PART A: INTRODUCTION

1. OVERVIEW OF THE GUIDELINES

Preamble

1.1 The Guidelines on *musharakah* and *mudharabah* contracts for Islamic Banking Institutions (the Guidelines) sets out the relevant policies and regulatory provisions that govern the exposure of Islamic banking institutions under *musharakah* and *mudharabah* contracts.

1.2 In line with the aspiration to meet the increasingly diversified and sophisticated market demand, Bank Negara Malaysia encourages the Islamic banking institutions to diversify the range of Islamic products comprising debt-based structure as well as equity-based structure that encompass *musharakah* and *mudharabah* contracts.

1.3 It is acknowledged that a growing number of Islamic banking institutions have initiated the efforts to explore the feasibility of *musharakah and mudharabah* as new modes of financing and/or investment contract. The increasing appeal for equity-based financing will certainly elevate the Islamic banking industry in Malaysia into a new dimension of innovative and attractive product offerings. Based on this premise, there is a need to provide a broad framework to facilitate the healthy evolvement of such contracts in the Islamic banking industry.

Objectives

1.4 While an essential feature of Islamic banking institutions is the requirement to comply with *Shariah* rules and principles, the Guidelines provides the regulatory and prudential requirements for *musharakah* and *mudharabah* exposures.

1.5 The Guidelines on *musharakah* and *mudharabah* Contracts for Islamic Banks has been developed to achieve the following objectives:

(i) To enhance the corporate governance practices in managing *musharakah* and *mudharabah* exposures undertaken by Islamic banking institutions;

(ii) To improve risk management capabilities in identifying, monitoring, controlling and mitigating the risk arising from *musharakah* and *mudharabah* exposures;

(iii) To provide appropriate enabling environment for diversification of Islamic banking risk profile into equity-based or floating-rate exposures; and

(iv) To serve as an assessment tool for Islamic banking institutions in ensuring compliance with the relevant regulatory and prudential guidelines issued by Bank Negara Malaysia.

Applicability

1.6 The Guidelines is applicable to all non-interbank financing and investment (Islamic banking assets) undertaken by the Islamic banking institutions under *musharakah* and *mudharabah* contracts[1]. The coverage of the Guidelines excludes *mudharabah* interbank investment, Islamic Negotiable Instruments (INIs) based on *mudharabah*, *musharakah* or *mudharabah Sukuk*[2] and other equities in trading book of the Islamic banking institutions.

1.7 Islamic banking institutions refer to Islamic banks licensed under the Islamic Banking Act 1983 (IBA) and banking institutions participating in the Islamic Banking Scheme licensed under the Banking and Financial Institutions Act (BAFIA) 1989.

[1] Definitions, concepts and illustrations of *musharakah* and *mudharabah* investment and financing are provided in Appendix 1.

[2] Also termed as "Islamic Securities" based on *musharakah* and *mudharabah*.

Legal Provision

1.8 The Guidelines is issued pursuant to section 53A of IBA and section 126 of BAFIA. Unless specified otherwise, the Guidelines will be effective immediately and shall be read together with:

(i) The Islamic Banking Act 1983 (IBA) or the Banking and Financial Institutions Act (BAFIA) 1989, whichever is applicable;

(ii) The Companies Act 1965;

(iii) Other relevant regulations, guidelines or circulars relevant to the *musharakah* and *mudharabah* contracts that Bank Negara Malaysia may issue from time to time; and

(iv) Applicable guidelines issued by other relevant authorities.

1.9 Islamic banking institutions shall be exempted from section 25(1)(c) of the IBA and section 62(1)(b) of the BAFIA on the appointment of Board representative[3] to protect the interest of the Islamic banking institutions in the invested entities.

PART B: POLICY REQUIREMENTS

2. SOURCES OF FUNDS

2.1 There is no restriction on the sources of fund for *musharakah* and *mudharabah* contracts, subject to the following conditions:

(i) The Islamic banking institutions have undertaken an internal assessment on the appropriateness and suitability of each fund; and

[3] Board representative refers to Islamic banking institution's employees or external parties appointed as a board member in investee company to monitor business performance of *musharakah* and *mudharabah* exposures.

