

The 187th Meeting of the Shariah Advisory Council (SAC) of Bank Negara Malaysia

The SAC of Bank Negara Malaysia at its 187th meeting on 27 August 2018 ruled the following:

Application of *Musyarakah* Contract in Managing Expense Strain of a Takaful Operator

SAC Ruling

The SAC decided that the application of *musyarakah* contract between a retakaful operator and takaful operator in managing the expense strain of the latter arising from the implementation of 'Minimum Allocation Rate' requirement is permissible, subject to the following conditions:

- i. The *musyarakah* capital contribution especially in the form of cash, shall not be treated and accounted as an up-front *wakalah* fee as such treatment is inconsistent with the nature of a *musyarakah* contract;
- ii. The *musyarakah* capital shall be ring-fenced and shall not commingle with other capital in the shareholders' fund; and other funds especially the *tabarru`* fund;
- iii. Determination of profit and loss from the *musyarakah* must reflect the actual profit and loss of the identified portfolio, which must be ring-fenced from other portfolios; and
- iv. The in-kind *musyarakah* capital (if any) must be valued in monetary terms at the inception of the *musyarakah* contract.

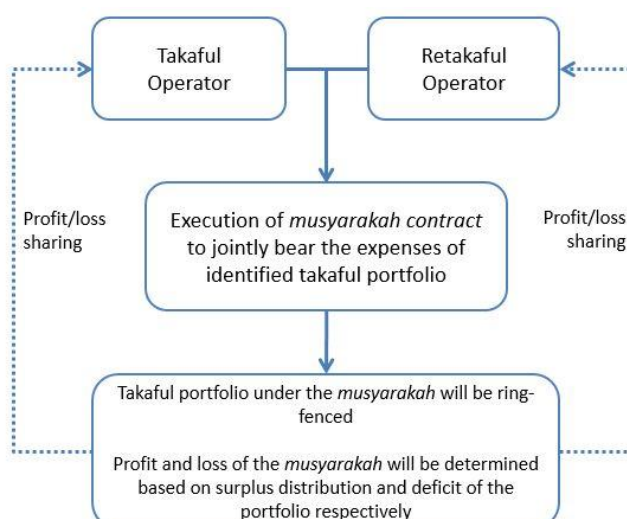
Background

- There was a proposal for a takaful operator (TO) to enter into *musyarakah* contract with a retakaful operator (RTO) which enables the TO to manage the expense strain of a new business portfolio in a more effective manner.
- This arrangement is one of the strategies to manage pressures on the shareholders' fund of TOs arising from the requirement of 'Minimum Allocation Rate' (MAR)¹ which will come into effect on 1 January 2019. The MAR requirement specifies the minimum proportion of contribution paid by takaful participants that must be retained in the unit fund for investment-linked products.
- Both TO and RTO will enter into a *musyarakah* contract to jointly bear the expenses of an identified takaful portfolio during a specified period of time.

Shariah Issue

- Is the proposed *musyarakah* structure Shariah compliant?

Illustration of *musyarakah* structure between Takaful Operator and Retakaful Operator



¹ Life Insurance and Family Takaful Framework, issued on 23 November 2015.

Key Highlights of the SAC Discussion

Method for calculating and distributing profit and loss under a *musyarakah* arrangement

- The profit calculation is based on the amount in excess of the initial *musyarakah* capital. The profit and loss of *musyarakah* contract will be determined based on the distribution of surplus and deficit of the portfolio under *musyarakah*.
- The source of profit for *musyarakah* is from the net cash-flow based on the following calculation:
 - ❖ Net cash-flow = [Wakalah fee + certificate charge + *tabarru`* fund's surplus] minus (-) [Commission for agent + management expenses]
- Profit and loss distribution to *musyarakah*'s partners is proportionate to the capital contributions of respective partners.

Justifications for profit distribution to the RTO (one of the partners)

- The RTO is entitled to receive the profit on the basis of its capital contribution although it is not actively involved in the takaful business of the portfolio under *musyarakah*.

Ring fencing of takaful portfolio under *musyarakah*

- The portfolio under *musyarakah* will be placed in a dedicated *tabarru`* fund that is managed separately from the *tabarru`* fund of other takaful portfolios.
- The takaful portfolio under *musyarakah* will be fully ring-fenced and recorded separately from accounting perspectives. In this regard, there is no commingling and cross-subsidisation between the *tabarru`* fund under the *musyarakah* and other *tabarru`* funds.

Application of *qard* in the event that the *tabarru`* fund under *musyarakah* experiences deficit

- The obligation to provide *qard* to the *tabarru`* fund in the event of a deficit remains with the TO, in accordance to the 'Guidelines on Takaful Operational Framework' issued by Bank Negara Malaysia.
- However, the RTO may agree to provide *qard* to the *tabarru`* fund based on *musyarakah*'s terms and conditions. The provision of *qard* is not considered as an additional injection of *musyarakah* capital.

Permissibility for TO (as agent) to enter into *musyarakah* contract with RTO without specific consent from the takaful participant (as *muwakkil*)

- The SAC is of the view that there is no Shariah prohibition for the TO to enter into a *musyarakah* contract with the RTO without the specific consent from the takaful participants.
- This is premised on the fact that the *musyarakah* contract is not intended to transfer the *wakalah*'s mandate (between TO and takaful participant) to the RTO. It is a separate contract to raise capital/fund from the RTO.

Treatment of *musyarakah* capital from the RTO as *wakalah* fee

- There was a proposal from the TO for the RTO's *musyarakah* capital contribution to be treated as an upfront *wakalah* fee for the purpose of accounting treatment.
- The SAC viewed that the *musyarakah* capital contributed by the RTO cannot be treated as *wakalah* fee since the *wakalah* contract only involves the participants and the TO. The RTO acts as a partner under the *musyarakah* contract and not as a *muwakkil* (principal) in the proposed *musyarakah* structure.
- The SAC also viewed that the *musyarakah* capital fund must be ring-fenced and must not commingle with other funds especially the *tabarru`* fund. This is to attain more clarity in terms of the function and obligation of each fund.

Basis of Ruling

- There is no Shariah prohibition in the proposed *musyarakah* structure. The structure is also in accordance to the Shariah requirements as specified in the Policy Document on *Musyarakah* and Policy Document on *Wakalah*.
- The proposed methodology for profit and loss sharing is also in line with the Shariah principles of *musyarakah* contract as seen below:

الربح على ما شرطا والوضيعة على قدر المالمين

“Profit (of musyarakah) is based on what is agreed by both contracting parties and the loss is proportionate to their respective capital contributions”²

- The ring-fencing of the *musyarakah* capital fund from other funds especially the *tabarru`* fund; and the ring-fencing of the portfolio under the *musyarakah* from other portfolios are aimed at achieving greater clarity in terms of the function and obligation of each fund/portfolio.

Implication of SAC Ruling

- The proposed *musyarakah* structure can be one of the permissible methods to manage expense strain of a takaful operator that cannot be addressed under the existing retakaful arrangement; and at the same time fulfil the objectives of MAR.

This ruling is immediately effective. However, relevant institution applying this concept would also require to observe the Bank’s policy.

² Ibnu Nujaym, *Al-Bahr al-Ra’iq Syarh Kanz al-Daqa’iq*, Dar al-Kitab al-Islami, vol. 5, page. 188.