

Response to feedback received

Mudarabah

Introduction

Bank Negara Malaysia (“the Bank”) issued a Concept Paper (CP) on Shariah Requirements, Optional Practices and Operational Requirements of *Mudarabah* in December 2013 to seek feedback on the operational requirements of *mudarabah* 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.

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 *Mudarabah* ventures

- 1.1 The CP proposed that once *mudarabah* 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 *mudarabah* ventures as its risk profile is different from debt-based financing.
- 1.2 Some respondents highlighted that the proposal 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 *mudarabah* 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 *mudarabah* venture; and
 - b. the amount of losses or impairment on *mudarabah* venture is low or insignificant at all times e.g. losses or impairment is not more than 5% of total *mudarabah* 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 *mudarabah* ventures.

2. Appointment of an external party as observer for the IFI at *mudarabah* venture level

- 2.1 In order to monitor and assess the performance and conduct of *mudarib* in managing a *mudarabah* venture, the IFI may appoint an observer at the *mudarabah* 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 *mudarabah* venture.

- 2.3 The final policy document allows for the appointment of external parties subject to the following conditions:
- a. The IFI have in place an assessment process in appointing the external party 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 *mudarabah* ventures

- 3.1 The CP limits the sources of fund for *mudarabah* ventures to investment accounts and shareholders' fund only.
- 3.2 Some respondents disagreed to the proposal and highlighted the possibility of allowing certain percentage of deposits to fund *mudarabah* 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 *mudarabah* ventures. This is due to the significant mismatch of risk and reward profile between deposits and *mudarabah* ventures in terms of availability of funds to meet withdrawals and inability of deposits to absorb losses.

4. Scope of prohibition of *rabbul mal's* involvement in a *mudarabah* venture

- 4.1 The CP proposed for a *mudarabah* venture to be managed by the *mudarib* while the *rabbul mal* shall have access to information. The *rabbul mal* shall not be involved in decision making, influence decision making in core business areas and be involved in the day-to-day management of the *mudarabah* venture.
- 4.2 Some respondents highlighted that such prohibition would not protect IFI's interest in situations where the IFI is the *rabbul-mal*.
- 4.3 The Bank wishes to maintain the prohibition in order to uphold the Shariah requirement on the roles and responsibilities of *rabbul-mal* and *mudarib*. It is important for IFI to ensure that there is robust risk management during the pre-contractual stage, in particular, identifying safeguard measures such as detailing the mandate and expectations on the *mudarib*, full excess to information, application of specific covenants and identification of capability to exit in order to cut loss.