Muzakarah
on Failure Resolution of Islamic Financial Institutions

Session 2

Resolution of Investment Accounts in Failure of an Islamic Bank

Prof. Datin Dr. Rusni Hassan
Dean
IIUM Institute of Islamic Banking and Finance (IIiBF)
International Islamic University Malaysia

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Muzakarah on Failure Resolution of Islamic Financial Institutions

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Muzakarah on Failure Resolution of Islamic Financial Institutions

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4. Shariah Concepts of Transferibility
5. Transfer Mechanism for UA and RA
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1.Introduction

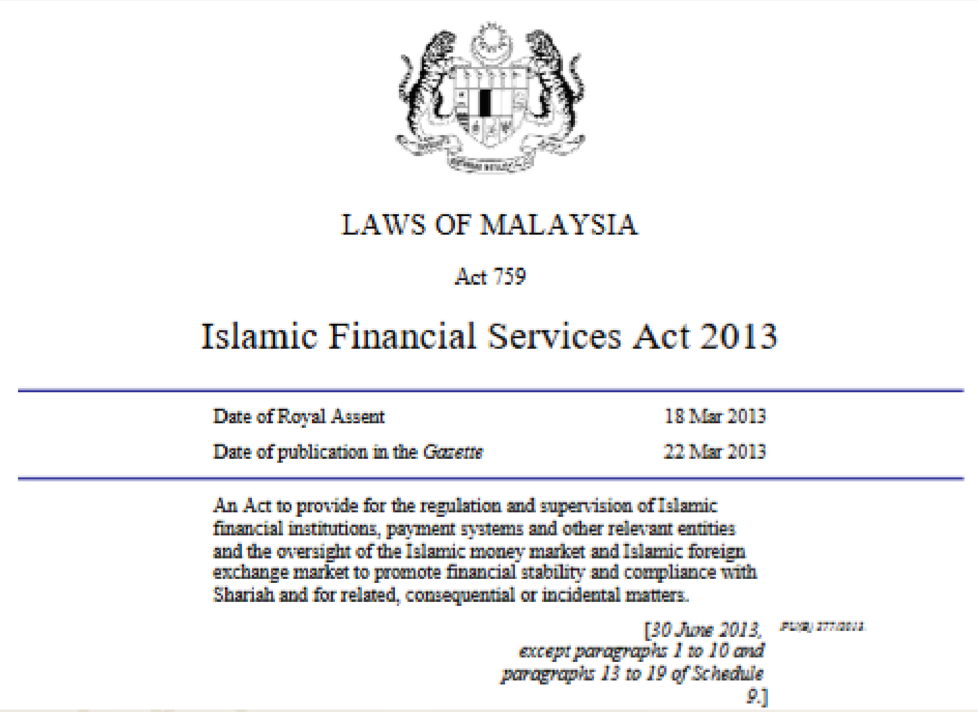
- Introduction of IFSA provides a milestone in definition and treatment for investment accounts (IA) differing from deposits by using Shariah contracts with risk-sharing and no guaranteed returns.

IFSA 2013

"investment account" means an account under which money is paid and accepted for the purposes of investment, including for the provision of finance, in accordance with Shariah on terms that there is no express or implied obligation to repay the money in full and

(a) either only the profits, or both the profits or losses, there on shall be shared between the person paying the money and the person accepting the money; or

(b) with or without any return;



LAWS OF MALAYSIA

Act 759

Islamic Financial Services Act 2013

Date of Royal Assent	18 Mar 2013
Date of publication in the *Gazette*	22 Mar 2013

An Act to provide for the regulation and supervision of Islamic financial institutions, payment systems and other relevant entities and the oversight of the Islamic money market and Islamic foreign exchange market to promote financial stability and compliance with Shariah and for related, consequential or incidental matters.

[30 June 2013, except paragraphs 1 to 10 and paragraphs 13 to 19 of Schedule 9.]

Source: IFSA (2013)

The Investment Account Platform (IAP), launched by Bank Negara Malaysia in 2016, is the first bank-intermediated fintech platform in Islamic finance, designed to channel funds into SMEs and innovation-driven ventures through risk-sharing, transparent, and Shariah-compliant mechanisms.

