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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Agenda

1. Introduction
2. Failure Resolution
3. Application of Dharar in Islamic Bank Failure
4. Shariah Concepts of Transferibility
5. Transfer Mechanism for UA and RA
6. Scenario for Failure Resolution (Gone & Going Concern)
7. Failure Resolution Mechanism Going Concern
8. Failure Resolution Mechanism Gone Concern
9. Shariah Issues
10. Proposed Mechanism for Gone & Going Concern

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1.Introduction

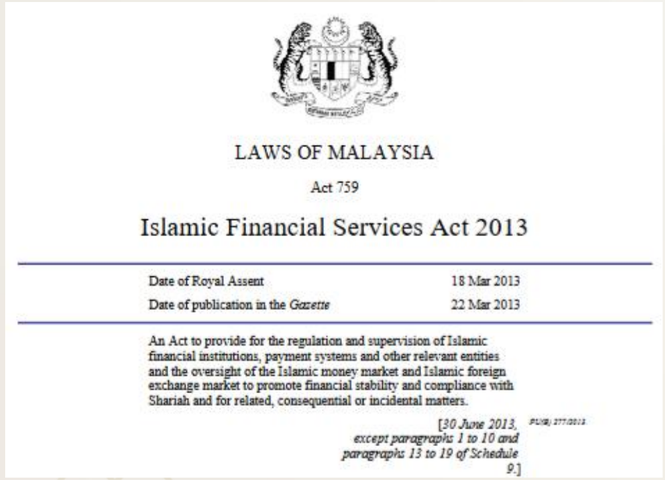
- Introduction of IFSA provides a milestone in definition and treatment for investment accounts (IA) differing from deposits by using Shariah contracts with risk-sharing and no guaranteed returns.

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)

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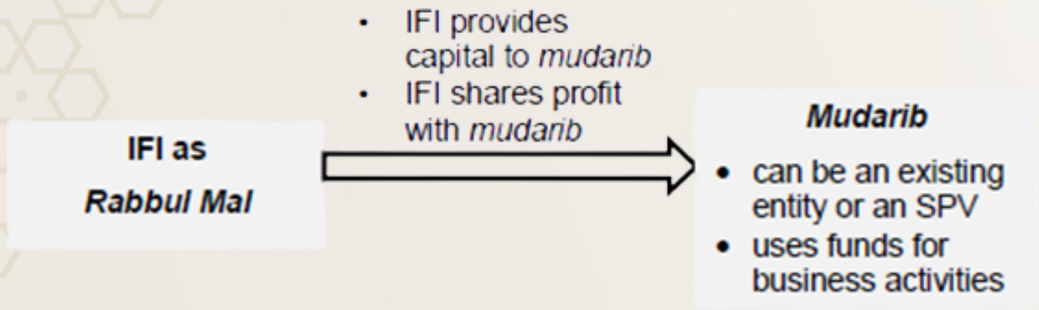
1.Introduction

Key Structures

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

IFI roles:

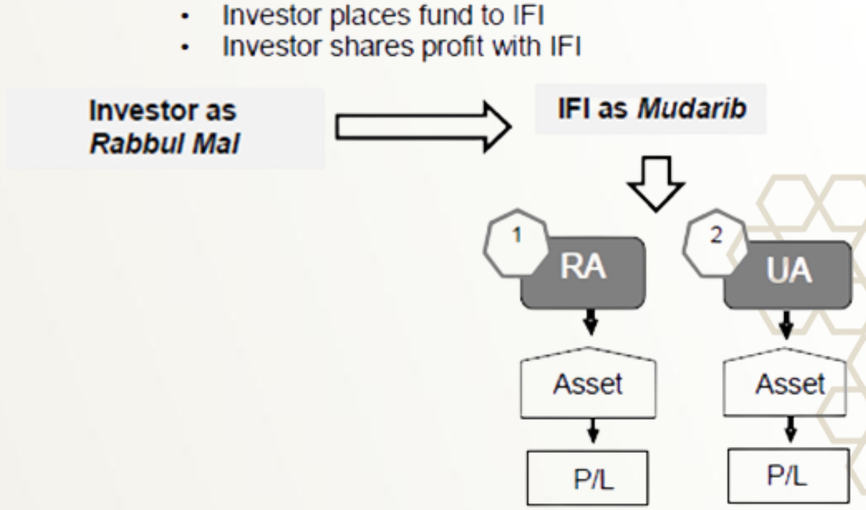
- As Rabbul Mal → provides capital, shares profit



