabbul mal imposes
       specific restrictions on the mudarabah terms. The rabbul mal may
       specify conditions restricting the mudarib such as the determination of
       location, period for investment, type of project and commingling of
       funds.

G 11.4 The contracting parties may mutually agree to change the type of
mudarabah they have entered into to another type of mudarabah at any
point in time.

COMPONENTS OF MUDARABAH

12. Contracting parties

S 12.1 The contracting parties in a mudarabah are a rabbul mal and a mudarib.

S 12.2 Both the rabbul mal and the mudarib must be a natural person or a legal
entity who shall have legal capacity\(^3\) to enter into the mudarabah contract
including the capacity to perform agency (wakalah) contract either as a
principal or as an agent.

G 12.3 The contracting parties in the mudarabah contract may involve more than
one mudarib or rabbul mal.

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\(^3\) The legal capacity of a person, from Shariah perspective, is defined as capacity to assume rights and
responsibilities; and capacity to give legal effect to his action. Among the important conditions are that the
person must possess sound mind and the capacity to distinguish between what is harmful or beneficial to one’s
interests. Legal capacity of a legal entity is defined as eligibility of an entity to acquire rights and assume
responsibilities. In Malaysia, the legal capacity is governed under the Contracts Act 1950 and the Age of
Majority Act 1971.

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G 12.4 In the case of the mudarabah involving more than one rabbul mal, an agreement among the rabbul mal may be established whereby:
(a) an existing rabbul mal agrees to relinquish his right over a certain portion of the profit if he withdraws from the mudarabah prior to its maturity date; and
(b) a new rabbul mal agrees to assume liability in respect of the mudarabah which is already in operation prior to his participation.

S 12.5 Any terms or conditions in the mudarabah contract has been mutually agreed between the rabbul mal and mudarib, and does not contravene the Shariah shall be binding on both parties.

13. Offer (ijab) and acceptance (qabul)

S 13.1 A mudarabah contract shall be entered into by an offer and acceptance between a rabbul mal and a mudarib.

G 13.2 The offer and acceptance may be expressed verbally, in writing or any other methods which could be evidenced by appropriate documentation or record.

14. Management

S 14.1 A mudarib shall have the right to manage a mudarabah venture.

S 14.2 The mudarib is responsible to ensure proper management of the mudarabah venture and acts in the interests of the rabbul mal.

S 14.3 The mudarib’s mandate shall be provided under the terms and conditions of the contract.

G 14.4 The mudarib may assign the mudarabah capital under his management to another mudarib in another mudarabah (mudarib yudarib) or to an agent (wakil) subject to the condition that the consent of the rabbul mal is obtained.

S 14.5 A rabbul mal shall not be involved in managing the mudarabah venture but shall have a right of access to reasonable information regarding the mudarabah venture.

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15. **Capital**

S 15.1 Capital is an asset provided by a *rabbul mal* to a *mudarib* for the purpose of a *mudarabah* venture.

S 15.2 The capital of *mudarabah* (the capital) shall be provided by the *rabbul mal* and managed by the *mudarib*.

S 15.3 The capital shall be identifiable, readily available and accessible for the *mudarib* to commence business activities.

G 15.4 The capital may be in the form of cash or in-kind, including intangible assets.

S 15.5 Where the capital is in-kind, it shall be valued in monetary terms either by agreement between the contracting parties or by a third party, which may include experts, valuers, or any qualified person, at the time of entering into a *mudarabah* contract.

S 15.6 Where the capital is denominated in a different currency, it shall be valued based on a specific currency as agreed by the contracting parties at the time of entering into the *mudarabah* contract.

S 15.7 All forms of debts shall not qualify as capital, including all account receivables and payments due to the *rabbul mal* either from the *mudarib* or a third party.

S 15.8 All remaining capital shall be returned to the *rabbul mal*, if any, upon dissolution or termination of the *mudarabah* contract.

S 15.9 Any amount of capital due to the *rabbul mal* under paragraph 15.8 and profit, if any, shall be deemed as a liability due to the *rabbul mal*.

S 15.10 The *mudarib* shall not guarantee the capital except in the case of his misconduct (*ta`addi*), negligence (*taqsir*) or breach of specified terms (*mukhalafah al-shurut*).

G 15.11 The *mudarabah* contract may provide for the gradual withdrawal of capital.

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by the rabbul mal during the tenure of the mudarabah contract unless stated otherwise.

G 15.12 Subject to paragraph 15.13, the mudarib may with the consent of the rabbul mal commingle the capital with other investment funds.

S 15.13 The mudarib shall observe the agreed terms and conditions of the respective contract.

G 15.14 The mudarib may inject his own funds into the capital subject to the consent of the rabbul mal and hence a musyarakah contract is formed between the mudarib (as partner under musyarakah) and the mudarabah venture.

G 15.15 The mudarabah expenditure may be charged to the capital.

S 15.16 The mudarabah expenditure shall be direct expenses that are identifiable and measurable with regard to a specific investment activity.

G 15.17 The capital may be fully or partially disbursed as per the terms of the mudarabah contract.

G 15.18 Where a rabbul mal fails to provide capital as agreed under a mudarabah contract (defaulting rabbul mal) –

(a) In the case where the defaulting rabbul mal has not paid the capital within the time stipulated in the mudarabah contract, the contracting parties may unilaterally terminate the contract. If the mudarib has commenced work, the rabbul mal has to reimburse the mudarib for any mudarabah expenditure incurred and pay the mudarib fair and reasonable wages or fees;

(b) In the case of the mudarabah contract involves one mudarib and one rabbul mal with staggered capital payment which the defaulting rabbul mal has made partial capital payment, the contracting parties may,

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Investment activity in the context of this paragraph refers to Shariah compliant profit generating activities which may include Shariah compliant provision of finance provided by mudarib using mudarabah fund.
subject to the terms and conditions of the mudarabah contract, -

(i) revise the mudarabah contract based on the actual capital paid by the defaulting rabbul mal; or

(ii) terminate the mudarabah contract and consequently:

(a) the mudarib shall return the capital contributed to the defaulting rabbul mal if any and share the profits with the defaulting rabbul mal, if any; and

(b) the defaulting rabbul mal shall bear the mudarabah expenditure incurred by the mudarib. If the justified mudarabah expenditure\(^5\) incurred exceeds the actual capital contribution, such liability shall be borne by the defaulting rabbul mal up to the limit of the total capital amount committed under the mudarabah contract.

(c) in the case of the mudarabah contract involves one mudarib and multiple rabbul mal with single capital payment by each rabbul mal, and where one or more rabbul mal failed to pay, the mudarib may terminate the mudarabah contract with the defaulting rabbul mal who failed to pay and may based on agreed terms impose on him to indemnify the mudarabah venture for any expenses incurred due to his default.

(d) in the case of the mudarabah contract involves one mudarib and multiple rabbul mal with staggered capital payment by each or some of the rabbul mal and where one or more rabbul mal failed to make the subsequent capital payment, the non-defaulting contracting parties shall have the following remedies including:

(i) requiring the defaulting rabbul mal to sell his interest to the other

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\(^5\) Explanation on mudarabah expenditure is provided under paragraph 15.16.

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rabbul mal or to a third party;

(ii) the non-defaulting contracting parties may agree to revise the mudarabah contract based on actual capital paid; or

(iii) the non-defaulting contracting parties may terminate the mudarabah contract with the defaulting rabbul mal and may, based on agreed terms, require him to indemnify the mudarabah venture for any expenses incurred due to his default.

16. Profit

S 16.1 Profit sharing is the primary motive of a mudarabah contract and therefore it is a fundamental component of the contract.

G 16.2 A mudarabah profit (the profit) is the value created over and above the capital which is determined based on a methodology acceptable by market conventions or practices.

S 16.3 A mudarib shall not guarantee any profit.

S 16.4 A rabbul mal and a mudarib shall share profit based on a ratio mutually agreed between them.

S 16.5 The PSR shall be determined at the time of entering into a mudarabah contract.

G 16.6 The PSR may be revised during the tenure of the mudarabah contract.

S 16.7 Subject to paragraph 16.6, a revision of the PSR shall be mutually agreed by the rabbul mal and the mudarib.

S 16.8 The mudarabah contract shall not stipulate a pre-determined fixed amount of profit to one contracting party which deprives the profit share of the other contracting party.

S 16.9 The profit shall not be fixed in the form of a certain percentage of the capital.

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G 16.10 Notwithstanding paragraph 16.9, the ex-post performance profit amount (based on the PSR which had been mutually agreed upon between the *rabbul mal* and the *mudarib*) may be translated into a fixed percentage yield of the capital.

G 16.11 In a multi-tiered *mudarabah*, two or more profit sharing arrangements may be agreed upon. In the first tier, a *rabbul mal* and a *mudarib* may agree on a certain PSR. Whilst in the second tier, the *rabbul mal* (*mudarib* in the first tier *mudarabah*) and the other *mudarib* may agree on another PSR. Such arrangement may apply to the following tier respectively. The profit generated in each tier shall be shared according to the respective PSR.

S 16.12 Pursuant to paragraph 15.14, where a *mudarib* commingles or injects his own fund to a *mudarabah* venture, the *mudarib* is entitled to the profit based on his capital contribution in the commingled fund and the remaining profit shall then be distributed based on PSR in the *mudarabah* contract.