Source: IAP, website

BANK NEGARA MALAYSIA

CENTRAL BANK OF MALAYSIA

Investment Account

The Investment Account policy document (2017) outlines the regulatory requirements on the conduct of investment accounts including failure resolution.

Source: BNM IA Policy Document (2017)

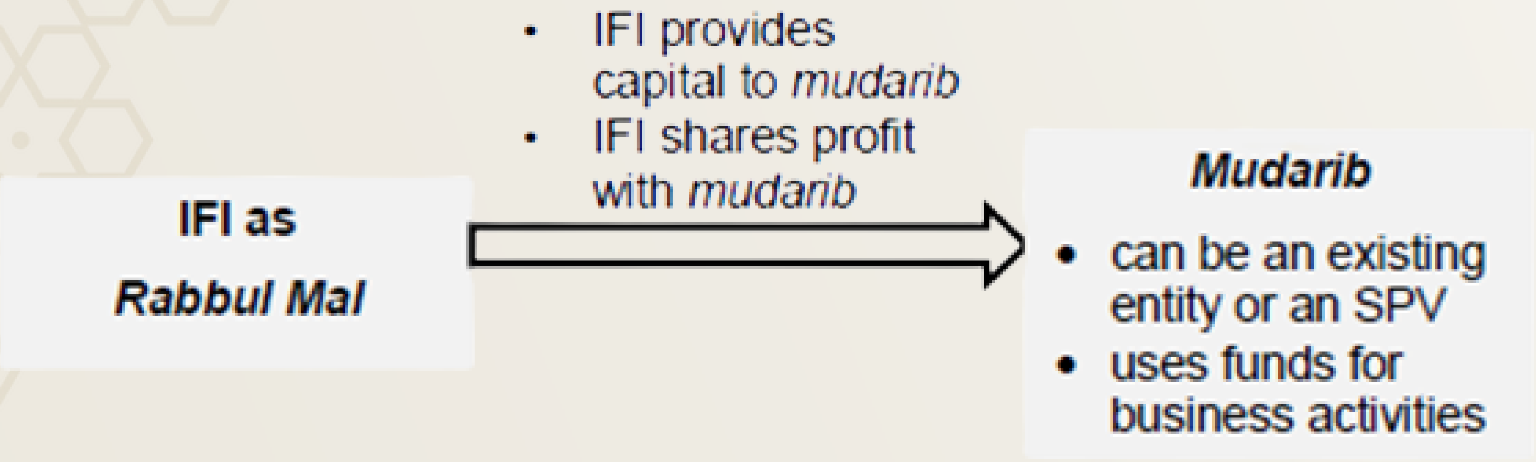
1.Introduction

Key Structures

- Mudarabah: Profit sharing (PSR), losses borne by rabbul mal (unless misconduct by mudarib)

IFI roles:

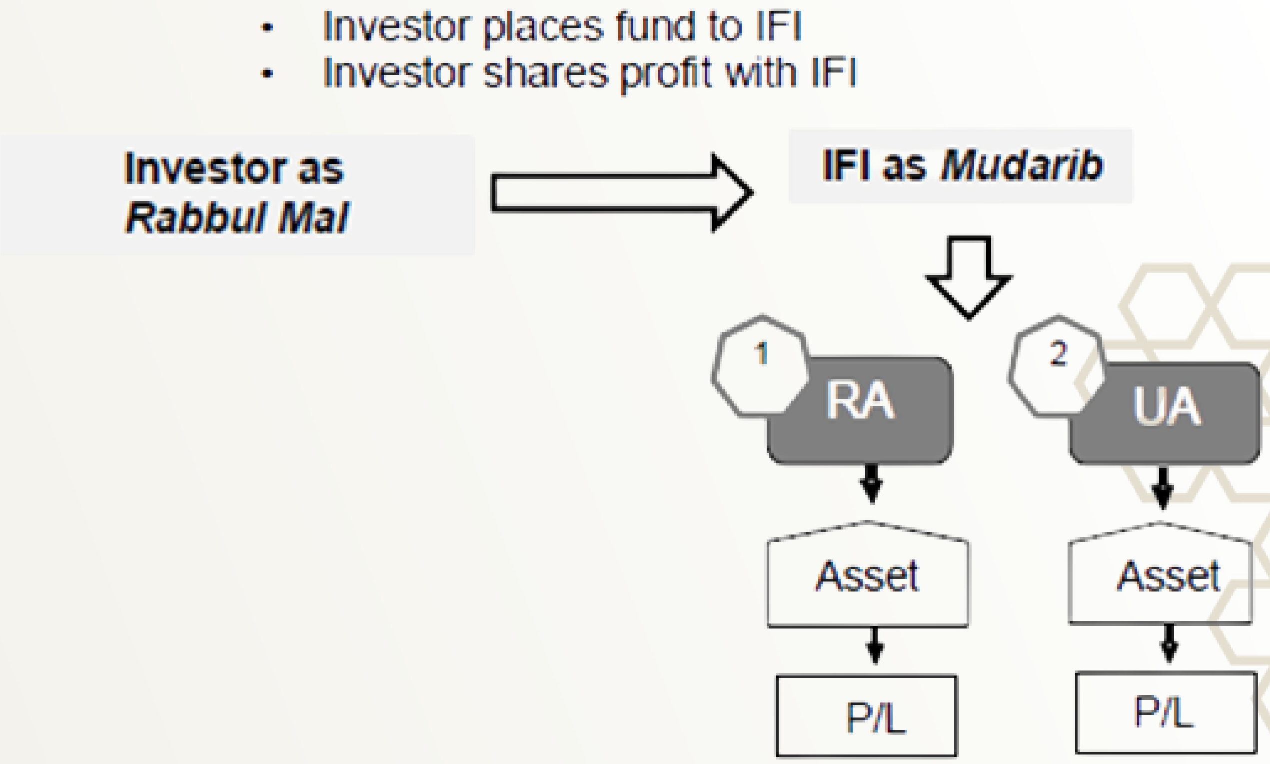
- As Rabbul Mal → provides capital, shares profit



Source: BNM, Mudarabah Policy Document

IFI roles:

- As Mudarib → manages funds on behalf of investors



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.

Source: BNM, Mudarabah Policy Document

2. **Failure Resolution**

Failure Resolution in Islamic Banking: Key Risks in IFIs

Shariah non-compliance risk

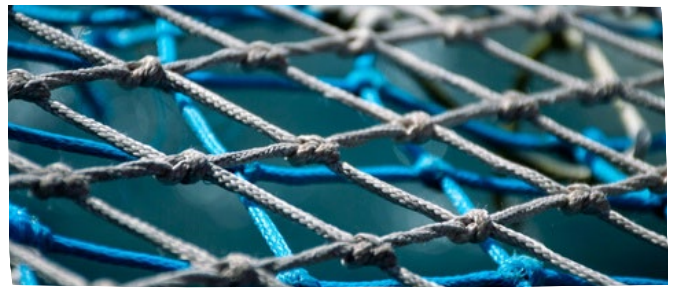
Legal, reputational, and financial impact

Equity risk

Losses from mudarabah/musharakah if ventures fail

Liquidity constraints

Limited Shariah-compliant liquidity tools (sukuk, wakalah, commodity murabahah)



Limited Shariah-Compliant Safety Nets

Limited of Shariah-compliant approach for deposit insurance & lender of last resort (SLOLR)

Implications for Investment Accounts (IA)

IA Features:

- No capital guarantee; losses borne by IAH unless due to bank negligence/misconduct
- Not covered by Shariah-compliant deposit insurance scheme

Resolution Challenges:

- Transfers/novation require IAH consent to avoid gharar/zulm
- Risk of premature withdrawals ("flight to safety") under low confidence
- Dispute resolution must differentiate market risk vs. negligence/Shariah breach

3. Application Dharar in Islamic Bank Failure Scenario

Islamic Bank Failure/ Insolvency

Dharar Mamnuʿ (Prohibited Harm)

Forms of Ḍarar Mamnuʿ

- Negligence (Taqsir): Failure of duty (e.g., mismanagement in Muḍarabah), breach of Contract (Taʿaddi): Unauthorized actions, concealment, Shariah breach, fraud/Deception: Ghash (fraud), tadlis (misrepresentation), exploitation.
- Prophet (ﷺ): “Whoever deceives us is not one of us.”