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

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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

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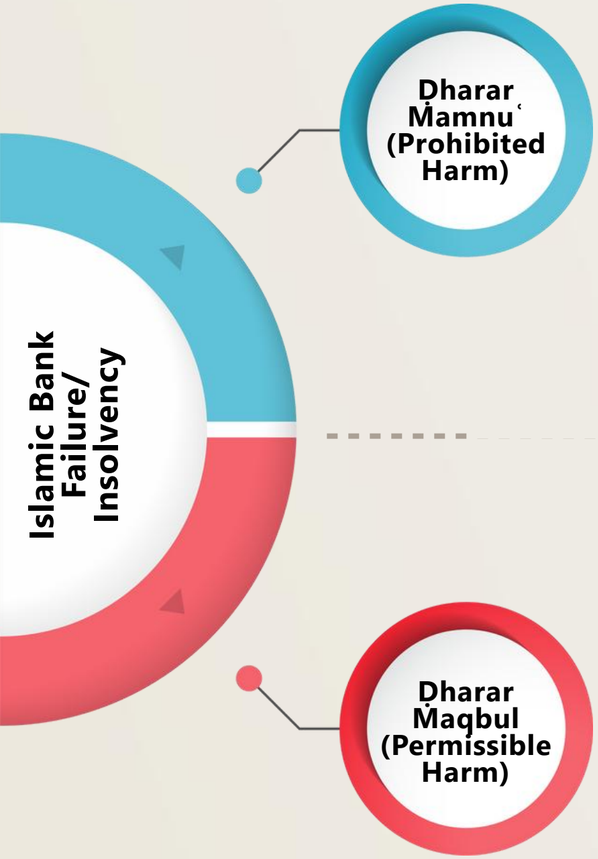
3. Application Dharar in Islamic Bank Failure Scenario



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

Sources of Ḍarar Maqbul

- Accepted if harm is unavoidable, lesser than alternative harm, and in public interest.
- Juristic foundation: "الضَّرَر الأشد يُزال بالضَّرَر الأخف" (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

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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 muḍarib.
- 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)

