Muzakarah on Failure Resolution of Islamic Financial Institutions

Session 1

Transferability of Investment Accounts

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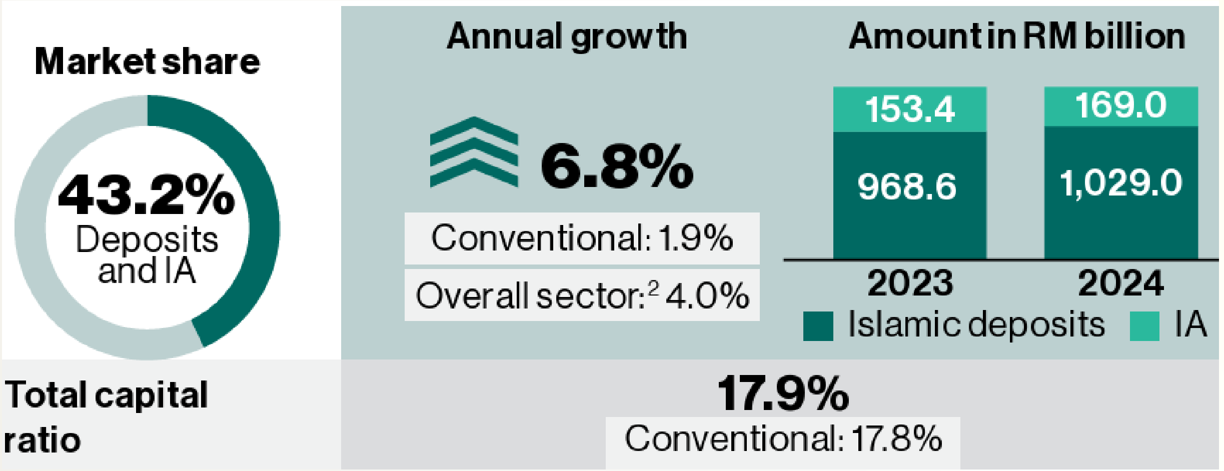
CONTENT

INTRODUCTION

INTRODUCTION

- An Investment Account (IA), which is 'defined by the application of Shariah contracts with **non–principal guarantee** feature for the purpose of investment', forms part of an Islamic bank's liabilities, complementing Islamic deposits.



Source: Annual report BNM 2024

- In Malaysia, IA have become an important part of the Islamic banking landscape. As of **June 2025**, these accounts reached a total value of **RM180.42 mil**, showing strong demand and confidence in Shariah–compliant investment options. Islamic banks typically offer IA products under two main structures, namely ***mudarabah*** (profit sharing) and ***wakalah*** (agency).

INTRODUCTION

LITERATURE REVIEW

- Transferring IA portfolios in Islamic banks is challenging due to strict Shariah requirements and complexities of Islamic financial contracts
- No research specifically addresses IA transfers
- Previous studies focus on Shariah concepts on *mudarabah* and *wakalah;* and suggest hawalah as possible method to facilitate transfers
- These studies can serve as useful references for IA structuring

CASE STUDIES

- Most observed cases involve transfer of the bank's asset portfolio to a new entity, transfer of the IA portfolio together with other assets and liabilities (a "stock and barrel" approach), especially in resolution contexts.
- In theory, IA could be transferred as a standalone portfolio, but in practice, no such standalone transfers of IA to a new entity have taken place.

INTRODUCTION

Research Objective

1. Assess the current features of IA products and possible transferability to an acquiring Islamic bank
2. Identify Shariah considerations that justify the transferability;
3. Examine the potential Shariah issues pertaining to the transfer and to provide PIDM with the relevant solutions to overcome the issues;
4. identify and propose Shariah–compliant mechanisms to transfer the IA portfolio to an acquiring Islamic bank;

INVESTMENT ACCOUNT: APPLICATION AND STRUCTURE

TYPES OF INVESTMENT ACCOUNT

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Unrestricted Investment Account (URIA)

- The IAH rely on the Islamic bank's expertise to determine a broad investment mandate, and the Islamic bank holds full discretion in investing the funds received from the IAH.
- URIA funds are not linked to specific assets and are instead invested on a general mandate basis.
- This allows the bank much wider discretion to manage the funds in a diversified pool without having to match them to particular financing assets.
- URIA are reported by Islamic banks as an on-balance sheet item.