G 16.13 The *rabbul mal* and the *mudarib* may agree on a PSR based on a specified profit threshold. In the event that:

(a) the actual profit is equivalent or below the threshold, the profit shall be shared based on the agreed PSR.

(b) the actual profit exceeds the threshold, the excess amount may be:
    (i) distributed based on a different PSR agreed by the parties; or
    (ii) paid to any of the contracting parties as agreed

G 16.14 The PSR may be varied to correspond with different periods of investment, different amount of the capital or pre-mature withdrawal of the capital, provided that the conditions for the variation have been agreed upon by the contracting parties at the time of entering into the *mudarabah* contract.

S 16.15 In a single *mudarabah* contract involving more than one *mudarib*, a common PSR is agreed between the *rabbul mal* and all the *mudarib*. All *mudarib* shall share the *mudarib*’s profit portion as per the agreed terms.

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S 16.16 Profit shall be recognized based on the following methodology:

(a) realized basis by actual liquidation of assets of the *mudarabah* partnership (*al-tandid al-haqiqi*); or

(b) constructive basis according to acceptable profit recognition method which may include valuation according to acceptable market methodology, independent valuation or valuation based on estimated figures (*al-tandid al-hukmi*).

G 16.17 In the case of the profit recognized based on constructive basis, a profit reserve may be created.

S 16.18 In the case of the profit recognized based on constructive basis, a final consolidation and adjustment shall be undertaken to determine the actual profit, either:

(a) at the end of a certain period; or

(b) at the point of actual profit realization.

S 16.19 The profit shall be distributed upon the maturity of a *mudarabah* venture or at an agreed period.

S 16.20 Unrealized gains recognized during the *mudarabah* tenure shall be recognized as the profit and be included in the profit and loss calculation for the *mudarabah*.

S 16.21 A mudarib is only entitled to the profit for works which are integral to the *mudarabah* venture and shall not earn any additional fee for such works.

G 16.22 A *rabbul mal* may commission a *mudarib* for a fee to perform works apart from the works integral to a *mudarabah* venture.

G 16.23 The parties to the contract may agree to set aside the profit as a reserve or for any other purpose.

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S 16.24 In relation to paragraph 16.23, the reserve shall only be created from the profit.

S 16.25 In the case where profit reserved is utilised to cover depletion of the capital, only the profit portion of a *rabbul mal* in the reserve shall be utilised⁶.

G 16.26 The contracting parties may agree to a condition whereby a *rabbul mal* may be subject to lower or no profit payment if the capital is withdrawn before the maturity of the *mudarabah* venture.

17. Loss

S 17.1 Loss shall be borne by a *rabbul mal* up to the capital value.

S 17.2 A *mudarib* shall not be liable for any impairment of asset unless such loss is due to the *mudarib’s* misconduct (*ta`addi*), negligence (*taqsir*) or breach of specified terms (*mukhalafah al-shurut*) of the contract.

S 17.3 Notwithstanding paragraph 17.2, in the case of any loss, the *mudarib* shall furnish the reason for the occurrence of the loss.

S 17.4 In the case of multiple *rabbul mal* in a single *mudarabah*, the loss shall be borne by each *rabbul mal* proportionate to his capital contribution.

S 17.5 In the case where a *mudarib* commingles or injects his own fund to a *mudarabah* venture, the loss shall be borne based on the proportion of the *mudarib’s* capital contribution in the commingled fund.

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⁶ This requirement is specified to prevent implication of capital guarantee by *mudarib*.

⁷ A loss is depletion from the value of capital.
ARRANGEMENT OF MUDARABAH WITH OTHER CONTRACTS OR CONCEPTS

18. Arrangement for guarantee

S 18.1 Subject to paragraph 15.10, a mudarib shall not guarantee the capital and/or profit.

G 18.2 Notwithstanding paragraph 18.1, the following measures may be exercised:

(a) a rabbul mal may take a collateral from the mudarib, provided that the collateral could only be liquidated in the event of a misconduct (ta`addi) or negligence (taqsir) or breach of terms (mukhalafah al-shurut) of a contract by the mudarib; or

(b) the rabbul mal may require the mudarib to arrange for an independent third party guarantee.

S 18.3 Pursuant to paragraph 18.2(b), the following requirements shall be observed:

(a) the guarantee shall be executed in a separate contract;

(b) the guarantee shall be utilised to cover any loss or depletion of the capital; and

(c) the third party guarantor shall be independent from the mudarib such that it shall not be a related party where:

(i) the mudarib has majority ownership and/or has control over the third party guarantor; or

(ii) the third party guarantor owns or has control over the mudarib.

19. Arrangement of a mudarabah with a wadi`ah, a wakalah or a musyarakah

G 19.1 Contracting parties may agree to an arrangement whereby a certain amount of fund is assigned as a mudarabah capital and another portion of the fund is assigned under wadi`ah, wakalah or musyarakah contracts.

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S 19.2 Pursuant to paragraph 19.1, the contracting parties shall observe the requirements of the *mudarabah* on the part of fund assigned under the *mudarabah* and shall observe the requirements of the *wadiah*, *wakalah* or *musyarakah* on the part of fund assigned under the respective contract.

20. **Arrangement of a *mudarabah* with a *hibah***

G 20.1 A *mudarib* may provide a *hibah* to a *rabbul mal*.

S 20.2 Pursuant to paragraph 20.1, provision of a *hibah* shall observe the following conditions:

(a) the *hibah* shall not be sourced from the capital or the *rabbul mal*’s portion of profit; and

(b) provision of the *hibah* shall not amount to a guarantee of capital and/or profit by the *mudarib*.

21. **Arrangement of a *mudarabah* with a promise (wa’*d*)**

G 21.1 A *mudarabah* contract may be arranged with a promise (wa`d) where:

(a) a *mudarib* undertakes to purchase a *mudarabah* asset upon the occurrence of a specified event as stipulated in the *mudarabah* contract; or

(b) an agent (*wakil*) appointed by a *mudarib* undertakes to purchase a *mudarabah* asset upon the occurrence of a specified event as stipulated in the *mudarabah* contract.

G 21.2 The *rabbul mal* may request the *mudarib* to give a promise (wa`d) to purchase the *mudarabah* asset over an agreed period of time at market value, fair value or any price to be agreed by the parties at the time of purchase.
DISSOLUTION

22. Dissolution of mudarabah

S 22.1 A mudarabah contract is dissolved under the following circumstances:

(a) unilateral termination by any of the parties in the absence of any prohibitive circumstances as per paragraph 11.2;
(b) unilateral termination by any of the parties due to misconduct (ta`addi), negligence (taqsir) or breach of specified terms (mukhalafah al-shurut) of contract by the other;
(c) mutual agreement to terminate the mudarabah contract between the parties;
(d) the mudarabah contract expires upon the maturity date agreed by the parties;
(e) demise or dissolution of either a mudarib or a rabbul mal;
(f) loss of legal capacity; or
(g) invalidity of the mudarabah.
PART C OPERATIONAL REQUIREMENTS

23. Background

23.1 Part C outlines the expectations for the establishments of policies and procedures for a *mudarabah* venture where an IFI\(^8\) is the *rabbul mal* and/or the *mudarib*. It covers requirements to enable effective governance and oversight, sound risk management, proper product structuring and appropriate financial disclosure and reporting of a *mudarabah* venture. It also highlights expectations on IFIs’ business and market conduct. The policy intent of these operational requirements is to provide adequate safeguards for stakeholders’ interests, promote effective implementation of business and risk management strategies and drive the development and establishment of the necessary systems, processes and control measures.

24. Governance and oversight

**Principle 1:** The IFI shall establish sound governance and oversight structure to ensure that *mudarabah* ventures are conducted based on sound practices and comply with Shariah requirements.

S 24.1 This policy document complements the *Guidelines on Corporate Governance for Licensed Islamic Banks* and *Guidelines on Corporate Governance for Development Financial Institutions*.

S 24.2 While the broad governance and oversight principles can be applied, specific requirements are needed to manage the distinct risks and the unique nature of a *mudarabah* venture. An IFI shall have sufficient understanding of its risk profile and availability of resources with the appropriate knowledge and skill set.

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\(^8\) *Illustration on the differences in the role of IFI is given in the Appendix 4.*

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S 24.3 The IFI shall identify areas for further enhancements which include the establishment of additional roles of the board of directors, board committee, Shariah committee, senior management and the dedicated function or unit.\(^9\)

**Board of Directors**

S 24.4 The board of directors (the Board) shall establish a sound governance structure to facilitate an effective oversight function on the management of a *mudarabah* venture. The adequacy of governance structure shall commensurate with the nature, complexity and risk profile of the *mudarabah* venture.

S 24.5 The roles and responsibilities of the Board with respect to the *mudarabah* venture shall include the following:

(a) setting the IFI’s business strategy and risk appetite with regard to the *mudarabah* venture;

(b) approving and overseeing policies and procedures for effective risk management to ensure compliance with the relevant law and regulations;

(c) ensuring that a comprehensive and effective Shariah governance framework is in place;

(d) ensuring that the IFI has adequate and qualified personnel with sufficient knowledge and competency on the concept, application and risks associated with the *mudarabah* venture; and

(e) ensuring that independent reviews are conducted regularly to assess compliance with the policy documents issued by the Bank and internal policies established by the IFI.

**Board Committee**

S 24.6 Key responsibilities of the board committee shall include conducting oversight to ensure that a *mudarabah* venture is managed effectively,

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\(^9\) Dedicated function or unit as per paragraph 30.2.