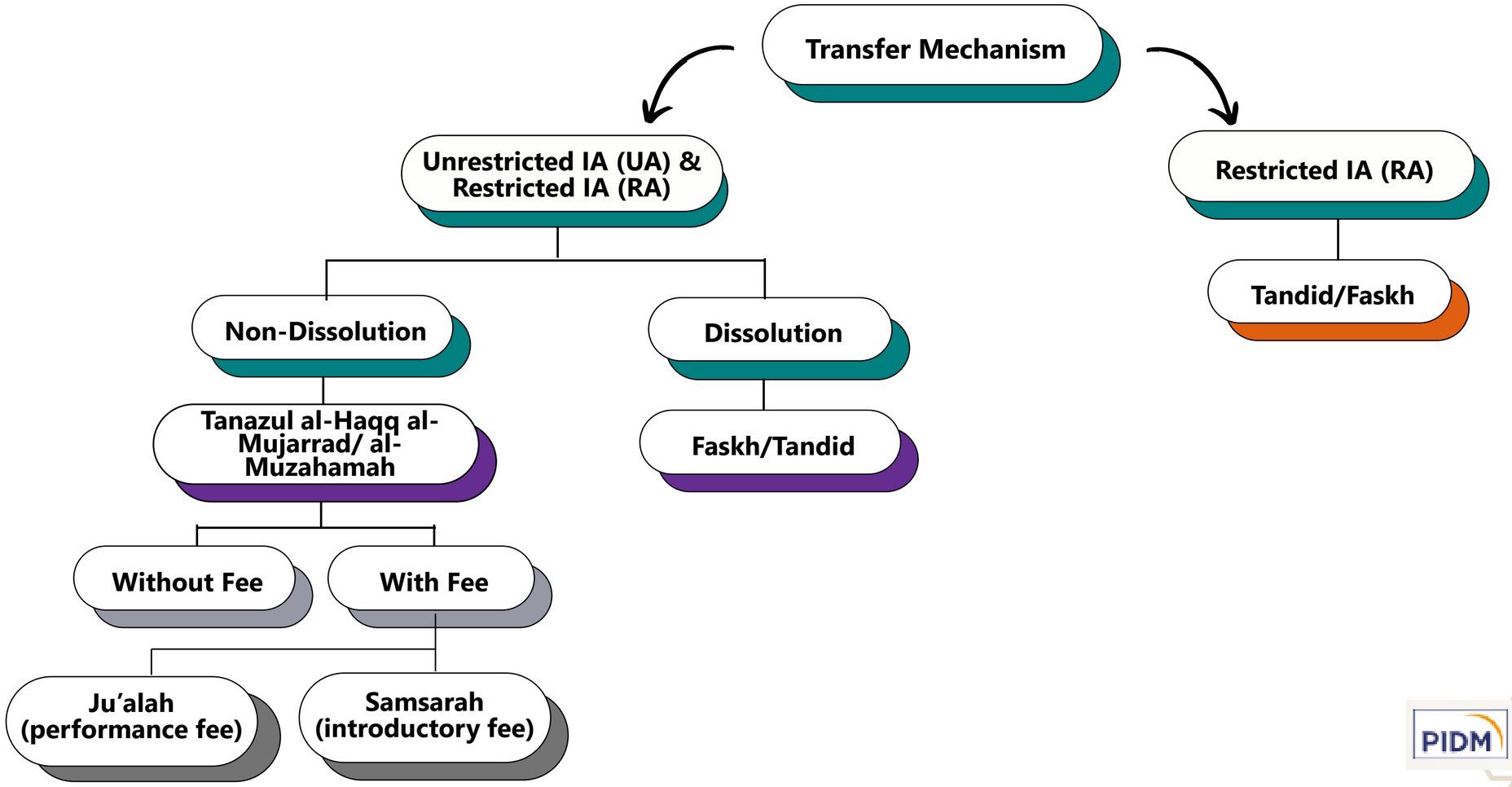
Applied when no viable prospects remain or when customers disagree with bank's strategy

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)



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

Scenario

Going Concern

Failing Bank

↓

Seamless Sale or Transfer of Operations

↓

Outcomes:

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

Gone Concern

Failing Bank

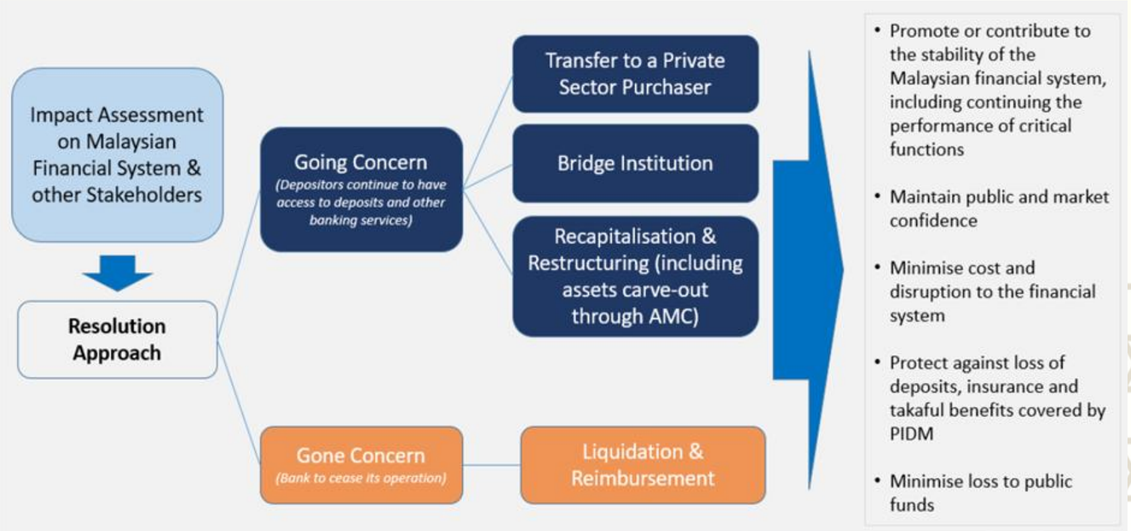
↓

Orderly Closure / Liquidation of Institution

↓

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.