Restricted Investment Account (RIA)

- The IAH stipulate certain restrictions on when, where, or how the bank can invest the funds, and the Islamic bank invests the funds according to the investment mandate set by the IAH.
- The investments must be clearly tagged to identified assets, and any attempt to transfer the portfolio would need the bank to ensure that the same asset or investment conditions can be maintained.
- In most cases, it would require fresh consent from the IAH, particularly if the original asset is no longer available or cannot be managed in the same manner.
- RIA are reported by Islamic banks as an off-balance sheet item.

STRUCTURE OF AN INVESTMENT ACCOUNT

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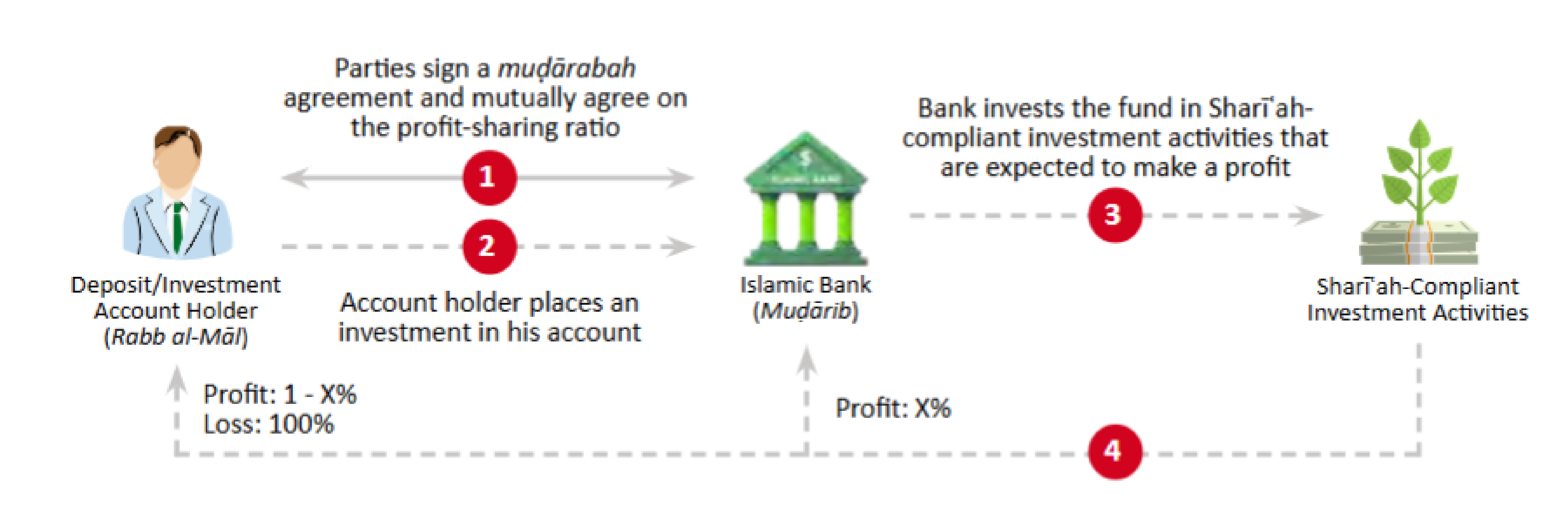
Mudarabah