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assisting the Board in performing its oversight function and providing recommendations in respect of the management, operations and performance of the *mudarabah* venture.

**s 24.7** The board committee shall consist of members who are qualified with sufficient knowledge, competency and understanding of the risks associated with the *mudarabah* venture.

**Shariah Committee**

**s 24.8** The Shariah committee shall perform the following to ensure that all activities associated with a *mudarabah* venture undertaken by the IFI are conducted in line with Shariah requirements:

(a) endorse that the Shariah requirements are appropriately applied in the relevant policies and procedures governing the *mudarabah* venture;

(b) deliberate and endorse that the terms and conditions stipulated in legal documentation and other documents\(^\text{10}\) are in compliance with Shariah;

(c) ensure Shariah review and Shariah audit are conducted, identify issues and propose appropriate corrective measures; and

(d) advise and provide clarification on relevant Shariah rulings, decisions or guidelines on Shariah matters issued by the Bank and, if relevant, any other authorities.

**Senior Management**

**s 24.9** The roles and responsibilities of the senior management with regards to the *mudarabah* venture shall include the following:

(a) developing and implementing business strategies, internal control and risk management requirements in line with IFI’s business objectives;

(b) establishing policies, processes and procedures with regard to proper management of the *mudarabah* venture;

(c) implementing relevant internal systems, infrastructure and adequate

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\(^{10}\) *Such as information published in promotional materials, product manuals or other publications.*
mechanisms to identify, measure, control and monitor risk inherent in the mudarabah venture;

(d) ensuring that the IFI monitors and has proper and adequate reporting of the mudarabah venture operations and performance;

(e) identifying, assigning and training of key personnel with the appropriate skill set for the mudarabah venture and ensuring that the roles and responsibilities are properly delegated to the relevant functions within the IFI;

(f) undertaking regular reviews and monitoring compliance with the approved policies; and

(g) ensuring timely disclosure of relevant information to the Board and the Shariah committee.

25. Structuring

Principle 2: The IFI shall ensure that structuring and implementation of mudarabah venture is supported by comprehensive policies and procedures, processes, adequate infrastructure and robust documentation.

Principle 3: The IFI shall ensure a sound structuring of mudarabah venture which includes conducting end-to-end process to match the risk and reward profile between sources and usage of funds.

Shariah Compliance

S 25.1 An IFI shall be responsible for ensuring:

(a) the overall operations a of mudarabah venture are in compliance with Shariah requirements;

(b) the product structure, strategies, terms of agreement, asset portfolio\(^{11}\) and type of business involved\(^{12}\) are endorsed by the Shariah committee; and

(c) the opinion of the Shariah Advisory Council (SAC) of the Bank is

\(^{11}\) Such as the underlying asset portfolio for a Mudarabah Investment Account.

\(^{12}\) Such as the business or services conducted by the customer as mudarib in a mudarabah venture.

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sought to resolve issues pertaining to Shariah matters as outlined in the Shariah Governance Framework for Islamic Financial Institutions.

s 25.2 The IFI shall establish an effective framework that is supported by adequate policies and procedures and competent personnel to ensure that the mudarabah venture continues to adhere to Shariah requirements.

**Contracting Parties**

s 25.3 An IFI shall undertake an assessment on the suitability of the contracting parties before entering into a mudarabah venture.

s 25.4 The contracting parties' roles and responsibilities shall be stipulated clearly in the legal documentation.

G 25.5 The contracting parties in a mudarabah venture may involve more than one rabbul mal which could exist under the following structures:

(a) a “single” PSR structure which creates a mudarabah venture between a group of rabbul mal with a mudarib; or

(b) a “multiple” PSR structure which creates a mudarabah venture between each rabbul mal with a mudarib.

Illustration of these structures is given in Appendix 6.

**Management of mudarabah venture**

s 25.6 As per paragraph 14.5, a mudarabah venture shall only be managed by the mudarib while the rabbul mal shall have access to information. In this regard, the rabbul mal shall not:

(a) be involved in the decision making in respect of the mudarabah venture;

(b) influence decision making in core business areas of the mudarabah venture

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13 Refer to the rabbul mal and the mudarib unless defined otherwise.

14 E.g. a rabbul mal providing advisory services directly contributing to major decision making for the mudarabah

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(c) be involved in the day-to-day management of the \textit{mudarabah} venture.

\textbf{Capital}

\textbf{S 25.7} An IFI shall determine the value of capital\textsuperscript{15} upon the execution of a \textit{mudarabah} contract.

\textbf{S 25.8} Notwithstanding the type of capital allowed under paragraph 15.4, the capital shall only be in the form of cash. The capital shall be identifiable, readily available and accessible at the date of commencement of the \textit{mudarabah} venture. The capital shall not be in the following forms:

(a) debt or receivables owing to the \textit{rabbul mal}; and

(b) encumbered assets\textsuperscript{16}.

\textbf{S 25.9} Upon disbursement of the capital, the \textit{rabbul mal} shall assume its rights and liabilities of the \textit{mudarabah} venture up to the limit of the amount of capital disbursed or contributed.

\textbf{S 25.10} In the event where there is commingling of funds by a \textit{mudarib} as mentioned in paragraph 15.12, the IFI shall ensure the following:

(a) identification of funding purpose and assets is clearly stated in the terms and conditions;

(b) proper tagging of assets (either dedicated or proportionate) at all times using an appropriate mechanism by the \textit{mudarib} such as separate record keeping;

(c) proper valuation of underlying assets under the \textit{mudarabah} venture is carried out periodically; and

(d) the \textit{rabbul mal} has the rights\textsuperscript{17} on the underlying assets funded by the \textit{rabbul-mal} at all times, including upon exit and upon the \textit{mudarib}’s winding-up.

\textsuperscript{15} To be received by the IFI as a mudarib or to be contributed by the IFI as a rabbul mal.

\textsuperscript{16} E.g. assets pledged as collateral.

\textsuperscript{17} Rights as stipulated in the legal documentations.

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S 25.11 Any subsequent commingling of funds arising from the injection of the mudarib’s own funds into the mudarabah venture shall:

(a) not nullify the mudarabah contract between the rabbul mal and the mudarib;
(b) continue to cause application of this policy document for the mudarabah contract;
(c) cause requirements of the musyarakah to apply for the musyarakah between the mudarib and the mudarabah venture; and
(d) require proper distribution of profit and loss. This is illustrated in Appendix 7.

S 25.12 The IFI shall observe the applicable prudential limits and requirements based on the type of mudarabah funds used as specified in the relevant policy documents as per Appendix 10.

Profit

S 25.13 The PSR shall be mutually agreed between a rabbul mal and a mudarib and stipulated clearly in a mudarabah contract at the time of entering into the contract.

G 25.14 In determining the appropriate PSR, the IFI may consider the following factors:

(a) estimated return on the mudarabah venture;
(b) benchmark rate of return of equivalent product, underlying asset or business segment; and
(c) estimated management or operational costs incurred by the mudarib in managing the mudarabah venture.

S 25.15 Notwithstanding the requirements in paragraph 16.16, the profit shall be recognized and measured based on the applicable Malaysian Financial Reporting Standards (MFRS).

S 25.16 As required under paragraph 16.18, an IFI shall conduct and, in the case
where the IFI is the *rabbul mal*, ensure that the *mudarib* conducts an assessment at the end of a certain period of the *mudarabah* venture or upon actual realisation of profit to arrive at the actual amount of profit. A final adjustment in accordance with MFRS shall be undertaken to the amounts already recognized, to reflect the actual profit of the *mudarabah* venture.

S 25.17 The methodology used for determining the profit distribution shall be objective, transparent and acceptable to all contracting parties. Only direct expenses shall be deducted in calculating the profit, defined\(^\text{18}\) as expenses which are:

(a) identifiable and measurable; and
(b) compulsory and incurred in order to complete specific activities in the *mudarabah* venture.

S 25.18 The contracting parties shall determine the time period or date for the profit distribution of the *mudarabah* venture.

**Loss**

S 25.19 Pursuant to paragraph 17.1, any loss shall be recognized and measured based on the applicable MFRS.

S 25.20 Expectations and requirements on the *mudarib* shall be sufficiently provided in the terms and conditions to ensure proper conduct of the *mudarib* and to protect the interests of the *rabbul mal* in the event of loss.

S 25.21 The *mudarib* shall be fully liable if it is proven that the loss is due to his misconduct (*ta’addi*), negligence (*taqsir*) or breach of specified terms (*mukhalafah al-shurut*).

S 25.22 If the loss is not attributed to misconduct, negligence or breach of specified

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\(^{18}\) As per definition under the policy document on Rate of Return.

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terms of the *mudarib*, the loss shall be borne by the *rabbul mal* up to the amount of capital contributed.

S 25.23 Application of any mechanism which will effectively cause the *mudarib* to guarantee the principal amount upfront\(^\text{19}\) is prohibited.

**Guarantee or Collateral**

S 25.24 For the purpose of paragraph 18.2 (b), an independent third party guarantee shall exclude the following parties:

- **(a)** for corporate guarantors:
  - (i) entities\(^\text{20}\) with control over the *mudarib*; or
  - (ii) entities controlled by the *mudarib* as defined in the MFRS\(^\text{21}\).

- **(b)** for individual guarantors:
  - (i) employee (and his close relatives) of the *mudarib*; or
  - (ii) controlling shareholder (and his close relatives) of the *mudarib*.