Parameter

- **Deliberate or Negligent** – harm arises from taʿaddī (transgression) or taqsir (neglect)
- **Fraud, Deception, Exploitation** – ghash (fraud), tadlis (misrepresentation), ikhtilal (exploitation)
- **Breach of Trust / Contract** – failing obligations in mudarabah, wakalah, etc
- **Unjust or Unlawful** – violates Shariah rights, fairness, or maqasid
- **Violation of Maqasid al-Shariah** – especially hifz al-mal (protection of wealth), hifz al-ʿird (dignity), and social justice

Dharar Maqbul (Permissible Harm)

Sources of Ḍarar Maqbul

- Accepted if harm is unavoidable, lesser than alternative harm, and in public interest.
- Juristic foundation: “Ĩ ŅXƒœĂĚ″Ħ› ƒĔŋUXƒœĂĚ″Ħ” (Greater harm removed by lesser harm).
- Al-Shāṭibī: Shariah tolerates minor harm for higher objectives.

Parameter

- **Unintentional or Unavoidable** – not caused by negligence or deliberate wrongdoing
- **Lesser Harm Prevents Greater Harm** – principle of al-darar al-ashadd yuzal bi al-darar al-akhaff
- **Arises from Legitimate Activity** – e.g., trade, mudarabah, public policy
- **Serves Higher Shariah Objectives** – like protecting wealth, stability, or public interest
- **No Injustice, Fraud, or Misconduct** involved

4. Shariah Concepts of Transferibility

Tanazul Haqq/ Al-Isqat

(relinquishIng/waiving rights)

Application in Islamic Banking:
- Bank may waive rights to profit (partial or full) in IA transfer
- **Partial Profit Release:** Bank keeps reduced profit, shares liability
- **Full Profit Release:** Bank forfeits all profit but still holds liability unless Mudarabah is terminated

Hawalah

(Transfer of debt or rights from one party to another)

Types:
- Hawalah **Muqayyadah** (Restricted): Payer settles debt using funds/assets of the transferor
- Hawalah **Mutlaqah** (Unrestricted): Payer pays from own funds, then reclaims from the transferor

Muḍarib Yuḍarib

(In Mudarabah, the muḍārib (manager) may appoint another muḍārib (sub-manager)

Profit Distribution:
- First: Between rabb al-māl & first muḍārib.
- Then: Remaining profit between first & second muḍārib (if allowed)

Application:
Used in IFIs when capital is invested with third parties

Faskh / Tandid

(termination/dissolution of a Mudarabah IA → liquidate assets & return proceeds to IAHs)