Source: Islamic Financial System, 2023

STRUCTURE OF AN INVESTMENT ACCOUNT

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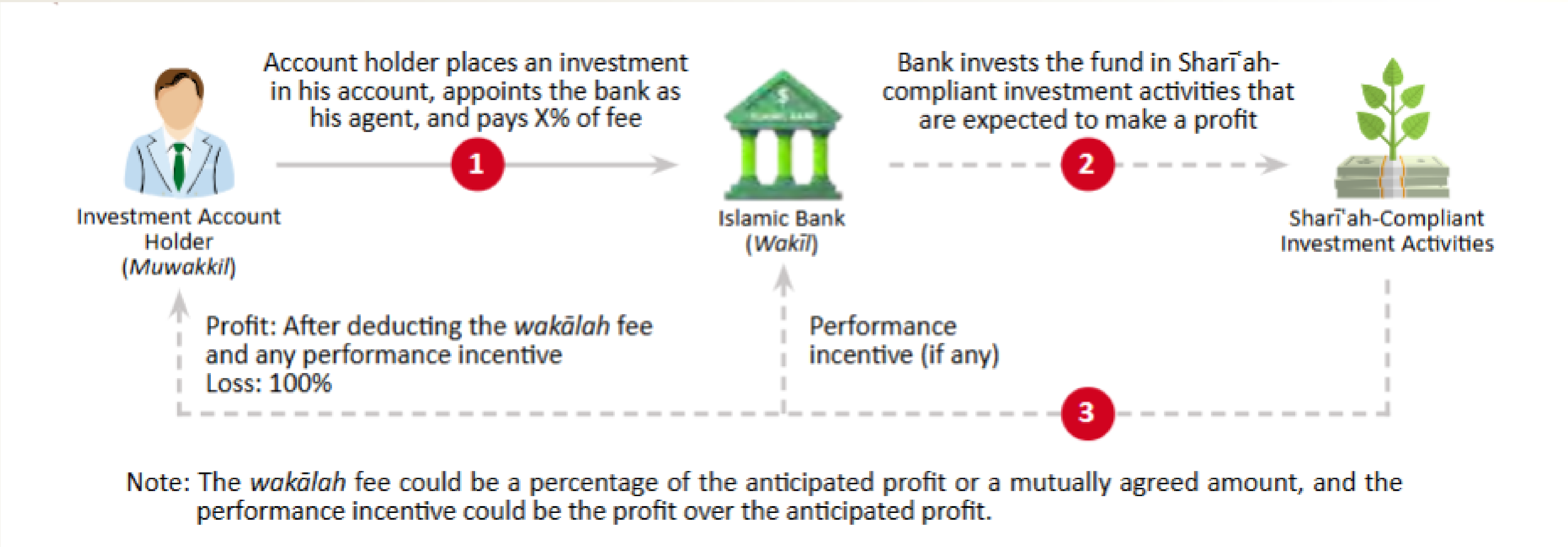
Wakalah