**Exit\(^\text{22}\) from venture**

S 25.25 An IFI shall clearly stipulate the terms and conditions of an exit of a *mudarabah* venture, which includes the:

- **(a)** tenure of the *mudarabah* venture;
- **(b)** time or intervals allowed for the purpose of withdrawal or redemption;
- **(c)** qualifying criteria for an exit before maturity;
- **(d)** methodology for valuation of underlying assets and calculation of profit and loss upon the exit;
- **(e)** potential amount payable or to be received, including compensation or damages incurred; and
- **(f)** operational procedures for the exit including submission of relevant

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19 E.g. upfront waiver on loss absorption or wa’/d to purchase assets or rights at price equivalent to capital provided.
20 E.g. parent company.
21 Namely, MFRS 127 Separate Financial Statements.
22 May be in the form of dissolution, termination, withdrawal or redemption of the *mudarabah* capital.
documents, notice period, number of days taken to process the transaction and settlement period.

Documentation

S 25.26 An IFI shall develop comprehensive and legally enforceable documentation for a *mudarabah* venture which are in compliance with Shariah and regulatory requirements.

S 25.27 At a minimum, the legal documentations shall clearly stipulate the following:

(a) the purpose of the *mudarabah* venture;
(b) the contractual relationship between the various parties;
(c) the rights, roles and responsibilities of the parties to the *mudarabah* venture;
(d) the amount of capital contributed by the *rabbul mal*;
(e) the PSR;
(f) the loss that shall be borne by the relevant contracting parties;
(g) the calculation methodologies and timing for profit distribution;
(h) the tenure of the *mudarabah* venture;
(i) the pricing or valuation method of underlying assets;
(j) requirements on the reporting of the *mudarabah* venture’s performance which includes the frequency and the information to be reported;
(k) details on the collateral and guarantees including rights over assets, if any;
(l) the terms and mechanism of exit; and
(m) the terms, fees and charges to be borne by the relevant contracting parties where applicable.

S 25.28 The use of Arabic terminology in the documents shall be sufficiently clarified or translated to facilitate understanding of the contracting parties.

S 25.29 Where there is an arrangement of *mudarabah* with other Shariah contracts, the IFI shall ensure that the documentation involved is separated and
executed in a sequence that is consistent with Shariah requirements.

26. Risk management

Principle 4: The IFI shall institute and implement sound and integrated risk management system to effectively manage risks throughout the life cycle of the mudarabah ventures.

G 26.1 A mudarabah venture may expose a rabbul mal to various types of risks, such as equity, market, liquidity, credit and operational risks. These risks, which appear at various stages of transactions, may change in nature and may necessitate a comprehensive and sound risk management infrastructure, reporting and control framework.

S 26.2 An IFI shall establish comprehensive risk management policies and procedures, systems and internal control to address risks in line with its risk appetite, throughout the life cycle of a mudarabah venture and shall include the following:
(a) the identification and monitoring of risks;
(b) the appropriate valuation and calculation methodology for underlying assets and distribution of profit;
(c) the risk exposure limits;
(d) the risk mitigation techniques; and
(e) the monitoring and reporting mechanisms.

S 26.3 Internally, the IFI shall clearly specify and communicate the policies, procedures and limits to all its relevant functions.

S 26.4 The IFI shall establish a systematic process to review and update its policies, procedures, internal limits and shall ensure consistency with the risk appetite of the IFI and material changes within the industry.

S 26.5 The IFI shall have in place a rigorous stress testing framework on the
mudarabah venture.

S 26.6 In structuring the products based on mudarabah contract, the IFI shall ensure appropriateness of product structure against the intended risk and reward profile\textsuperscript{23,24}.

27. Financial disclosure

Principle 5: The IFI shall provide adequate disclosure and transparency to facilitate stakeholders’ understanding and assessment of mudarabah ventures.

S 27.1 An IFI shall maintain accounting records and other records in a timely manner which will sufficiently enable the preparation and reporting of financial statements that give a true and fair view.

S 27.2 Requirements stipulated in the Guidelines on Financial Reporting for Islamic Banking Institutions, Guidelines on Financial Reporting for Development Financial Institutions, Capital Adequacy Framework for Islamic Banks – Disclosure Requirements (Pillar 3) issued by the Bank and all applicable MFRS shall be observed by the IFI.

S 27.3 Specific governance and oversight function\textsuperscript{25} in place for a mudarabah venture, if any, shall be disclosed.

\textsuperscript{23} For example, IFI as a mudarib shall structure an Investment Account product which is commensurate with the objective as well as targeted risk and return profile of the particular investment account.

\textsuperscript{24} For example, IFI as rabbul mal shall consider, among other matters, whether the mudarabah requires a Special Purpose Vehicle or any other specific arrangements.

\textsuperscript{25} E.g. board observer in respective mudarabah venture and their roles

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28. **Business and market conduct**

**Principle 6:** The IFI shall undertake *mudarabah* ventures in a fair and transparent manner in line with Shariah to protect stakeholders’ interests.

s 28.1 An IFI shall give due regard to the interests of contracting parties\(^{26}\) in its policies and procedures to ensure that a *mudarabah* venture is conducted in a fair, transparent, responsible and professional manner.

**Fair dealings**

s 28.2 The internal policies and procedures of an IFI on business and market conduct for a *mudarabah* venture shall reflect fair dealing practices to the contracting parties, including:

(a) the suitability assessment;
(b) the information provided which shall be accurate, clear and not misleading;
(c) the fees and charges (if any); and
(d) reasonable care is taken to ensure suitability of advice and recommendations, if any.

s 28.3 All conflicts of interests including those that will potentially occur under a *mudarabah* venture shall be disclosed to the contracting parties by the IFI.

s 28.4 The IFI shall ensure fairness in the terms of the *mudarabah* contract including in any amendments to the *mudarabah* contract during renegotiation or extension of tenure.

**Disclosure of information**

s 28.5 At the pre-contractual stage, an IFI shall provide adequate and relevant information to the potential contracting parties in the marketing and promotional materials, product disclosure sheet and any other relevant

\(^{26}\) For purposes of paragraph 28, contracting parties refer to the rabbul mal when the IFI is the mudarib or the mudarib when the IFI is the rabbul mal.
materials with regard to a mudarabah venture. The information shall include:
(a) a comprehensive description of the mudarabah venture, which includes;
   (i) the contractual relationship between the mudarib and the rabbul mal;
   (ii) the concept of profit sharing between the mudarib and the rabbul mal and loss bearing by the rabbul mal;
(b) an overview of the transaction’s structure;
(c) the roles, responsibilities, rights and obligations of the contracting parties;
(d) the key terms and conditions of the mudarabah contract; and
(e) the requirements, if any, for guarantee and/or collateral (including the rights and obligation of contracting parties on the collateral pledged).
In relation to the product disclosure sheet, the IFI is also required to observe the minimum information to be disclosed in the product disclosure sheet as prescribed in the Guidelines on Product Transparency and Disclosure.

S 28.6 The IFI shall facilitate the contracting parties’ understanding of the concept of a mudarabah contract.

S 28.7 At the point of entering into the contract, the IFI shall disclose the salient features of the mudarabah venture in the legal documentation to facilitate the contracting parties’ understanding of the terms and conditions of the mudarabah contract.

S 28.8 The IFI shall provide appropriate disclosure to the contracting parties during the tenure of the mudarabah venture such as providing timely notice of changes to terms and conditions, features, rights and obligations as well as fees and charges (if applicable).
PART D SPECIFIC OPERATIONAL REQUIREMENTS FOR IFI AS CAPITAL PROVIDER

29. Background

S 29.1 In addition to the general operational requirements in Part C, an IFI is subject to the specific operational requirements under this Part D for a *mudarabah* venture which consists of products or services structured using a *mudarabah* contract where the IFI is the *rabbul mal*. The IFI shall refer to the Investment Account policy document for specific operational requirements for a *mudarabah* contract where the IFI is the *mudarib*.

30. Governance and oversight

S 30.1 Sound governance and oversight function requirements for *mudarabah* ventures shall reside within both the IFI and the *mudarabah* venture.

IFI's level

*Dedicated function or unit at operational level*

S 30.2 An IFI shall set up a dedicated function or unit specifically for *mudarabah* ventures within the IFI with the relevant skills and expertise to provide oversight on the *mudarabah* ventures.

S 30.3 The roles and responsibilities of the dedicated function or unit include:

(a) conducting appraisal of proposals received from a potential *mudarib* and recommending a *mudarabah* venture to the relevant management committee if it is deemed viable;

(b) monitoring the progress of the *mudarabah* venture, regular on-site visits, on-going collection of relevant information and conducting analysis on impact to the *mudarabah* venture;

(c) ensuring that risk management policies and internal control to manage exposures are adhered to; and

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27 Recorded as assets in the books of the IFI.
28 Includes on-site visit for Shariah compliance purposes.
(d) promptly alerting the senior management if abnormalities are detected and preparing progress reports to the management on a periodical basis.

S 30.4 The dedicated function or unit shall consist of personnel with the appropriate expertise, knowledge and competencies in the *mudarabah* venture.

G 30.5 The IFI may appoint an external party to complement the operations of the dedicated function or unit\(^{29}\) in areas or business activities where the IFI does not possess such expertise.