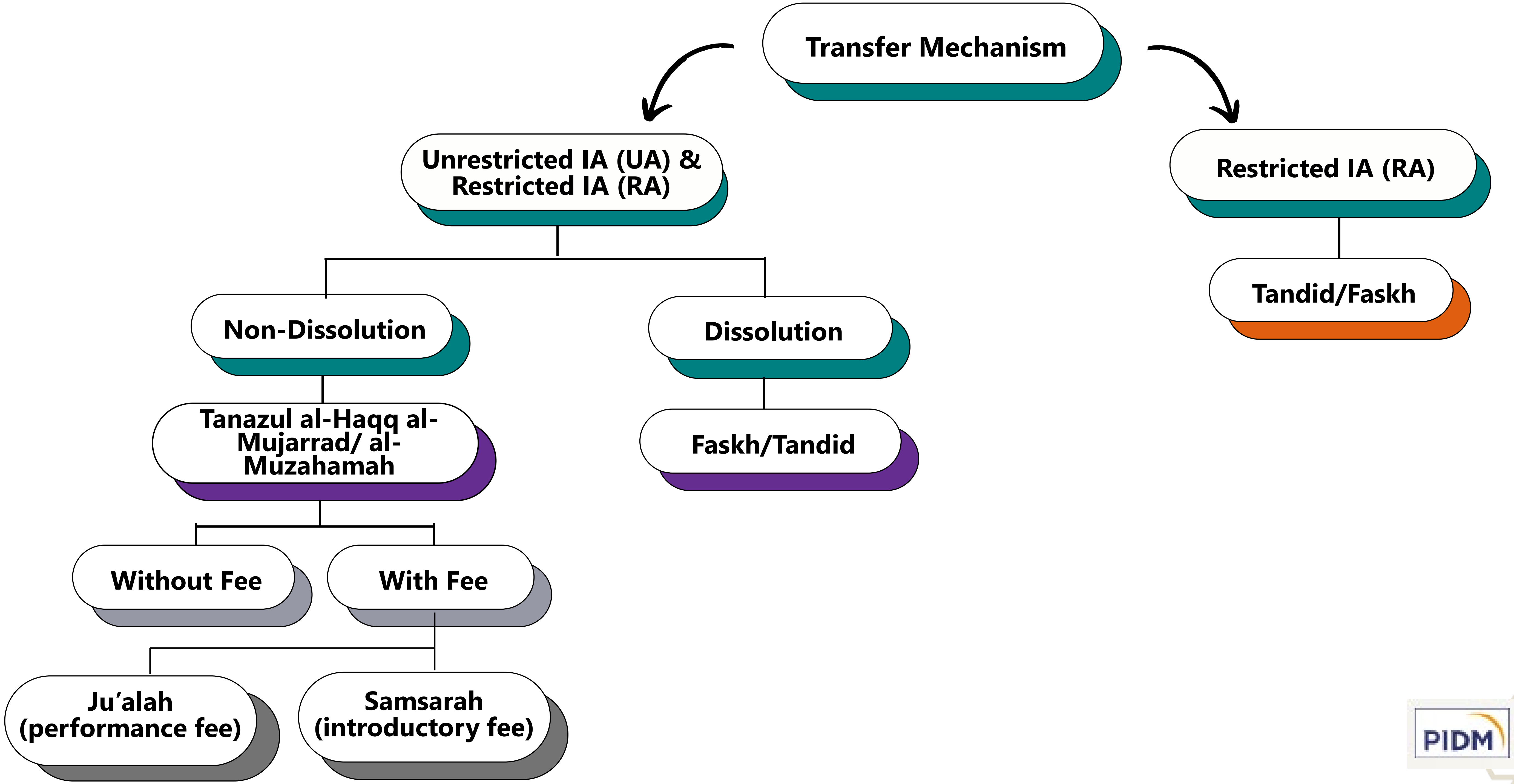
Applied when no viable prospects remain or when customers disagree with bank's strategy

Sale / Bayʿ

Sale of debt (Bayʿ Dayn bi-Sila') in exchange for a commodity → Shariah-compliant debt transfer.

- Use Case: Suitable for transferring Restricted Accounts (RA) linked to specific projects or financing portfolios
- Example: Bank A sells receivable (100m financing to client X) to RA fund using bayʿ dayn bi-sila'

5. Transfer Mechanism for Unrestricted Investment Account (UA) & Restricted Investment Account (RA)



6.Scenario of Failure Resolution (Going & Gone Concern)

Scenario

Going Concern

Failing Bank

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Seamless Sale or Transfer of Operations

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Outcomes:

- Essential services continue
- Depositors protected
- Confidence in the financial system is maintained

Gone Concern

Failing Bank

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Orderly Closure / Liquidation of Institution