Source: Islamic Financial System, 2023

KEY TAKEAWAYS FROM SURVEY

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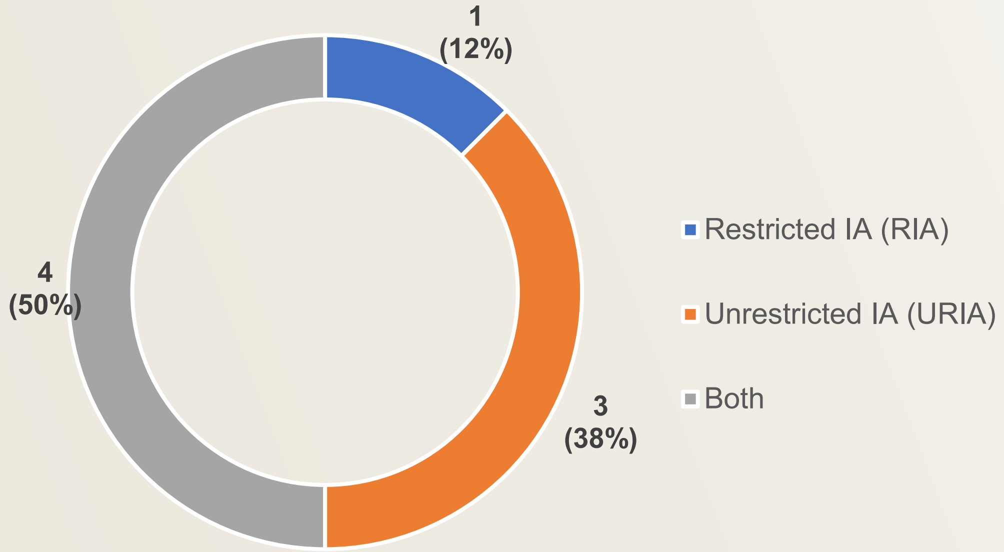
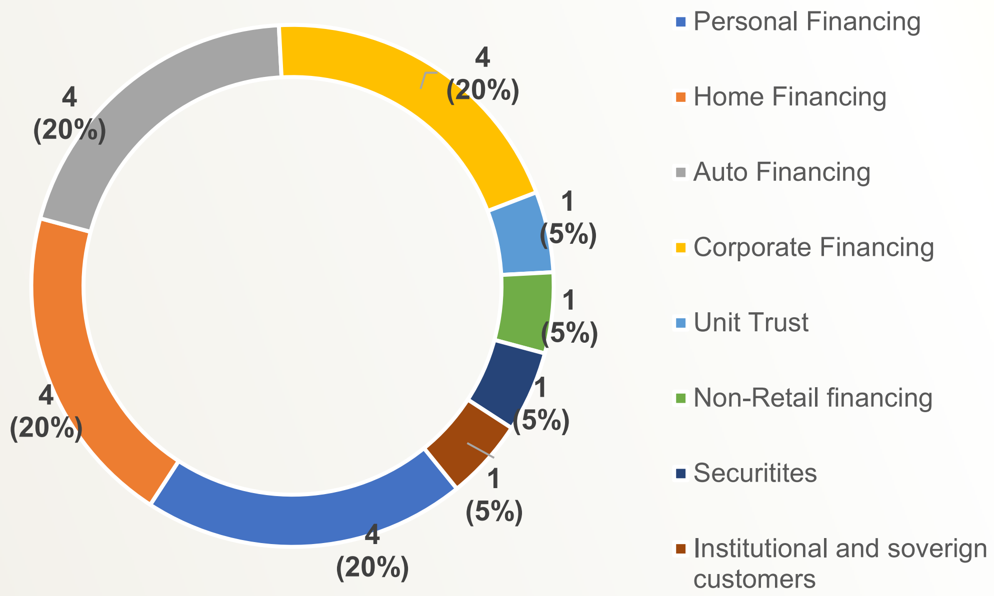
1. A total of **16 responses** (covering 19 questions) were received from the Islamic banks.
2. IA is not offered by every bank - While IA is a recognised and regulated product, **not all Islamic banks have offered the product.**
3. Legal agreements cover misconduct, but not everything - Most banks have robust legal agreements that clearly define the consequences of breach of contract, misconduct or negligence by the bank in its role as mudarib or wakil. However, there are still some grey areas in the legal agreements that may **need to be improved and addressed,** especially as to what happens if the bank fails or if the IA portfolio is transferred to another institution.
4. Deemed consent is the preferred approach - In cases where changes are made to IA structures, most banks adopt a **deemed consent with an opt–out option**, allowing customers to be informed and given the choice to object.
5. Most banks structure their IA products using the mudarabah contract, with some also using wakalah. Although musharakah is cited as a potential structure in the IA PD, none of the banks reported using it in practice.

KEY TAKEAWAYS FROM SURVEY

Types of investment accounts offered by Islamic banks



Types of bank-managed assets funded by investment accounts



CLASSIFICATION OF INVESTMENT ACCOUNT

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Accounting Perspective

Islamic banks currently report investment accounts as financial liabilities under MFRS 132 because they ensure that the full principal will be repaid to investment account holders.

Investment accounts can meet the definition of financial liability, which is defined in paragraph 11 of MFRS 132 Financial Instruments: Presentation as "any liability that is –

(a) a contractual obligation

- i. to deliver cash or another financial asset to another entity; or
- ii. ii. to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or

(b) a contract that will or may be settled in the entity's own equity instruments"

Shariah Perspective

In financial contracts, the *wakil* and *mudarib* carry an *iltizam* (contractual obligation) to perform their duties, particularly in investing the funds entrusted to them. Iltizam refers to a self-imposed commitment that was not originally binding but becomes obligatory once the contract is concluded. It differs from *dhaman* and *zimmah*.