S 30.6 For such appointment under paragraph 30.5, the IFI must ensure that:
(a) the external party has the credibility, capacity, sufficient knowledge and expertise in the areas or business activities involved;
(b) there is no conflict of interest between the external party and the IFI;
(c) there is no conflict of interest between the external party and the *mudarib*; and
(d) appropriate legal documentation governing the transactions between the IFI and the external party to ensure enforceability of provisions such as liabilities, roles and responsibilities and confidentiality.

*Dedicated Structure at Board and Senior Management level*

S 30.7 Where the exposure\(^ {30}\) to *mudarabah* ventures reaches 25% of the total capital\(^ {31}\), an IFI shall establish dedicated oversight committees as follows to enable higher level of focus and in-depth deliberation:
(a) Board Investment Risk Committee (BIRC) at board level; and
(b) Investment Committee (IC) at management level.

S 30.8 The BIRC shall oversee the senior management’s activities in managing

\(^{29}\) Includes advisory, assessment, monitoring, review or any other processes necessary in managing the *mudarabah* venture.

\(^{30}\) Includes non-sale based contracts where IFIs may be exposed to capital loss e.g. Musharakah venture.

\(^{31}\) As defined under the Capital Adequacy Framework for Islamic Banks (Capital Components).

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The dedicated structure and details of the respective roles and responsibilities are given in Appendix 8.

s 30.10 The membership of the BIRC is limited to non-executive directors with at least three members and chaired by an independent director.

s 30.11 The IFI shall ensure that at least one member in the BIRC and the IC has the expertise and experience\(^\text{32}\) in the main business segments\(^\text{33}\) relating to *mudarabah* ventures.

\(^{32}\) For example, if the IFI is involved mainly in properties, there must be at least a committee member who has experience in the real estate industry such as involvement in property development companies. In this regard, experience merely as a banker in real estate or mortgage financing may not be adequate.

\(^{33}\) If the IFI is involved in more than one business segment at a time, the IFI shall apply judgment in identifying the main business segments that require the existence of a specific committee member with the relevant expertise.
G 30.12 Notwithstanding the requirements to establish a BIRC under subparagraph 30.7(a), the IFI may leverage on the existing board committee such as Board Risk Management Committee (BRMC) to undertake the functions of the BIRC.

S 30.13 If the approach under paragraph 30.12 is adopted, the IFI shall ensure that:
(a) mechanisms are in place to enhance the competency and credibility of the board committee members, including ensuring that at least one member in the existing board committee has the expertise and knowledge in the main business segments relating to the mudarabah venture; and
(b) the amount of losses or impairment of the mudarabah venture is low or insignificant\(^\text{34}\) at all times.

**Mudarabah Venture’s level**

**Observer**

S 30.14 For an IFI as a rabbul mal, the IFI shall ensure that effective mechanisms are in place to monitor and assess whether the mudarib is executing his duties effectively, diligently and in accordance with the stipulated terms and conditions of the mudarabah contract.

S 30.15 The IFI shall establish appropriate safeguard measures to ensure effective governance and oversight at the venture level.

G 30.16 The safeguard measures may include the appointment of a suitable observer with the necessary skills and experience at the mudarabah venture’s board, management or project level. This is to ensure that the IFI has access to timely information, enhanced understanding of issues and is able to closely monitor the mudarib’s conduct in executing fiduciary duties both at the highest as well as at the working level in the mudarabah venture.

\(^{34}\) For example, losses or impairment is not more than 5% of total mudarabah venture exposure.

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S 30.17 Where an observer is appointed for a complex structure such as a *mudarabah* venture involving multi-tiered SPV or indirect exposures, such appointment shall be made at the entity that conducts the actual business activity and/or the entity which has control over the actual business activity. Illustration of a complex structure is given in Appendix 9.

S 30.18 The IFI shall establish policies and procedures on the appointment of the observers which includes the eligibility criteria, conduct, roles and responsibilities and the review mechanism to enable the observer to discharge his duties effectively.

S 30.19 The appointed observer shall:

(a) possess skill and in-depth knowledge of the nature of the business of the *mudarabah* venture;

(b) possess the necessary qualifications, experience and qualities that enable him to discharge his duties effectively;

(c) possess the maturity to understand the deliberations carried on in the *mudarabah* venture, especially those appointed at the Board level; and

(d) must be “fit and proper” to hold the post which encompass:

(i) his probity, diligence, competence and soundness of judgment;

(ii) his reputation, character, integrity and honesty; and

(iii) any history of offence(s) involving fraud, dishonesty, violence, incompetence or malpractice, including any engagement in deceitful, oppressive or improper business practices or any practices which would discredit him.

G 30.20 The appointed observer may be an employee of the IFI, an employee of an entity within the IFI’s group of companies or an external party as the subject matter expert from the relevant industry.

S 30.21 The appointment of the observer shall be subject to the following conditions:

(a) no conflict of interest between the observer and the IFI that may jeopardize the IFI’s interest. In particular, the IFI is not allowed to
appoint its Board member as a board observer in the mudarabah venture;

(b) no conflict of interest between the observer and the mudarib which may cause the oversight function to be ineffective;

(c) the appointment terms shall define the rights and responsibilities of the observer including duties to the IFI, the prohibited conduct and the disclosure requirements;

(d) if the observer is an external party to the IFI:
   (i) the IFI must have in place an assessment process in appointing an external party as an observer to ensure that he has the credibility, knowledge and expertise in the areas or business activities involved; and
   (ii) the external party shall provide a written undertaking to the IFI on the obligation to comply with the secrecy provision stipulated in section 145 of IFSA, section 133 of FSA or section 119 of DFIA, as the case may be.

S 30.22 The roles and responsibilities of the observer shall include the following:

(a) reporting the progress and performance of the mudarabah venture to the IFI in a timely manner;

(b) safeguarding the IFI’s interest;

(c) obtaining necessary information in order to validate any issues faced by the mudarib; and

(d) maintaining a high level of integrity and avoiding any transactions with the mudarib or any other parties for personal benefit or gain.

S 30.23 The IFI shall have the following policy in place to ensure the effectiveness of the observer’s function:

(a) the mudarabah venture is recognized as one of his core job functions;

(b) establish an internal limit on the number of invested entities for which each individual is allowed to be an observer e.g. each observer is limited to only two ventures at any time;

(c) any assignment of an alternate observer shall be limited to only one
other specified\textsuperscript{35} person, who shall also be subject to the terms and conditions of the appointment of an observer; and

(d) any fees or remuneration payable to the observer for conducting this function cannot be sourced from the \emph{mudarib}.

\textbf{s 30.24} The IFI shall immediately relinquish the observer’s function upon disposal of the IFI’s interest in the \emph{mudarabah} venture.

\textbf{s 30.25} The IFI shall ensure the independence of all functions at the IFI and venture level are preserved at all times to enable checks and balances e.g. the board and project level observer shall not be the same person and the head of the dedicated unit or function shall not be the board observer.

\section*{31. Structuring}

\textbf{Sources of funds}

\textbf{s 31.1} An IFI’s capital contribution under a \emph{mudarabah} venture shall be subjected to the following requirements:

(a) funding from Unrestricted Investment Account (UA)\textsuperscript{36} and Restricted Investment Account (RA) are allowed provided that the requirements as per the policy document on Investment Account\textsuperscript{37} are adhered to. In addition, any utilization of UA fund shall be subject to conditions that would significantly mitigate\textsuperscript{38} liquidity risks;

(b) funding from shareholders’ funds are allowed subject to the following:

(i) the IFI maintains adequate capital as required under the \emph{Capital Adequacy Framework for Islamic Banks (Capital Components)};

and

(ii) the IFI clearly establishes its risk appetite for \emph{mudarabah}

\textsuperscript{35} Specified means an alternate observer who shall be made permanent throughout the assignment and not be replaced by any other person.

\textsuperscript{36} For the purpose of funding real estate business, UA is eligible as source of fund subject to conditions specified in paragraph 7.6 of Guidelines on Property Development and Property Investment Activities by Islamic Banks.

\textsuperscript{37} UA and RA refer to URIA and RIA, respectively in the policy document on Investment Account

\textsuperscript{38} This may include mechanisms such as matching of tenure between source and usage of funds, allowing redemptions only upon liquidation of underlying assets or replacement of investors other than the IFI.

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ventures and establishes an internal limit on the use of shareholders’ funds which commensurate with its risk appetite; and

(c) funding from deposits are not allowed.

S 31.2 Where the mechanism of matching tenure under subparagraph 31.1(a) is used to significantly mitigate liquidity risk, any extension to the tenure of the mudarabah venture shall also be supported by an extension of redemption period for the UA and RA funds.

Usage of funds

S 31.3 In utilising funds for purposes of a mudarabah venture, an IFI shall assess the business venture viability and risk profile i.e. cash flow and risk and reward, in line with the IFI’s risk appetite and sources of funds.

Contracting parties

S 31.4 The terms and conditions for the appointment of a mudarib shall include clarification of the liabilities to be borne by the mudarib.

S 31.5 An IFI shall assess the need for safety measures to ensure that any assignment of a mudarabah venture bya mudarib to another mudarib i.e. second mudarib will not impose additional risk to the mudarabah venture.