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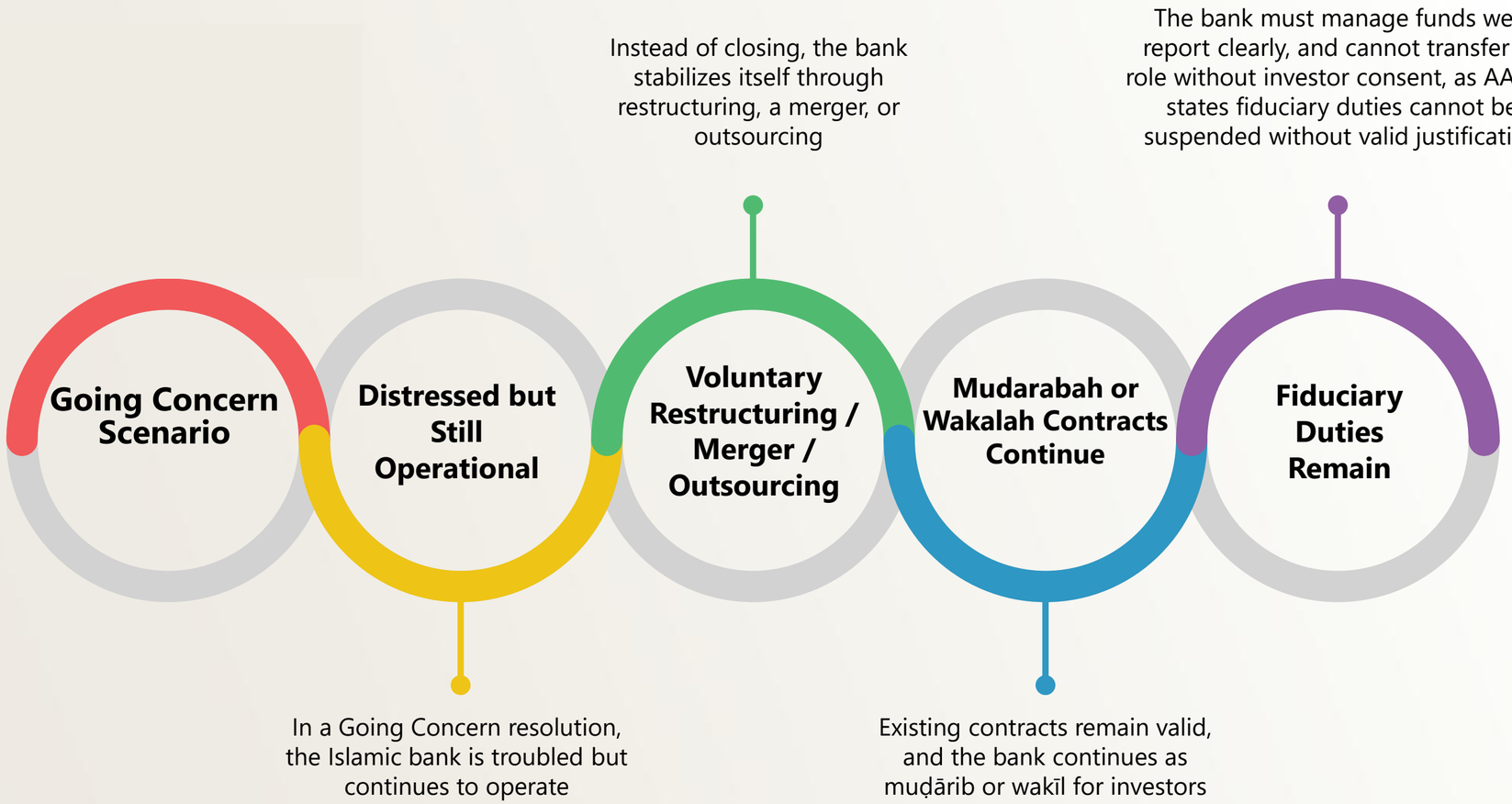
7. Failure Resolution Mechanism Going Concern