CONSIDERATIONS IN THE TRANSFER OF INVESTMENT ACCOUNTS PORTFOLIO

KEY CONSIDERATION

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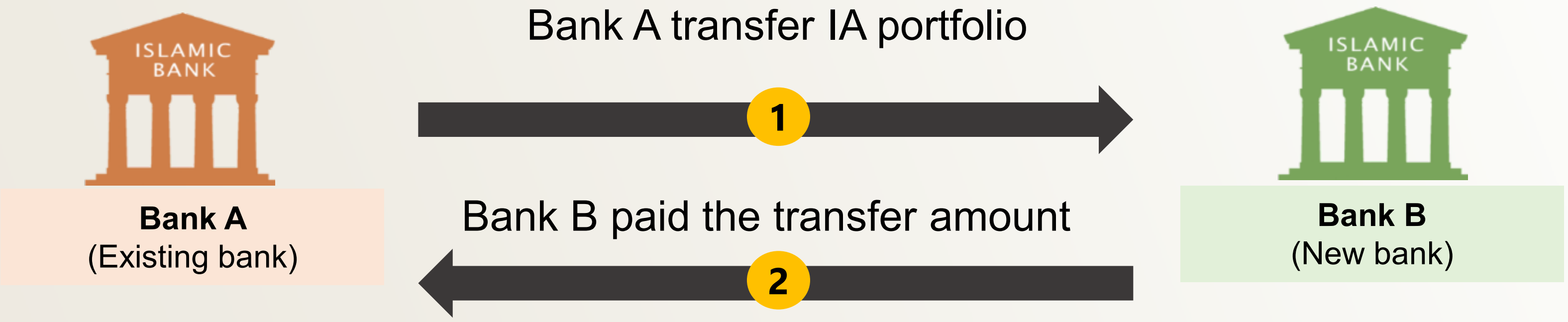
- Each of these areas will have different implications for the transfer process and play a key role in identifying which Shariah contract should be adopted for the specific circumstances.



EXISTING IA PRODUCT

Types - URIA or RIA
Performance Outcomes - Profit, partial loss, or total loss
Contract Status - Existing *mudarabah* or *wakalah* contracts terminated or not?

DURING TRANSFER PROCESS

Enabler - With or without vesting order
Transfer type - Full transfer or partial transfer
Customer Consent - For substitution of wakil/mudarib via deemed consent or pre-consent
Shariah Contract - To be determined as the underlying contract for transfer
IA Contract - Whether to establish a new IA contract or continue under the existing contract

KEY CONSIDERATIONS OF THE EXISTING IA PRODUCT

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01

RA OR URIA

understanding both categories is key when planning for an IA portfolio transfer, as it directly affects the operational complexity, customer's consent (either explicit or implicit), and the type of documentation or restructuring that may be required

02

PERFORMANCE OF THE INVESTMENT

There are generally three possible situations when evaluating the performance of an investment: total loss, partial loss, or profit.

Total Loss: The contract naturally ends, and there is more likely nothing to transfer unless the new institution voluntarily assumes the responsibility of liability.

Partial Loss: The capital is still intact and both parties need to decide whether the contract should be continued or wound down.

Profit: Before any transfer, profits must be calculated and distributed according to the agreed terms

KEY CONSIDERATIONS OF THE EXISTING IA PRODUCT

03

STATUS OF THE CONTRACT

A key question arises as to whether the contract remains valid when the *mudarib* or wakil ceases to be a party to the contract due to the failure of the *mudarib* or *wakil*, transfer, merger, or liquidation.

(a) Bankruptcy of the mudarib or wakil

If a bank is declared non-viable (although not reaching the bankrupt status) by the regulatory authority, the mudarib is deemed to have lost its legal capacity (mahjur 'alayh), which can be analogised to bankruptcy. From the Shariah perspective, the mudarabah contract ends automatically because the mudarib is no longer legally capable of fulfilling its contractual obligations (haqq al-tasarruf).

(b) Demise of the mudarib or wakil

According to the Hanafi, Shafiʿi and Hanbali schools, mudarabah and wakalah contracts are automatically terminated upon the death of the agent (mudarib or wakil). On the other hand, the Maliki school allow the contract to continue through a trustworthy heir, especially when ending it would cause more harm than good. One important point to consider is the Maliki view, which holds that the mudarabah contract is not automatically terminated upon the death of the mudarib. Instead, the responsibilities of the contract may be passed on to a trustworthy heir.