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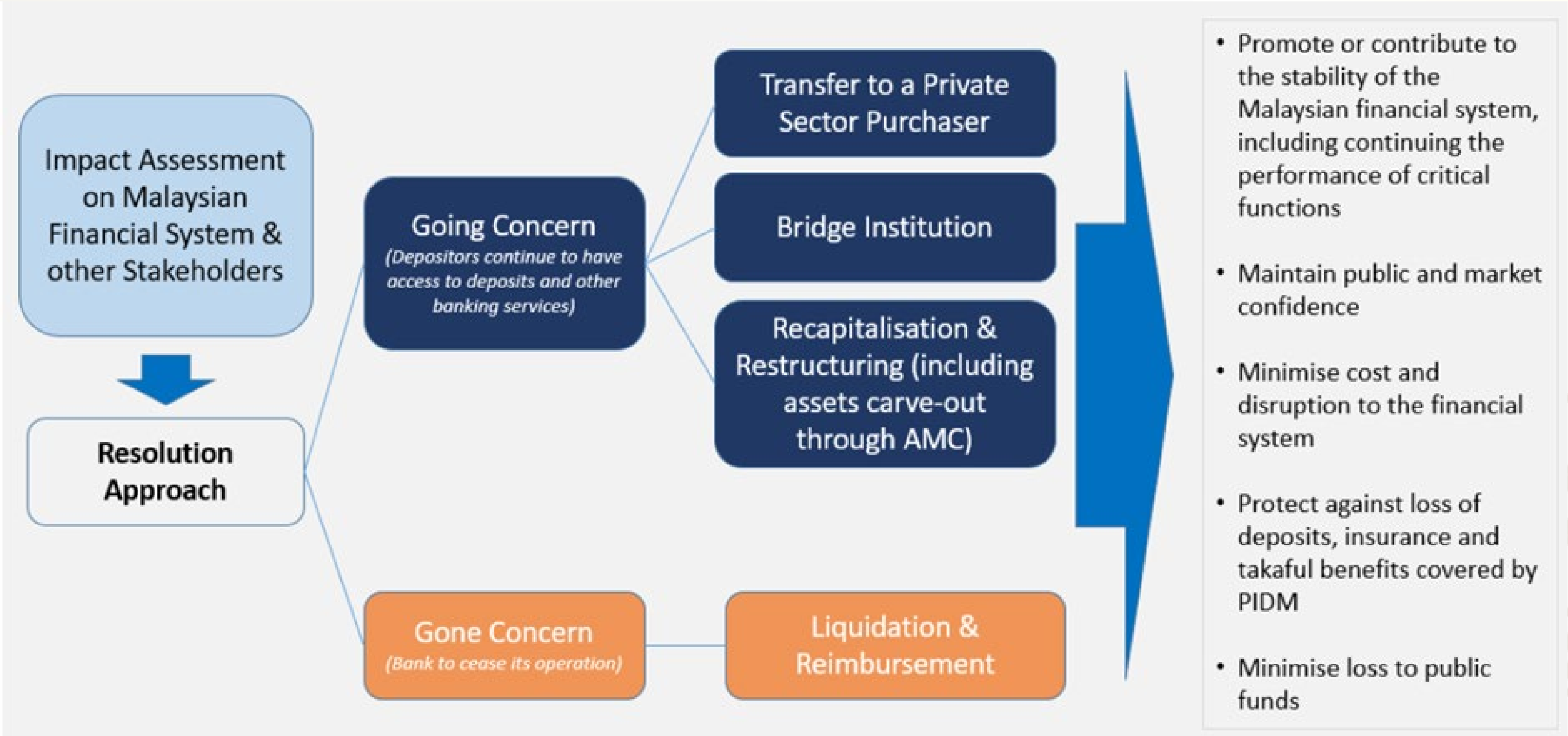
Outcomes:

- Insured depositors compensated promptly
- Creditors repaid according to priority
- Systemic risks contained
- Financial stability maintained



Source: Source: PIDM Website

Two main approaches:

- Going Concern – bank continues operation with restructuring/recapitalization.
- Gone Concern – bank fails, enters insolvency, and is wound down.

7. Failure Resolution Mechanism Going Concern

Going Concern Scenario

Distressed but Still Operational

In a Going Concern resolution, the Islamic bank is troubled but continues to operate

Voluntary Restructuring / Merger / Outsourcing

Instead of closing, the bank stabilizes itself through restructuring, a merger, or outsourcing

Mudarabah or Wakalah Contracts Continue

Existing contracts remain valid, and the bank continues as muḍārib or wakīl for investors

Fiduciary Duties Remain

The bank must manage funds well, report clearly, and cannot transfer its role without investor consent, as AAOIFI states fiduciary duties cannot be suspended without valid justification

8. Failure Resolution Mechanism Gone Concern

Gone Concern Scenario

Failed / Insolvent Bank

In a Gone Concern resolution, the Islamic bank has failed or become insolvent and can no longer operate

Orderly Liquidation or Transfer of Investment Accounts

The bank is either liquidated or its investment accounts are transferred to another bank

New Contracts Required with Acquiring Bank

The acquiring bank cannot automatically act as muḍārib or wakīl; new contracts must be signed with investor consent.

