Muzakarah on Failure Resolution of Islamic Financial Institutions

Session 2

Resolution of Investment Accounts in Failure of an Islamic Bank

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INTRODUCTION

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- In resolution scenarios, the legal and operational framework governing the transfer of Investment Accounts (IA) differs significantly from Business-As-Usual (BAU) transfers.
- Resolution cases are governed by special statutory mechanisms, such as the issuance of a Vesting Order (VO) by a court or a designated resolution authority.
- From a Shariah perspective, the resolution process may involve two situations
    i. Either the bank is declared non-viable or bankrupt, which resembles the concept of iflas in classical jurisprudence; or
    ii. The bank remains financially viable, but resolution measures such as merger or bail-in are undertaken to strengthen its position and preserve stability

INTRODUCTION

However, this raises important questions regarding:

1. Whether customer's consent remains necessary from a Shariah perspective, particularly in the case of IA structured under *wakalah* or *mudarabah* contracts?

2. Whether the existing IA contract is deemed terminated upon the declaration of *iflas* (bankruptcy) of the institution, given that such contracts rely on the legal and operational capacity of the contracting party?

3. Whether a court-issued directive or VO can override Shariah requirements, and to what extent the authority of the court intersects with the principles governing Shariah contracts?

CONSIDERATIONS IN THE TRANSFER OF INVESTMENT ACCOUNTS PORTFOLIO

KEY CONSIDERATION

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- In the resolution process, two key items need to be focused on, as compared to BAU

01 VESTING ORDER

In resolution, a vesting order is mandatory, unlike in BAU. It facilitates the immediate and compulsory transfer of selected assets, liabilities, and contractual obligations, including IA portfolios, from a failed institution to an acquiring entity.

02 DEEMED CONSENT

For resolution, the approach of deemed consent is workable in situations where the transfer process needs to be completed within a short timeframe. In contrast, under BAU, there is sufficient time to obtain consent directly from the customer.

VESTING ORDER

VESTING ORDER

- VO is usually granted by the High Court, and acts as a strong legal tool that allows assets and liabilities to be transferred directly without going through all the usual steps of rewriting contracts or getting individual consent from customers.

- It serves as a legal instrument that facilitates the immediate and compulsory transfer of selected assets, liabilities, and contractual obligations, including IA portfolios, from a failed institution to an acquiring entity without requiring individual customer approval.

- In other words, once the court approves, the transfer happens by law. The acquiring institution effectively steps into the position of the transferor, assuming all rights, responsibilities, and obligations as if it were the original contracting party.

POWER OF VESTING ORDER

- In civil law jurisdictions, VOs have generally been upheld as legally binding instruments, with courts often granting broad deference to regulatory authorities.
- Common law precedents demonstrate that customer consent is not typically required when a VO is issued under statutory authority, such as during the transfer of assets under national resolution frameworks.
- These transfers are presumed valid, so long as the resolution process complies with the enabling legislation.

SHARIAH PERSPECTIVE

- From the Shariah perspective, a VO falls under the purview of *siyasah shar'iyyah* as it is regarded as one of its tools that serve the public needs.

- This is in line with the legal maxims:

حكم الحاكم يرفع الخلاف

'The ruling of the judge lifts the disagreement'

تصرف الإمام على الرعية منوط بالمصلحة

'The affairs of the leader over the people are [to be] based on maslahah'

DEEMED CONSENT

DEEMED CONSENT

- The concept of deemed consent is considered a pragmatic solution for transferring IA, especially during resolution, considering the impracticality of obtaining explicit consent from every customer.

- This mechanism enables financial institutions to proceed with and conclude the contractual transfers or modifications based on the customer's silence or inaction or passive behavior (e.g., continued account usage) as implied agreement, rather than explicit consent.

- In principle, silence cannot replace active consent. However, exceptions may apply in very specific and legitimate contexts when there is *hajah* (legitimate need) and proper safeguards are in place (such as court scrutiny, prior disclosure, customer benefit, or existing agreement that pre-emptively covers such eventuality).

DEEMED CONSENT

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The proper safeguards shall include:

Customer Notification

All IAH must be formally notified of the proposed transfer through **appropriate communication** channels, such as email, SMS, and/or official letters as well as publicly accessible channels such as announcements in newspapers; notice boards at branches; and bank websites.

Adequate Response Period

Customers must be given a **reasonable period to review** the notification and respond. This time frame should be sufficient for them to seek clarification, consider the implications, and make an informed decision.

Right to Object or Opt–Out

The process must **clearly state the customer's right to object to the transfer or opt out** entirely. In the absence of a response within the stipulated period, consent may then be deemed to have been given the IAH’s failure to act on his/her own rights may also become restricted due to principle of estoppel.

LEGAL CLAUSE

- The existing IA contract should remain valid. The new bank should be able to continue the contract, effectively slipping into the shoes and stepping into the role of the previous bank, without needing to start a new agreement from scratch.
- To execute the process, the IAH should give their consent in advance, with the option to reject/opt-out if they disagree with the transfer and accordingly, customers must be allowed a fair duration of time to respond. Importantly, the concept of deemed consent must not be abused to disadvantage the customer or unfairly leave them in a worse position than before.