KEY CONSIDERATIONS OF THE EXISTING IA PRODUCT

Mawsuʿah al-Fiqhiyyah al-Kuwaytiyyah clearly elaborates on the issue of demise and its impact on the continuation of the mudarabah contract:

KEY CONSIDERATIONS DURING THE TRANSFER PROCESS

01 EXECUTION OF TRANSFER WITH OR WITHOUT A VESTING ORDER

- Typically and most often, transfers of assets between the transferor and transferee institutions involves two main steps either VO or both parties might decide to go ahead with the transfer based on a mutual agreement without going through the court.

02 CONSENT OF THE INVESTMENT ACCOUNT HOLDER (IAH)

- By default, consent of IAH is needed to transfer the management of the assets/ventures to the new entity.
- If a VO is obtained from the High Court, the transfer is effected by operation of law, and the acquiring institution steps into the role of the transferor **without** needing to obtain consent from each individual IAH.
- If the transfer is carried out without a VO, then the contractual path **requires consent** of the IAH, especially when it involves changes to contractual roles or terms.

KEY CONSIDERATIONS DURING THE TRANSFER PROCESS

03 TRANSFER OF IA PORTFOLIO: STANDALONE OR TOGETHER WITH ASSETS

- When transferring the IA portfolio, it is important to determine whether it is:
    - transferred together with the assets funded by IA (e.g., house or car financing), or
    - transferred on its own.
- Standalone transfers may happen when the original assets have already been liquidated and the proceeds credited back to the IAH.

04 SHARIAH CONTRACT THAT WILL BE USED FOR TRANSFER

In principle, it is required for every party involved in the resolution process to execute new contracts, both between a failed bank and a new acquirer and between existing customers and the new acquirer.

05 LEGAL DOCUMENTATION

Legal documentation **needs to be strengthened**, particularly to cover scenarios where an Islamic bank undergoes resolution or transfers its business to another institution. This is essential to safeguard the interests of the IAH while ensuring the process remains Shariah-compliant and aligned with legal requirements

TRANSFER OF IA DURING BAU

PRE–TRANSFER ASSESSMENT OF IA (BAU)

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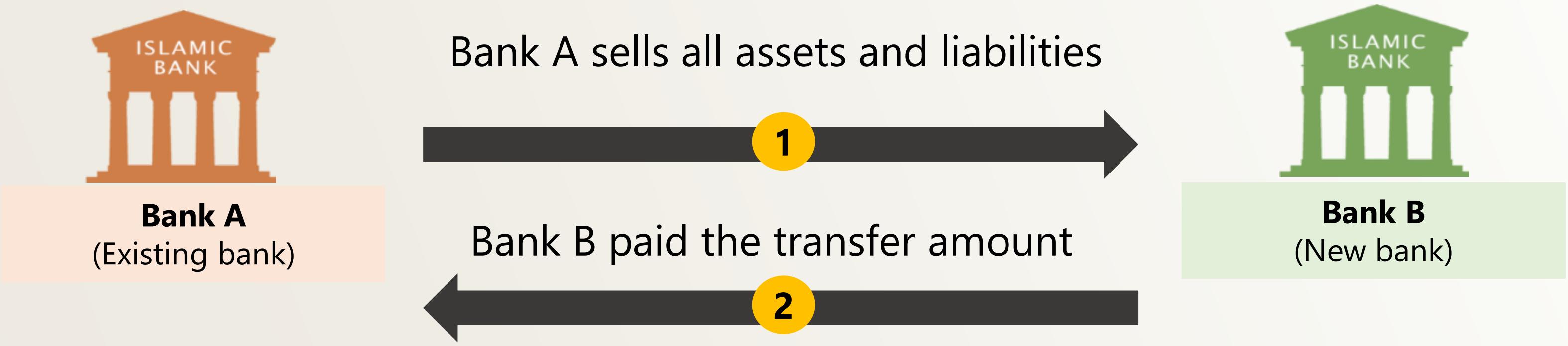
1st Identification	2nd Identification	3rd Identification
RIA or URIA	Termination of existing contract	Customer consent for assigning a new wakil or mudarib
URIA – Since the mandate of investment is broad, the investment can typically continue with the new acquiring institution. RIA – The investment mandate is specifically set by the IAH. Therefore, any transfer to a new institution must ensure the investment objective and scope remain consistent.	OPTION 1: The existing contract is terminated. Therefore, the proceeds (loss or profit) from the sale of the portfolio funded by IA will be transferred to the new entity. OPTION 2: The existing contract continues, with the role of *mudarib/wakil* transferred to the new entity.	OPTION 1: Deemed consent. subject to fair notifications. OPTION 2: Explicit consent from the IAH

