Response to feedback received
Musyarakah

Introduction

Bank Negara Malaysia ("the Bank") issued a Concept Paper (CP) on Shariah Requirements, Optional Practices and Operational Requirements of *Musyarakah* in December 2013 to seek feedback on the operational requirements of *musyarakah* contract. The key objective of the proposed requirements is to promote consistency and transparency of Shariah contract application which would strengthen Shariah compliance by Islamic Financial Institutions (IFIs). It will also be the foundation for IFIs to establish the necessary operational framework and infrastructure to ensure that financial transactions are conducted consistent with Shariah and the entire intermediation process is carried out holistically.

The Bank appreciates the constructive feedback and suggestions received during the consultation period, whereby respondents were broadly supportive of the proposals set out in the CP. The feedback have been taken into account and incorporated in the final policy document where appropriate. Key comments received and the Bank's responses are set out in this document.

Bank Negara Malaysia
20 April 2015

1. Establishment of a dedicated oversight structure for *Musyarakah* ventures

1.1 The CP proposed that once *musyarakah* ventures reach 15% of total capital, the IFI shall establish a dedicated oversight structure comprising of a board and management committee and a dedicated unit/function. This is intended to enhance the management of *musyarakah* ventures as its risk profile is different from debt-based financing.

1.2 Some respondents highlighted that the proposed requirement may not be cost effective and would create a duplication of roles of board committees. In addition, the threshold set is too small and may be restrictive in terms of facilitating the development of *musyarakah* ventures.

1.3 The Bank maintains the view that the dedicated oversight structure should be established. However, IFIs are allowed to leverage on the existing board committee subject to ensuring the following:

a. mechanisms are in place to enhance the competency and credibility of the existing board committee members, including ensuring that at least one member of the existing board committee has the expertise and knowledge in the main business segments relating to the *musyarakah* venture;

b. the amount of losses or impairment on *musyarakah* venture is low or insignificant at all times e.g. losses or impairment is not more than 5% of total *musyarakah* exposure.

1.4 The threshold for establishing the dedicated oversight structure has also been increased from 15% to 25% of total capital to provide greater flexibility in managing *musyarakah* ventures.

2. Appointment of an external party as representative for the IFI at *musyarakah* venture level

2.1 As part of the measures to monitor and assess the performance and conduct of a managing partner in managing a *musyarakah* venture, the IFI may appoint a representative at the *musyarakah* venture level. In the CP, such appointment is limited to an employee of the IFI or its group of companies to ensure protection of IFI's interest.

2.2 Some respondents were of the opinion that such appointment should be opened to external parties, especially those with specialised expertise and knowledge suitable to the type of business under the *musyarakah* venture.

2.3 The final policy document allows for the appointment be opened to external parties subject to the following conditions:

a. The IFI shall have in place an assessment process in appointing an external party as an observer to ensure his credibility, knowledge and expertise in the business activities involved; and

b. The external party provide a written undertaking on the obligation to comply with secrecy provision under the respective Banking Acts.

3. Investment accounts and shareholders' funds as sources of fund for *musyarakah* ventures

3.1 The CP limits the sources of fund for *musyarakah* ventures to investment accounts and shareholders' fund only.

3.2 Some respondents highlighted on the possibility of allowing certain percentage of deposits to fund *musyarakah* ventures. This will provide more funding avenues and possibly higher returns to depositors.

3.3 The Bank wishes to maintain the prohibition on using deposits to fund *musyarakah* ventures. This is due to the significant mismatch of risk and reward profile between deposits and *musyarakah* ventures in terms of availability of funds to meet withdrawals and inability of deposits to absorb losses.

4. Requirements on *Musharakah* financing for assets under construction

Invocation of wa'd arising from failure to complete or deliver assets

4.1 The CP proposed that for *musyarakah* financing for assets under construction, failure to complete or deliver assets should not be a trigger event to invoke *wa'd.* Such invocation would result in customers being obligated to purchase IFI's portion of the assets, consequently owning an incomplete asset and create an outstanding amount payable to the IFI.

4.2 Some respondents highlighted that the proposal may result in exposure of IFIs to potential losses due to operational issues such as non-completion of assets. Therefore, moving forward this may render *Musyarakah* to be unsuitable for application against assets under construction.

4.1 The Bank wishes to maintain the prohibition in order to uphold the fundamental requirement under a *musyarakah* contract on profit and loss sharing. This is in line with the Shariah Advisory Council resolution[1] which requires for *wa'd* to be

---

[1] 64th and 65th SAC meeting dated 18th January 2007 and 30th January 2007 respectively.

applied in a fair manner and not deny the profit and loss sharing element among the contracting parties. Such prohibition would avoid moral hazard, ensure fair market practices and promote better selection of developers or contractors for purposes of financing assets under construction.

4.2 The final policy document further clarifies the requirements that any losses resulting from the incompletion of assets shall be shared based on the capital contribution ratio between the contracting parties.