Sample clause:

> *"I hereby agree and authorize that this account may be transferred to another institution in the event of a resolution or transfer to a new acquirer. If no objection or withdrawal is received within 21 days from the date of notification from the bank, the bank can then consider that i have agreed to continue under the new arrangement."*

CUSTOMER CONSENT FROM VESTING ORDER

OPTION 1
No Consent Required from IAH

- When a vesting order is issued, the transfer of assets, liabilities, and contractual obligations is mandatory and legally binding.
- Customer consent is not required because the vesting order itself operates as a statutory instrument that overrides contractual requirements for consent.

OPTION 2
Pre-Consent from Customer at Initial Agreement Signing

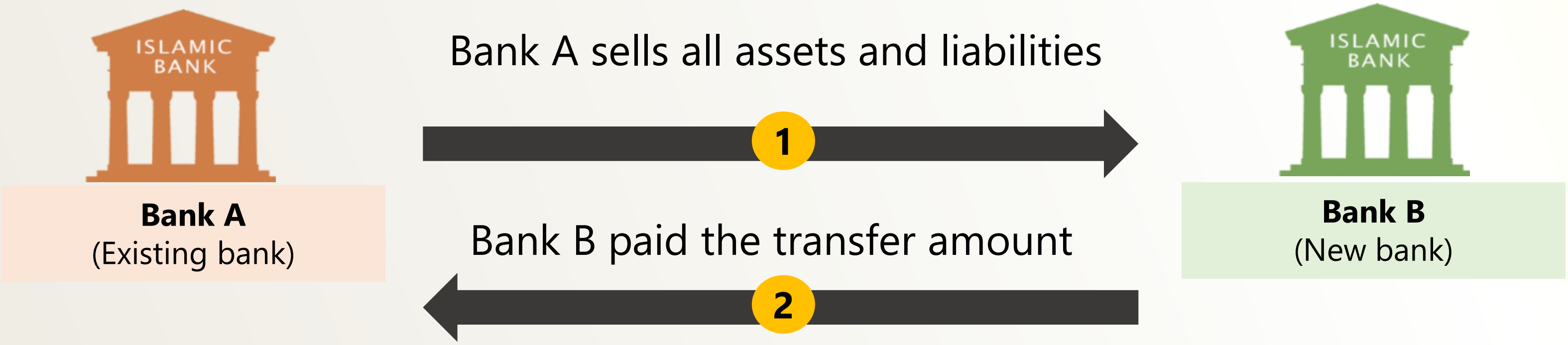
- To fulfil the Shariah requirement of obtaining customer consent, it may be proposed that the existing agreement be amended to include an additional clause.
- This clause would state that the customer hereby provides advance consent to any direction issued by the regulator or relevant authority for the substitution of the *wakil* or *mudarib* in the event of a resolution or transfer.

TRANSFER OF IA DURING RESOLUTION

TRANSFER MECHANISM FOR RESOLUTION

Transfers during resolution may involve either a full transfer or a partial transfer. A partial transfer may occur if the acquiring bank opts for a "pick-and-choose" approach.

FULL TRANSFER



TRANSFER MECHANISM FOR RESOLUTION

PARTIAL TRANSFER

ISLAMIC BANK

Bank A
(Existing bank)

Bank A sells the portfolio(s)

1

Bank B paid the transfer amount

2

ISLAMIC BANK

Bank B
(New bank)

Scenario 1 (IA+ Other asset & liabilities)

Investment Account
Car Financing
House Financing

Corporate Financing

Personal Financing

The transfer includes the IA portfolio, together with other assets and liabilities.

Scenario 2 (IA portfolio)

Investment Account
Car Financing
House Financing

The IA, along with the portfolio it funded

Scenario 3 (IA Capital)

Investment Account

The project funded under the IA has been liquidated, and the IAH now has fresh capital available for new investment.

PROPOSED SHARIAH CONTRACT FOR THE TRANSFER

PROPOSE SOLUTION

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The proposed Shariah contracts to facilitate the transfer and continuation of the IA:

Scenario	Proposed Shariah Contract	Explanation
Full transfer & Partial Transfer (Scenario 1)	Outright Sale	Since the IA is transferred together with other tangible assets, the entire portfolio may be sold under an outright sale structure, supported by AAOIFI's permissibility of selling mixed asset portfolios. The IA is treated as part of an asset-based transfer, where the contractual roles (e.g., mudarib or wakil) are transitioned to the acquiring institution.
	Bayʿ al-dayn bi sila (if tangible asset is 50% and below)	In cases where the IA is sold together with other assets, the structure may be based on bayʿ al-dayn bi al-silaʿ, particularly if tangible assets comprise 50% or less of the portfolio.

PROPOSE SOLUTION

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Scenario	Proposed Shariah Contract	Explanation
Partial Transfer (Scenario 2 & 3)	Tahwil	The transfer of a contractual right or obligation from one party to another. The IA structure can be transferred from the existing bank to the new bank, provided there is consent and clarity on the roles.
	Bayʿ al-haq	The sale of rights is permissible if the IA is clearly defined and holds financial value. In this context, the haqq al-tasarruf of the mudarib can be transferred to the new entity through a sale.

CONCLUSION

Conclusion

- In the case of resolution, the transfer process may take place either through a full transfer or a partial transfer.
- Two key considerations must be observed: the issuance of a vesting order and the application of deemed consent.
- With respect to consent from the IAH, this may be achieved either through the mandate conferred by the vesting order or through pre-consent obtained from the IAH at the time of agreement.
- For the transfer of standalone IA, the concepts of tahwil and bayʿ al-haq can be explored as possible Shariah mechanisms