S 31.6 For purposes of paragraph 31.5, the IFI shall:

(a) stipulate criteria or conditions of the mudarib in the agreement to ensure proper selection, effective management and proper conduct of the second mudarib;

(b) have mechanisms in place to ensure that there is no conflict of interest between the mudarib and the second mudarib;

(c) ensure that the following mudarabah contracts are executed separately and shall not negate individual responsibility under each contract:

(i) the mudarabah contract between the IFI and the mudarib; and
(ii) the mudarabah contract between the mudarib and the second mudarib;

(d) ensure that the terms in the contract between the mudarib and the second mudarib includes:

(i) the roles and responsibilities of the second mudarib including reporting obligation, frequency and furnishing detailed reports on any occurrence of loss;

(ii) the liabilities to be held by the second mudarib; and

(e) assess areas where expectations or requirements as imposed by the IFI on the mudarib should be similarly imposed on the second mudarib.

S 31.7 The IFI shall have a mechanism in place to ensure that there is no conflict of interest between the mudarib and any parties appointed for business dealings.

**Capital**

S 31.8 An IFI shall provide capital only in cash\(^{39}\) to a mudarib. In addition, the capital provided shall not be via acquisition of shares\(^{40}\) of the mudarib or the mudarabah venture.

S 31.9 In addition to the requirements in paragraph 25.10, when there is commingling of the mudarabah capital with the mudarib's other funds, the IFI shall ensure that the terms and conditions as well as any other measures taken are legally enforceable and effective in ensuring the IFI’s rights on the underlying assets under the mudarabah venture.

G 31.10 The capital may be fully or partially disbursed as per the terms of a mudarabah contract and additional capital injection is allowed within the tenure of the mudarabah venture, subject to mutual agreement between the IFI and the mudarib.

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\(^{39}\) Capital in-kind is not allowed.  
\(^{40}\) Where IFI subscribes to the shares issued by the mudarib.
Profit

S 31.11 The methodology used for determining the calculation and distribution of profit shall be objective, transparent and acceptable to all contracting parties.

G 31.12 With regard to the final adjustment to the profit or loss calculation of a mudarabah venture as mentioned in paragraph 25.16, an IFI may wish to identify measures to prevent complications of the profit being over-distributed, before such adjustments are made between the IFI and the mudarib.

Loss

S 31.13 An IFI shall have effective processes in place to ensure that the mudarib provides justification and a detailed report on any occurrence of loss, underperformance against projected returns or derailment from expected performance in a timely manner to the IFI.

S 31.14 In order to mitigate risks, the IFI shall only provide restricted mudarabah funding to the mudarib. Under this arrangement, the IFI shall identify specific requirements such as details on the business scope, specific assets involved, milestones and deliverables by the mudarib.

G 31.15 The IFI may set criteria on misconduct and negligence in the mudarabah venture terms and conditions to provide clarity, encourage proper conduct of the mudarib and to protect the interests of the IFI in the event of loss.

S 31.16 The mudarabah venture shall be separated from the mudarib’s other businesses. The venture shall be structured via a separate entity e.g. an SPV if the business falls under the following circumstances:
(a) existence of high-risk activities; where the mudarib has other high-risk

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41 Such as setting expectations on maintaining proper books and records, transparency, disclosure of information.

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business activities which may affect the *mudarabah* venture. Examples of ventures that are considered as high-risk are:

(i) products that are still at the exploratory or prototype stage e.g. pharmaceuticals; or  
(ii) industries with a high rate of obsolescence e.g. technology sector; or  
(b) inability to practise effective management; where the IFI is unable to appoint observer(s) or unable to operationalize the use of the designated account\(^{42}\) under the non-SPV set-up.

S 31.17 The IFI shall assess whether the *mudarabah* venture should be segregated from the IFI and structured under a separate entity such as an SPV. The factors to be considered include:

(a) activities and level of risk involved such as the examples in subparagraph 31.16(a); and 
(b) the need to limit risks or claims on the IFI or potential legal impact to the IFI.

S 31.18 If the *mudarabah* venture is structured in the form of a separate entity, it shall be:

(a) a limited liability entity (e.g. established under the Companies Act 1965); and 
(b) for single-purpose only, which shall be determined by the IFI.

G 31.19 While requirements in paragraphs 14.5 and 25.6 limit the IFI’s involvement in the *mudarabah* venture, the IFI may identify covenants necessary to protect the IFI’s interest to be included in the legal documentation and agreed at the time of entering into the contract. For example:

(a) negative covenants preventing certain actions and conduct by the *mudarib* or positive covenants that requires the *mudarib* to conduct

\(^{42}\) As per paragraph 32.7.
specified actions; and/or
(b) prior notification needed to be given to the IFI on specific decisions or actions taken by the mudarib.

Tenure
s 31.20 An IFI shall determine a fixed tenure\(^{43}\) for a mudarabah venture. Any decision to extend the tenure of the mudarabah venture shall be supported by justifiable reasons such as delay in construction or significant change in market conditions and after conducting appropriate renegotiation and reassessment such as the cost benefit analysis.

Guarantee or collateral
s 31.21 For purposes of meeting the requirements under paragraph 18.2, an IFI shall conduct assessment on:
(a) the need for collateral or guarantee and its intended purpose\(^{44}\);
(b) the value of assets acceptable as collateral;
(c) acceptability of collateral and eligibility of guarantors, which includes:
   (i) existing legal impediments on collateral such as encumbered assets;
   (ii) financial strength of the guarantors; and
   (iii) third parties’ eligibility as guarantors as per paragraph 25.26.

s 31.22 The IFI shall ensure legal enforceability of any collateral or guarantee documentation.

Exit\(^{45}\) from venture
s 31.23 As part of the measures to mitigate risks, an IFI shall identify potential exit options in order to immediately cut loss, taking into consideration the overall impact to the IFI which may include potential compensation or damages.

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\(^{43}\) Takes into consideration the appropriate tenure to maximise returns.

\(^{44}\) To cover losses due to misconduct, breach of contract or negligence or to cover losses due to any other reasons.

\(^{45}\) May be in the form of dissolution, termination, redemption or withdrawal of the mudarabah capital.
payable to a *mudarib*.

32. **Risk management**

   S 32.1 An effective risk management framework shall consist of three main stages prevalent in a *mudarabah* venture:
   
   (a) the pre-contractual stage;
   
   (b) the during or on-going stage; and
   
   (c) the exit stage.

**Pre-contractual stage**

   G 32.2 At the pre-contractual stage, the risk management objective is to enable sufficiency of information for decision making purposes before embarking on a *mudarabah* venture.

**Feasibility assessment**

   S 32.3 An IFI shall ensure that the objectives and criteria of potential *mudarabah* ventures are in line with the IFI’s investment strategy.

   S 32.4 The IFI shall ensure that a comprehensive and robust feasibility and due-diligence framework is in place to facilitate effective decision making, which includes the following:

   (a) the assessment methodologies employed are suitable for the type of products, services and business segments under the *mudarabah* venture e.g. the use of an assessment framework under a similar business segment for sale-based financing\(^{46}\) may not be exactly suitable for a *mudarabah* venture due to differences in the nature of funding;

   (b) the assessment shall be based on empirical evidence based on both quantitative and qualitative analysis. Should there be any data limitations, the IFI shall identify other means to support the

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\(^{46}\) *Such as murabahah financing.*

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assessment such as using relevant data as proxies. Where judgment is significantly involved, the IFI shall have in place the parameters for the application of judgment in the assessment process e.g. identifying appropriate personnel or committee that can exercise such judgment;

(c) salient risks and important features affecting the prospects of the *mudarabah* venture have been taken into consideration. Salient risks such as investment, market, operational (which includes legal risk and Shariah non-compliance risk), liquidity and credit risks shall be assessed appropriately. All relevant factors affecting these risks shall be identified and assessed including:

(i) the credibility, capability, track record\(^{47}\) and experience of the *mudarib* including any other parties involved in the *mudarabah* venture such as a second *mudarib*, agents, contractors and suppliers. This also includes assessment of potential conflict of interest amongst the parties involved;

(ii) the transaction or venture characteristics such as marketability of products or services which are influenced by several factors including the type and design of the products or services, consumer demand, location, promotional strategies and competition;

(iii) the expected selling price, costs involved, expected cash-flow and any potential changes affecting the *mudarabah* venture; and

(iv) the enforceability of legal requirements, Shariah-compliance of the business activities as well as economic and regulatory changes;

(d) robust methodologies are applied in assessing projection of returns, costs involved and cash-flows, taking into consideration stressed conditions such as potential changes in the costs of materials, delay in sales, increase in labour costs or delay in delivery. For this purpose, the IFI shall ensure that sound assumptions based on objective

\(^{47}\) *Such as performance and financial track record.*
evidence are used in arriving at the projections. In addition, the IFI shall be more conservative in their projection of returns when the actual cash-in flow is based on bullet projection of repayments due to uncertainty in business and market conditions;

(e) the information used for assessment purposes are current, relevant and obtained from reliable sources; and

(f) the assessment process is conducted by parties with appropriate knowledge and expertise in the relevant business activity and no conflict of interest with the potential mudarib. Where external parties are involved, the IFI shall also have in place the policies and procedures which includes the criteria on the selection of suitable external parties.

G 32.5 In addition to the assessment usually applied for sale-based financing, the IFI may wish to apply an appropriate business courtship arrangement with the potential mudarib before embarking in a mudarabah venture. This will involve arrangement for getting to know the mudarib more thoroughly over a certain period of time involving close monitoring, information collection and familiarisation process before entering into the mudarabah venture.

S 32.6 The IFI shall ensure that the rights to fully access the books and records of the mudarib and any information that would potentially affect the mudarabah venture shall be clearly stipulated by the terms and conditions.