(ii) The Islamic banking institutions must ensure an effective management of liquidity mismatches between the *musharakah* and *mudharabah* exposures and their funding sources.

2.2 Notwithstanding that, the funding sources for direct exposure to property development and property investment activities shall be restricted to either shareholder's fund or specific investment account[4].

3. GOVERNANCE

3.1 All aspects of Islamic banking institutions' business operations, inclusive of *musharakah* and *mudharabah* contracts should adhere to and be reinforced by credible corporate governance practices. In this regard, the Guidelines aim to complement the existing broad principles, standards and requirements of good corporate governance by addressing the specific governance issues related to *musharakah and mudharabah* contracts.

3.2 In general, the governance of *musharakah and mudharabah* contracts and other business operations of the Islamic banking institutions must be in line with the principles stipulated in Bank Negara Malaysia Guidelines on Corporate Governance for Licenced Islamic Banks (Revised BNM/GP1-i). The formulation of governance principles is broadly consistent with the Guiding Principles on Corporate Governance for Institutions Offering only Islamic Financial Services (Excluding Islamic Insurance (Takaful) Institutions and Islamic Mutual Funds issued by the Islamic Financial Services Board (IFSB) in December 2006.

3.3 However, the Islamic banking institutions are required to observe four additional key governance principles with regards to *musharakah* and *mudharabah*:

(i) The Board of Directors of the Islamic banking institutions must ensure that the management of the Islamic banking institutions

4 As specified in Bank Negara Malaysia's Guidelines on Property Development and Property Investment Activities.

have adequate resources and qualified personnel with sufficient knowledge and understanding on the concept, application and risks associated with *musharakah* and *mudharabah* contracts. The Islamic banking institutions' Board of Directors must also ensure that the Islamic banking institutions posses the necessary expertise in the activities where the Islamic banking institutions will be financially involved;

(ii) Islamic banking institutions are required to determine the materiality of exposures that would require establishment of dedicated oversight committee or unit on *musharakah* and *mudharabah* exposures;

(iii) Islamic banking institutions must ensure comprehensive and effective *Shariah* governance framework is in place for proper conduct of the Islamic banking operations in accordance to *Shariah* principles; and

(iv) Any appointment of Board representative for *musharakah* and *mudharabah* exposures shall be subject to the conditions specified in the Guidelines.

4. APPOINTMENT OF THE BOARD REPRESENTATIVE

4.1 Based on the contractual relationship as business partners under *musharakah* and *mudharabah* contracts, Islamic banking institutions may require to monitor the operational affairs of the invested entities. In addition to other risk mitigation measures, there are instances where all contracted parties may reach to a mutual consent to allow the presence of board representative from the Islamic banking institutions as a surveillance mechanism in ensuring that the business operations are in accordance with the investment mandate[5].

[5] Illustration on the appointment of Board representatives for *musharakah* and *mudharabah* investment or financing are provided in Appendix 2.

4.2 The mandate of the board representative is to safeguard the interests of the Islamic banking institutions by providing continuous surveillance and monitoring of up- to-date information of the underlying business activities financed by the Islamic banking institutions. The presence of the board representative would be able to ascertain the prevailing financial position of the invested entities and consequently provides early alert mechanism to the Islamic banking institutions on the potential risks of the invested entities.

4.3 In relation to the above, Islamic banking institutions are allowed to appoint board representative in the company's which obtain investment or financing based on *musharakah* and *mudharabah* contracts subject to specific conditions in the Guidelines.

4.4 For appointment of board representatives, Islamic banking institutions must establish internal policies that must be approved by the Board of Islamic banking institutions. At minimum, the internal policies must incorporate the following conditions:

(i) Any appointment of the Board representative must commensurate with the size and complexity of the risk exposures undertaken by the Islamic banking institutions;

(ii) Definition of significant *musharakah* and *mudharabah* investments or financing with substantial risk exposures that qualify for appointment of board representative in the invested entities; and

(iii) Criteria on appointment of board representative, role of the board representative and proper mechanism to monitor effectiveness of board representative.