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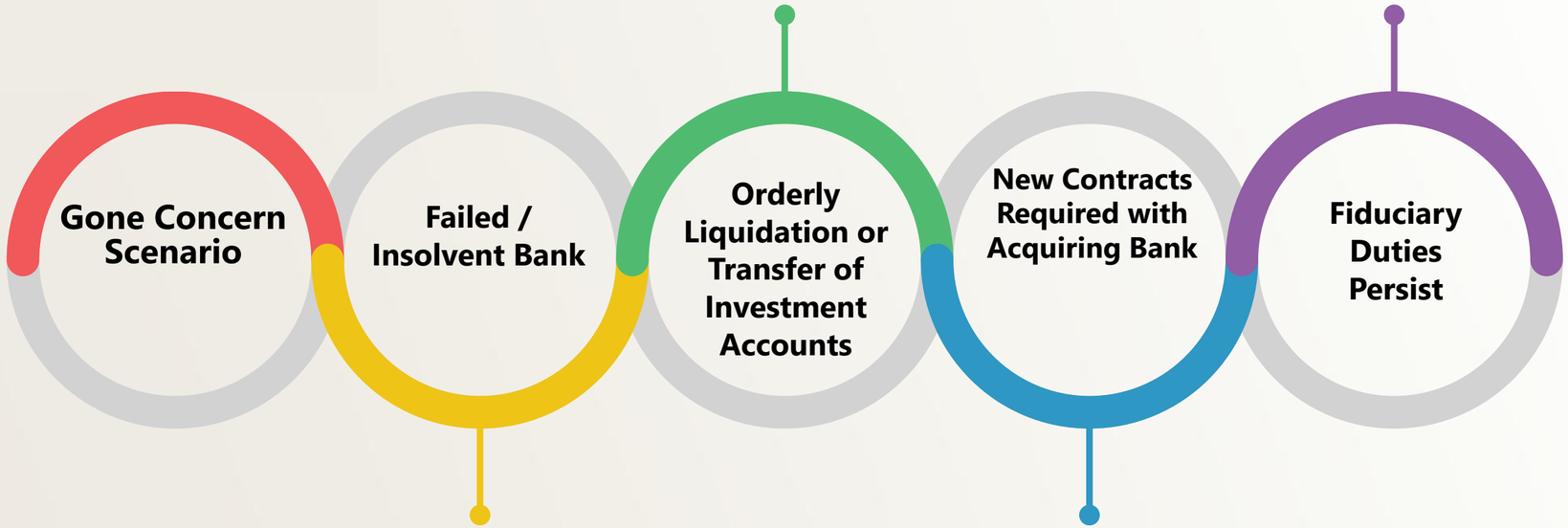
8. Failure Resolution Mechanism Gone Concern



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

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

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

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.

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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.

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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).

إِلَّآ أَن تَكُونَ تِجَٰرَةً عَن تَرَاضٍ مِّنكُم

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

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Session 2

Resolution of Investment Accounts in Failure of an Islamic Bank

Dr. Ahcene Lahsasna
Chief Executive Officer, SALIHIN Shariah Advisory

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20 YEARS
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CONTENT

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INTRODUCTION

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

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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

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- 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

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- 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

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- 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

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- 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

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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