Fiduciary Duties Persist

The failed bank remains responsible for past actions, disclosures, and misconduct unless legally discharged, in line with AAOIFI standards to protect wealth (ḥifẓ al-māl) and preserve trust

9. Shariah Issues

Ownership & Liability in Mudarabah

CORE CONCERN IN IA TRANSFER

- Does transfer only shift rights (huquq) or also liabilities (dhimmah)?
- Relevant for Mudarabah (profit-sharing) & Wakalah (agency) contracts.

KEY SHARIAH PRINCIPLE

- Rights (e.g., profit) can be waived (tanazul).
- Obligations (fiduciary duties) cannot be waived without mutual consent.

IMPLICATIONS IN BANK RESOLUTION

- Failed bank may waive profit entitlement but remains liable for past mismanagement.
- Supported by AAOIFI Shariah Standards No. 13 (Mudarabah) & classical fiqh.

CLASSICAL JURISTIC VIEW

- Mudarib = amīn (trustee), not liable unless:
  - Taʿaddī – Misconduct
  - Taqsir – Negligence
  - Mukhalafah li al-shuruṭ – Breach of terms
- Termination possible by notice, incapacity, or mutual agreement — but fiduciary duty remains until valid termination.

9. Shariah Issues

Transfer of Rights & Obligations of Investment Account

SHARIAH REQUIREMENT

- Mudarabah & Wakalah contracts are personal → change of counterparty needs explicit or constructive investor consent (rabb al-mal).
- Supported by AAOIFI Standard No. 13 (mudarabah) : Replacement of mudarib/wakil requires investor permission.

TRIPARTITE ARRANGEMENT NEEDED

Transfer of rights/ obligations of IA between tripartites:

- Transferring bank
- Acquiring bank
- Investors

Ensures Shariah compliance & contractual clarity.

ONGOING OBLIGATIONS OF FAILED BANK

- Liability for past mismanagement.
- Disclosure of investment results.
- Restitution if necessary.

AAOIFI STANDARD (FAS 27)

- Even if unrestricted IAs are off-balance sheet, they carry operational & fiduciary responsibilities with potential legal consequences for breach.

10. Proposed Mechanism for Gone & Going Concern

Consent

In Shariah, investor consent is **required** for any transfer of investment accounts, and a muḍārib cannot be replaced without their approval since the funds are a trust (amānah).

This requirement is based on the principles of riḍā (mutual satisfaction) and ikhtiyār (free choice), as the Qur'an commands trade only by mutual consent (al-Nisā' 4:29), and the Prophet ﷺ said that taking another's property without consent is unlawful.

PROPOSED MECHANISM	GOING CONCERN	GONE CONCERN
Tanāzul ʿan al-ḥaqq al-mujarrad bi ʿiwaḍ *(Transfer of non-possessory rights with consideration)*	✓	✗
Tanāzul ʿan al-ḥaqq al-muzāḥamah *(Waiver of a competitive right)*	✓	✗
Substitution of ʿĀmil *(Worker or Agent)*	✓	✗
Tandid/Faskh	✗	✓
Regulatory Intervention	✗	✓

Proposed Fee (Ujrah)

A service-based fee (ujrah) may be charged for transferring IAs if investors consent and services are provided (e.g., onboarding, due diligence, communication, legal, account migration).

Conditions:

- Justified: Fee must reflect real administrative and operational work.
- Transparent: Must be disclosed clearly with investor's written consent.
- Oversight: Requires approval from Shariah Supervisory Board and regulators.
- Fair & Proportionate: Flexible/tiered model to avoid unfair burden.
  - 1%–2% for high-value accounts (RM500k / USD100k+)
  - Up to 3% for lower-value accounts

Thank you