S 32.7 The IFI shall establish designated account(s) for the mudarabah venture where all financial transactions shall be maintained to enable close monitoring and supervision of transactions made by the mudarabah venture.

S 32.8 Any credit facilities other than the capital contributions made under the

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48 The party conducting the assessment may be internal or external party.

49 A period of time where an IFI engages and seeks for more information to better understand the business e.g. request for periodic performance overtime without any obligation.
mudarabah venture, extended by the IFI shall be made on an arm’s length basis whereby the terms and conditions for these facilities should not be more favourable than those granted to other obligors with similar background and creditworthiness.

S 32.9 The IFI shall assess potential exit strategies for the proposed mudarabah venture and potential compensation or damages of all contracting parties.

S 32.10 The legal mechanism on exit strategies shall be specifically and appropriately documented in the mudarabah contract to ensure a smooth exit.

S 32.11 The IFI shall classify the mudarabah venture as impaired or loss-making in accordance with the applicable MFRS.

G 32.12 For the purposes of internal assessment, the IFI may use relevant indicators\textsuperscript{50} to monitor and classify a mudarabah venture according to its level of performance.

**During or on-going stage**

*Active monitoring and continued assessment*

G 32.13 The risk management objectives at this stage are intended to ensure continuous monitoring in achieving long term strategy and value creation.

S 32.14 An IFI shall ensure continuous monitoring on a mudarabah venture through adequate and robust risk reporting, risk monitoring and risk control framework with the aim to reduce the IFI’s overall risk exposure and safeguard the IFI’s investment portfolio. Any gaps or inappropriate risk exposures must be reported immediately.

\textsuperscript{50} E.g. specified series of reduction or significant percentage of reduction in returns projection.

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S 32.15 The IFI shall have in place early-warning mechanism with pre-identified trigger events to facilitate prompt decision making upon any alarming performance of the mudarabah venture.

S 32.16 In respect of the mudarabah venture’s performance reporting, the IFI shall conduct the following:
(a) identify information required from the mudarib or other contracting parties, if any, including:
   (i) periodical management and financial accounts of the mudarabah venture;
   (ii) key performance indicators;
   (iii) risk management practices;
   (iv) minutes of the board of director’s meetings; and
   (v) significant activities or changes\(^5\) that have material effect on the performance of the mudarabah venture;
(b) mudarib provides periodical reports in a timely manner; and
(c) validate the reports received to mitigate the risk of potential manipulation on the performance results leading to understatements of mudarabah earnings. This may include validation of the reported earnings or losses, calculation of profits and valuation of underlying assets.

S 32.17 The IFI shall conduct assessment periodically on the projected returns of the mudarabah venture or upon the occurrence of material changes affecting the mudarabah venture. The frequency for such periodic assessment shall commensurate with the level of risk and complexity of the mudarabah venture.

S 32.18 The IFI shall have in place a sound valuation methodology that provides the

\(^{5}\) Such as change in management (e.g. resignation or election of new board of directors), change in key contractual parties (e.g. change of agent, contractor, supplier or other outsourcing party), and regulatory changes in business requirements (e.g. health and safety regulations and product bans).

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possible loss estimates for the *mudarabah* venture.

S 32.19 The IFI shall establish a process to collect and analyse data and information on the *mudarabah* venture.

S 32.20 If a third party is appointed to conduct any activity for the *mudarabah* venture, the IFI shall ensure that the *mudarib* conducts the following:
(a) undertake proper selection process;
(b) monitor the effectiveness of functions and conduct of the third party;
(c) disclose information about the third party; and
(d) ensure an exit mechanism is in place.

G 32.21 Legal documentation may contain clauses that will enable the IFI to take actions against the *mudarib*'s failure to prepare timely periodical reports within a reasonable period.

S 32.22 An effective asset-liability management shall be established to manage mismatch in returns and cash flows of the *mudarabah* venture and the IFI’s source of funding.

G 32.23 The contracting parties may appoint an independent third party to carry out valuations on the *mudarabah* venture to ensure transparency and objectivity in the valuation and distribution of the profits.

*Underperforming mudarabah venture*

S 32.24 If a *mudarabah* venture is or is expected to be underperforming, the IFI shall conduct a detailed assessment on whether the *mudarabah* venture would continue to be viable.

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52 *E.g.* sub-contracting, management of inventories.
53 *E.g.* performance history, financial strength and company reputation.
54 *E.g.* able to replace third party should the arrangement fail to deliver results.
S 32.25 The viability assessment shall take into consideration the following:

(a) the possibilities for improvement on the issues and factors that lead to the underperformance;
(b) the feasibility of improvement plans proposed by the mudarib, such as change in the management, operational processes and period for turnaround;
(c) the appropriateness of the revised projection of returns and assumptions used to support such projection;
(d) the additional funding required; and
(e) whether the mudarabah venture’s level of risk and reward are still within the IFI’s risk appetite.

S 32.26 After conducting the viability assessment of the mudarabah venture, any decision not to exit shall be:

(a) based on plausible grounds, such as to minimise losses or high potential to recover the profits and capital;
(b) time-barred, whereby the IFI shall identify a fixed period for the mudarib to turnaround the mudarabah venture; and
(c) followed by the identification of clear strategies, measures and action plans\(^{55}\) by the IFI.

S 32.27 Risk monitoring, assessment and control functions shall be strengthened\(^{56}\) if the underperforming mudarabah venture is to be continued.

**Exit Stage**

S 32.28 Processes and procedures on the exit mechanism shall be clearly stipulated and communicated to the relevant functions or departments in an IFI in order to ensure effective and efficient execution of exit.

S 32.29 An assessment on the impact of each exit options shall be conducted by the

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\(^{55}\) Which may include renegotiating the terms of the mudarabah venture.

\(^{56}\) An example of a turnaround process flow for a musyarakah venture is stipulated in Appendix 11.

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IFI to determine the best value realisation.

S 32.30 The IFI shall obtain legal opinion that the exit mechanism can be executed without any legal impediments.

S 32.31 In the event the IFI exits from the mudarabah venture, an assessment on any potential damages payable to the mudarib or any other parties involved shall be conducted.

33. Financial disclosure

S 33.1 The financial disclosure\(^{57}\) for a mudarabah venture shall include the following:

(a) the value of the mudarabah venture:

(i) the initial capital contribution;

(ii) the outstanding or recoverable value\(^{58}\) by sector including any losses incurred or provisions made during the period; and

(b) the composition of aggregate sources of funds.

S 33.2 Any potential consolidation\(^{59}\) in the financial statements of an IFI arising from the mudarabah venture shall be notified to the Bank in advance.

34. Business and market conduct

S 34.1 An IFI shall not disclose any material information, for example trade secrets, of the mudarabah venture to any third party without authorisation from the mudarib.

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\(^{57}\) Illustration of the disclosure requirements is given in Appendix 12.

\(^{58}\) Exposure value as per MFRS.

\(^{59}\) Refers to line-by-line consolidation.

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APPENDICES

Appendix 1  Legitimacy of mudarabah

1. The legitimacy of the mudarabah contract is derived from the Quran, and founded on the Sunnah of the Prophet Muhammad (peace be upon him), and the consensus of Muslim jurists (Ijma).

The Quran

2. The following verse of the Quran implies the general permissibility of commercial venture including mudarabah.

وَأَﺧَﺮُونَ يَﻀْﺮِبُﻮنَ ﰲِ اﻻَرْضِ ﻳَﺒْﺘَﻐُﻮنَ ﻣِﻦْ ﻓَﻀْﻞِ اﻟﻠﱠﻪِ

“(i) وَأَﺧَﺮُونَ يَﻀْﺮِبُﻮنَ ﰲِ اﻻَرْضِ ﻳَﺒْﺘَﻐُﻮنَ ﻣِﻦْ ﻓَﻀْﻞِ اﻟﻠﱠﻪِ”

“...and others travelling in the earth in quest of Allah’s bounty...”

The word (يَﻀْﺮِبُﻮنَ) in the verse implies permissibility to travel in managing wealth to seek the bounty of Allah SWT which may take the form of mudarabah.

The Sunnah of The Prophet Muhammad (peace be upon him)

3. عِن ابِن عَبَس قَالَ: كَانَ الْعَبَاسُ ﺑِنَ عَـبْـدِ اﻟْمُـتْـتَـلِبِ إِذَا دَفَﻊَ مَالًا مَـضَاـرِبًا إِشْرَطلَ عَلَى صَاحِبِه

أَن لا يَسْلِكِ بِهِ ﻧَحْرًا، وَلَا يَنْزِلَ بِهِ وَادِيًا، وَلَا يَشْرَتِ ﺑِهِ ذَاتٍ ﻣُـضَـرَّـبَةً، ﻦَفَ إِن فَهُوَ ﺣَرْأٍ، فَقَفْعُ ضَرْطَهُ إِلَى ﺮَسُوْلِ اللَّهِ صلى الله عليه وسلم فَأُجَازَهُ.

“Ibnu Abbas (may Allah be pleased with him) reported that: “When Abbas Ibn Abd al-Muttalib gave his property to someone for mudarabah, he stipulated conditions for his partner not to bring the capital onto the sea; and not to bring with him the capital crossing a valley; and not to buy

60 Surah al-Muzzamal, verse 20.
livestock with the capital; and if his partner violates the conditions, he should guarantee the loss occurred. These conditions have been brought to the attention of Prophet Muhammad (peace be upon him) and he approved them.  