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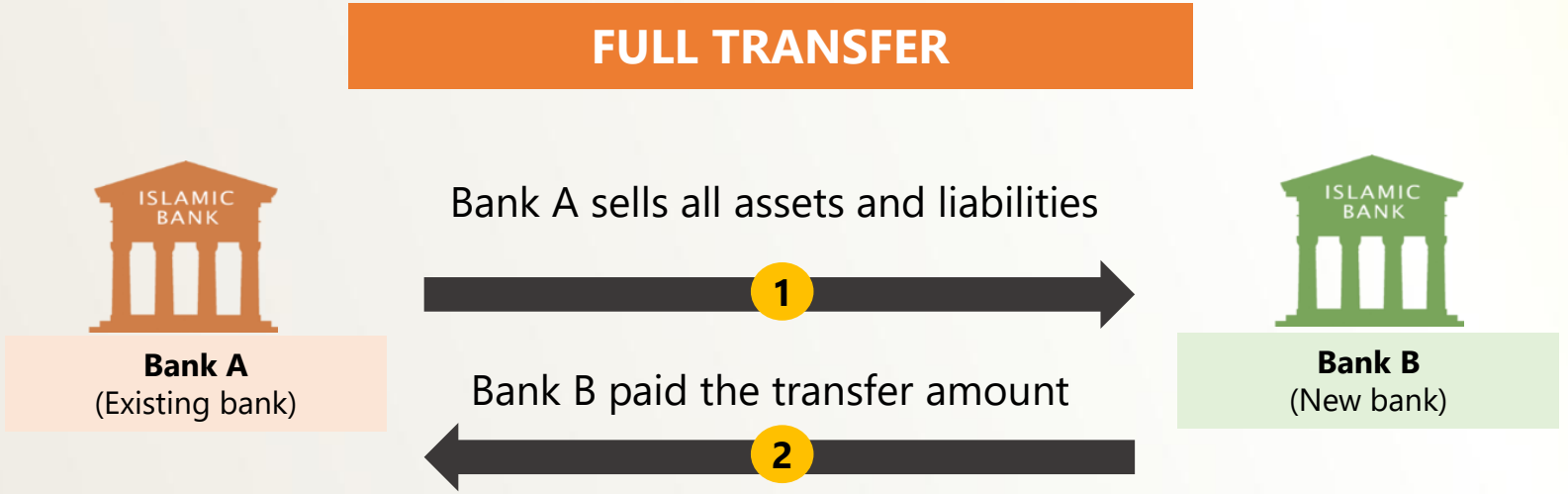
Transfers during resolution may involve either a full transfer or a partial transfer. A partial transfer may occur if the acquiring bank opts for a "pick-and-choose" approach.



TRANSFER MECHANISM FOR RESOLUTION

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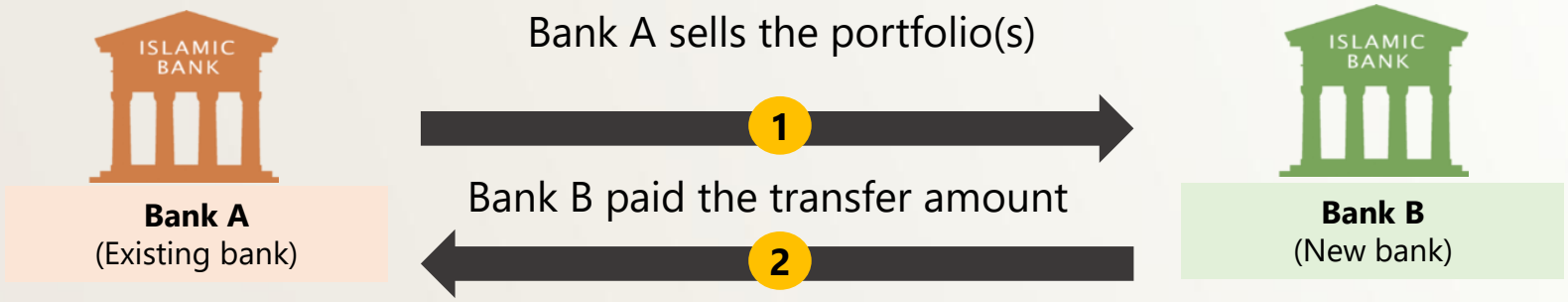
PARTIAL TRANSFER



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-silaʾ, particularly if tangible assets comprise 50% or less of the portfolio.

PROPOSE SOLUTION

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