TRANSFER MECHANISM FOR BAU

Under BAU, transfers may take the form of either a full transfer or a partial transfer.

FULL TRANSFER



TRANSFER MECHANISM FOR BAU

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.

PROPOSE SOLUTION

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

Scenario	Proposed Shariah Contract	Explanation
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.
	Bay῾ 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 bay῾ al-dayn bi al-sila`, particularly if tangible assets comprise 50% or less of the portfolio.

PROPOSE SOLUTION

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Scenario	Proposed Shariah Contract	Explanation
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.
	Sub-Wakalah	If the IA is based on wakalah, the current bank may appoint the new bank as a sub-agent, with the customer's deemed consent to continue managing the investment.
	Two tier Mudarabah	If the IA is structured under mudarabah, the new bank may act as a sub-mudarib, provided the original IAH has given permission through the deemed consent approach.

SHARIAH JUSTIFICATION

Option 1: Outright Sale

Shariah Justification

AAOIFI Shari'ah Standard No. 59 (sale of debt) states that it is **permitted** to sell such an entity or its share of (the debt) without considering the provisions of the sale of debt.

8/1 If the debt is part of the assets of an entity that is in existence and has ongoing permissible activities, whether these activities are commercial, financial, industrial, related to real estate, services, agricultural, import-export, sale and purchase of commodities, and the like,

then: it is permitted to sell such an entity or its share (of the debt) without considering the provisions of the sale of debt in regard to (the portion) of the debts out of its assets whatever would be the ratio of debts, as long as such debts are generated from the turnover (of business). That is because such debts are ancillary to the activity (of the entity).

SHARIAH JUSTIFICATION

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8/2 If the assets of the Institution include debts, tangible assets, usufructs and rights, and out such assets, the Institution recognised entity wherein **commingling of assets (*khulta*)** is materialised (e.g., a special purpose company or an investment portfolio that is registered with the relevant authorities), and assets of the Institutions are not turned over on an ongoing basis,

then: the Institution may sell or securitise such an entity (entirely or a common share out of it) or issue sukuk thereof, subject to the following rule:

8/2/1 The sale shall result in (its respective) Shariah effects, including transfer of ownership and risk to the buyer, as the buyer shall bear the risks (associated with) the asset. It is not permitted to stipulate that such risk will be borne by the seller at any stage of the process.

SHARIAH JUSTIFICATION

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Option 2: Bai al-Dayn bi al-Sila`

Shariah Justification

AAOIFI Shariah Standard No. 59 (Sale of Debt), Para 4 allows a sale of debt for cash to the debtor on a spot basis subject to the following conditions:

(i) The sale should not lead to riba.
(ii) The sale should not be a stratagem for riba.
(iii) The sale should not lead to establishing a new debt with an increased amount upon the existing debt.

SAC of SC agreed to accept bay` al-dayn. SAC BNM also permits buying a debt certificate in the secondary market using the bay` al-dayn with a condition that the debt must be in existence or known before it can be traded (dayn mustaqir) as per the condition set by the Shafi`i jurists.

SHARIAH JUSTIFICATION

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Option 3: Tahwil

Shariah Justification

- Based on the general Shariah concept of *tahwil* (transfer of obligation or right).
- The term *tahwil* تحويل is broader in scope than the classical *fiqhi* concept of *hawalah*. While *hawalah* is specifically defined by jurists as the transfer of a debt from one party's liability to another (*naql al-dayn min dhimmah ila dhimmah*), the linguistic meaning of *tahwil* encompasses a wider range of applications, including transfer, transformation, and substitution.
- This indicates that *tahwil* can be applied beyond debts to include the transfer of rights, obligations, positions, or contractual roles. For example, the transfer of an IA relationship from one Islamic financial institution to another does not constitute a debt, but rather involves the reassignment of fiduciary and contractual responsibilities.
- Recognising *tahwil* as a distinct Shariah contract allows for greater flexibility in structuring modern financial transactions while remaining within the bounds of Islamic legal principles.