4. 

`عن صالح بن صهيب عن أبيه قال: قال رسول الله صلي الله عليه وسلم: ( ثلاث فيهن البركة: البيع إلى أجل والمقارضة وأخلاط البر بالشعير للبيت لا للبيع )`

“Suhayb (may Allah be pleased with him) reported that the Prophet Muhammad (peace be upon him) said: Three matters that have the blessing (of Allah): A deferred sale, _muqaradah_ (mudarabah), mixing wheat with barley for domestic use and not for sale.”

**Consensus of The Muslim Jurists (Ijma’)**

5. The Muslim jurists have reached _ijma’_ among them on the permissibility of the _mudarabah_ contract.

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61 Al-Bayhaqi, _Al-Sunan al-Kubra_, v. 6, p. 111.

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### Appendix 2  Glossary

<table>
<thead>
<tr>
<th>Terms</th>
<th>Definition</th>
</tr>
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<tbody>
<tr>
<td>Hibah</td>
<td>A transfer of ownership of an asset from a donor to a donee without any consideration.</td>
</tr>
<tr>
<td>Mudarabah asset</td>
<td>Asset created under a <em>mudarabah</em> venture.</td>
</tr>
<tr>
<td>Mudarabah venture</td>
<td>Business or profit generating activities undertaken by <em>mudarib</em> in managing capital provided by the <em>rabbul mal</em>.</td>
</tr>
<tr>
<td>Mudarib</td>
<td>Entrepreneur of a <em>mudarabah</em> venture.</td>
</tr>
<tr>
<td>Mudarib yudarib</td>
<td><em>Mudarabah</em> contract where the <em>rabbul mal</em> invests his capital with a <em>mudarib</em> who subsequently invests the fund with another <em>mudarib</em>.</td>
</tr>
<tr>
<td>Musyarakah</td>
<td>A partnership between two or more parties, whereby all parties will share the profit and bear the loss from the partnership.</td>
</tr>
<tr>
<td>Profit sharing ratio</td>
<td>The ratio in which the profits are shared between the <em>rabbul mal</em> and <em>mudarib</em>.</td>
</tr>
<tr>
<td>Rabbul mal</td>
<td>Capital provider.</td>
</tr>
<tr>
<td>Wa`d</td>
<td>A promise or undertaking which refers to an expression of commitment given by one party to another to perform certain action(s) in the future.</td>
</tr>
<tr>
<td>Wadi`ah</td>
<td>A contract by which an asset is placed with another party for safekeeping.</td>
</tr>
<tr>
<td>Wakalah</td>
<td>A contract in which a party as principal authorizes another party as his agent to perform a particular task in matters that may be delegated, with or without imposition of a fee.</td>
</tr>
</tbody>
</table>
Appendix 3  Related Shariah rulings and policy documents

1. Investment Account
2. Shariah Advisory Council (SAC) rulings published by the Bank;\(^{63}\)
3. Guidelines on Corporate Governance for Licensed Islamic Bank;
4. Guidelines on Corporate Governance for Development Financial Institutions;
5. Shariah Governance Framework for Islamic Financial Institutions;
6. Rate of Return;
7. Musyarakah;
10. Capital Adequacy Framework for Islamic Banks – Disclosure Requirements (Pillar 3);
12. Capital Adequacy Framework for Islamic Banks (Capital Components);
13. Guidelines on Property Development and Property Investment Activities by Islamic Banks;
15. Single Counterparty Exposure Limit; and

\(^{63}\) Including Shariah resolutions in Islamic Finance, standards, circulars or any directive pertaining to Shariah matters issued by the Bank.

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Appendix 4  Differences in the role of IFI in *mudarabah*

1. **IFI’s role as a *rabbul mal***

   - IFI provides capital to *mudarib*
   - IFI shares profit with *mudarib*

   **IFI as *Rabbul Mal***
   **Mudarib**
   - can be an existing entity or an SPV
   - uses funds for business activities

2. **IFI’s role as a *mudarib***

   - Investor places fund to IFI
   - Investor shares profit with IFI

   **Investor as *Rabbul Mal***
   **IFI as *Mudarib***
   1. **RA**
      - Asset
      - P/L
   2. **UA**
      - Asset
      - P/L

   **Legend**
   - 1. **Restricted Investment Account (RA)** – capital provided by investor is invested into specific assets as determined by investor.
   - 2. **Unrestricted Investment Account (UA)** – capital provided is invested into assets determined by the IFI.

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Appendix 5  *Mudarabah* venture (providing capital via cash)

Diagram 1: Provide funding for a specific purpose in a company

Diagram 2: Provide funding for a special purpose vehicle (SPV)

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Appendix 6  Mudarabah involving multiple rabbul-mal

**Single PSR structure**

- Rabbul Mal A
- Rabbul Mal B
- Rabbul Mal C

Single PSR 50:50

**Mudarabah venture**
- Mudarib manage business

**Multiple PSR structure**

- Rabbul Mal A
  - Different PSR
    - PSR 60:40

- Rabbul Mal B
  - PSR 50:50

- Rabbul Mal C
  - PSR 70:30

**Mudarabah venture**
- Mudarib manage business

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Appendix 7  Proper distribution of profit and loss when *mudarib* injects capital

Example:

Upon the *mudarib* injecting his own funds/capital into the business:

1. *Musharakah* is formed between the *mudarib* and the *mudarabah* venture

2. Profit /Loss:
   
   i) For the *musharakah*, loss shall be distributed according to the amount of capital contribution i.e. ratio of 90:10 and profit shall be distributed according to agreed terms and conditions;

   ii) Subsequently, for the *mudarabah* venture, loss shall be absorbed by the *rabbul-mal* and profit is to be calculated as per PSR i.e. ratio of 50:50.
Appendix 8  Dedicated structure

**Board Risk Management Committee (BRMC)**

**Material**

**Board Investment Risk Committee (BIRC)**

- Review and ensure the effectiveness of policies and risk management framework
- Provide recommendation to the Board for new or change in investment strategy
- Set authorisation limit for investments
- Oversight role to Investment Committee

**Credit Committee (CC)**

**Investment Committee (IC)**

- Oversee the progress of investment activities
- Approval of investment application
- Provide recommendation related to investment proposal & strategy to BIRC
- Oversight function & approval of investment within limit/strategy set

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Appendix 9 An example of complex structure in *mudarabah*

![Diagram showing complex structure in mudarabah]

IFI → Capital → SPV 1 → SPV 2 → SPV 3 → SPV 4

- Appoint observer (board/management/project) at the entity/entities that:
  - Conducts the actual business activity; and/or
  - Has control over the actual business activity

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### Appendix 10 Prudential limits and requirements based on sources of funds

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Use of General Investment Account (GIA) is limited up to 15% of total GIA fund of IFI for funding real estate business</td>
<td>Permissible structure to participate in property development activities&lt;br&gt;• Must be through joint-venture or equity participation with reputable property development companies that are not subsidiaries of the IFI</td>
<td>Investment in each real estate business shall not exceed 25% of IFI’s total capital&lt;br&gt;• Aggregate book value of investment in shares, interest-in-shares, CIS and immovable properties shall not exceed 50% of IFI’s total capital&lt;br&gt;• Aggregate book value of investment in shares &amp; interest-in-shares shall not exceed 25% of IFI’s total capital</td>
<td>Treatment of exposures funded by RA and UA as per para 8.5 and 8.6 of the policy document</td>
</tr>
<tr>
<td>RA</td>
<td>Not applicable</td>
<td>Exempted⁶⁶</td>
<td>Exempted</td>
</tr>
<tr>
<td>UA</td>
<td>Applicable</td>
<td>Applicable</td>
<td>Applicable</td>
</tr>
</tbody>
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⁶⁴ Subject to changes in respective policy documents.
⁶⁵ Total capital as per defined in the Capital Adequacy Framework for Islamic Banks (Capital Components).
⁶⁶ RA funds which are off-balance sheet.
⁶⁷ For IFI which places RA/UA to another IFI, look-through approach shall apply.

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Appendix 11 Distress assessment process flow

Monitoring of mudarabah venture

- Performance matches expectation
  - Normal monitoring requirements
- Performance below expectation
  - Perform distress assessment
    - Exit (Cut loss limit)
    - Exit
      - Retain mudarabah venture
        - Implement turnaround strategy and more vigorous monitoring requirements

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Appendix 12 Illustration of additional financial disclosure for *mudarabah* venture

**Notes to Account**

**Amount funded by:**

<table>
<thead>
<tr>
<th>Amount Funded by</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Unrestricted Investment Accounts (UA)</td>
<td>x</td>
</tr>
<tr>
<td>Restricted Investment Accounts (RA)</td>
<td>x</td>
</tr>
<tr>
<td>Shareholders' fund</td>
<td>x</td>
</tr>
<tr>
<td></td>
<td>xxx</td>
</tr>
</tbody>
</table>

**Mudarabah**

<table>
<thead>
<tr>
<th>Sector</th>
<th>Initial Capital (RM'000)</th>
<th>Losses/Impairment Provisions (RM'000)</th>
<th>Amount as at 31 Dec 20XX (RM'000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property</td>
<td>xxx</td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>xxx</td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>xxx</strong></td>
<td><strong>xxx</strong></td>
<td><strong>xxx</strong></td>
</tr>
</tbody>
</table>

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