SHARIAH JUSTIFICATION

Option 4: Bai al-Haq

Shariah Justification

The concept of *al-haq* (right) in Islamic jurisprudence refers to a recognised interest or entitlement attached to a person over an object, service, or benefit.

In the paper *Bayʿ al-Huquq al-Mujarradah* written by Sheikh Taqi Usmani, based on his analysis and discussion on rights, the following are the conditions for *haq*:

1. The right should be established immediately, not expected in the future.
2. The right should be firmly established for its owner by origin, not just to avoid harm.
3. The right should be transferable from one person to another.
4. The right should be clearly defined and not involve uncertainty or ignorance.
5. The right, according to the custom of traders, should not be treated in the same manner as tangible assets and wealth in their circulation.

SHARIAH JUSTIFICATION

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Option 4: Bai al-Haq

- In the context of the *mudarabah* contract, classical jurists affirm that the *mudarib* holds the right of tasarruf over the capital entrusted to him.
- As explicitly stated in texts such as al-radd al-mukhtar ( ) and *al-ʿinayah sharh al-hidayah* ( ), the right of management and investment resides with the *mudarib* as part of the contractual framework.
- This juristic recognition of *haqq tasarruf* supports the broader principle that certain rights, when linked to financial interests or contractual obligations, are considered actionable and transferable.
- The Majma‘ al-Fiqh al-Islami, in its Resolution No. 63 (1/7), explicitly permits the transfer of certain rights that possess financial value and are customarily regarded as wealth. The resolution states:

SHARIAH JUSTIFICATION

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Option 5: Sub-Wakalah

Shariah Justification

The concept of sub–*wakalah* refers to the delegation of agency authority by a *wakil* (agent) to another person, known as a *wakil thani* (sub–agent). This occurs when the original agent, having been granted the authority to act on behalf of the principal (*muwakkil*), further appoints another party to carry out part or all of the assigned responsibilities. The permissibility of sub–*wakalah* is affirmed by the majority of jurists, provided that the original contract of *wakalah* either explicitly permits delegation, or the nature of the task and established custom (*ʿurf*) imply its acceptability.

As stated in PD *Wakalah*:

14.7 The principal may consent to – (a) the agent appointing another agent on the principal's behalf; or (b) the agent appointing another agent (sub–agent) for himself (initial agent) to perform all or any part of the task.

4.8 The agent shall not appoint a second agent or delegate his role to a sub–agent except with the consent of the principal.

SHARIAH JUSTIFICATION

Option 6: Two tier *mudarabah*

Shariah Justification

- From a Shariah standpoint, this arrangement is generally permissible, but it must meet specific conditions.
- Classical jurists are clear that the *mudarib* is not inherently allowed to assign the capital to another *mudarib* without permission from the original *rabb al-mal*.
- This is because the *mudarabah* contract is based on trust and personal agency.
- The principal (*rabb al-mal*) appointed the *mudarib* due to confidence in that specific person or institution.
- Transferring that responsibility to a third party without consent could violate the underlying terms of trust.

The jurists unanimously agreed that the mudarib may not hand over the capital to another as a mudarabah except with the permission of the capital owner

CONCLUSION

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Conclusion

- From a classification perspective, although MFRS categorises IA as liabilities, from a Shariah standpoint the wakil and mudarib carry an *iltizam* (contractual obligation) to perform their duties, particularly in investing the funds entrusted to them.
- Before the transfer process takes place, several aspects need to be emphasised: Status of the existing IA contract and transfer process.
- For the transfer of an IA portfolio as a standalone, the Shariah contracts that can be explored are *tahwil* and *bayʿ al-haq*. In the case of a full or partial transfer, the portfolio may be transferred via *bayʿ* or *bayʿ al-dayn bi al-silaʿ*.