Criteria on Appointment of Board Representative

4.5 A board representative appointed by Islamic banking institutions must satisfy the following key criteria:

(i) Skilled personnel which possess in-depth knowledge on the nature of business involved in the invested entities;

(ii) Possess necessary qualifications, experience and qualities that will enable them to perform their duties effectively;

(iii) The board representatives are limited to Islamic banking institution's employees or external parties. Islamic banking institutions are not allowed to appoint their Board member as board representatives in the invested entities; and

(iv) The personnel must be 'fit and proper' to hold the position as board representative, taking into account the following consideration:

(a) His/her probity, diligence, competence and soundness of judgment;

(b) His/her reputation, character, integrity and honesty; and

(c) Any history of offence(s) involving fraud, dishonesty, violence, incompetence or malpractice, including any engagement in deceitful/oppressive/improper business practices or any practices which would discredit him/her.

Role of Board Representative

4.6 The roles and responsibilities of the board representative are as follows:

(i) As a management exercise to safeguard the interest of the Islamic banking institutions by providing regular surveillance and monitoring role on the invested entities;

(ii) The scope of duties shall be governed by the terms and conditions of board representative agreed between the Islamic banking institutions and the invested entities;

(iii) In discharging him/her duties, the board representative must:

(a) Maintain high level of integrity;

(b) Avoid any transactions for personal benefits or other related gains;

(c) Safeguard Islamic banking institution's interest by carrying out his/her duties in the best possible way;

(d) Duly report the progress and performance of invested entities to the Islamic banking institutions; and

(iv) The board representative is not eligible to earn director's fees provided by the invested entities. Any fees earned or provided by the invested entities shall be credited to Islamic banking institution's account to avoid any potential conflict of interest.

Mechanism to Monitor the Effectiveness of Board Representative

4.7 The Islamic banking institution's internal policy on board representative must take into account the following mechanism to monitor the effectiveness of board representative:

(i) Ensure that the appointment of individual as board representative does not affect his/her core duties and performance as an employee of the Islamic banking institutions.

(ii) If the appointed board representative is an external party, he/she must provide a written undertaking on the obligation to comply with the secrecy provision stipulated in Section 34 of IBA or Section 97 of BAFIA;

(iii) Islamic banking institutions are required to establish internal limit on the number of invested entities for each individual who is allowed to be board representative;

(iv) The Islamic banking institutions must establish clear definition of the exit mechanism, including the conditions that the Islamic banking institutions shall immediately relinquish the board representative representation upon disposal of the Islamic banking institutions' interest in the invested entities;

(v) Any subsequent credit facilities extended by the Islamic banking institutions to the invested entities shall be made on arm's length basis. The terms and conditions for these credit facilities should not be more favourable than those granted to other borrowers with similar backgrounds and creditworthiness; and

(vi) Islamic banking institutions should ensure timely and reliable information on progress and performance of invested entities.

5. RISK MANAGEMENT

5.1 The distinct risk profile of *musharakah* and *mudharabah* contracts which is a form of equity participation may expose the Islamic banking institutions to various types of risks, such as counterparty credit risk, equity investment risk, liquidity risk and reputational risk. These risks require proper, adequate and sound risk management infrastructure and internal controls.

5.2 In general, the formulation of risk management of the Islamic banking institutions is broadly consistent with the IFSB Guiding Principles of Risk Management for Institutions (other than Insurance Institutions) offering only Islamic Financial Services[6].

5.3 Islamic banking institutions need to ensure the availability of a comprehensive risk management infrastructure, system and internal control to manage *musharakah* and *mudharabah exposures* that cover the Islamic banking institution's strategy, policies and procedures; valuation methodology; and exit strategies and mechanism.

Strategies, Policies and Procedures

5.4 The Islamic banking institutions must have in place a comprehensive risk management and reporting process to **identify, measure, monitor, and control** the risks associated with *musharakah* and *mudharabah* contracts. These risk management activities and processes require active oversight by the Board and senior management.

5.5 Appropriate policies and procedures on *musharakah* and *mudharabah* contracts must be clearly specified and communicated. There should be a systematic process to regularly review and update the *musharakah* and *mudharabah* policies, processes and limits to take into accounts the risk

[6] Islamic banking institutions may also refer to other internationally recognised standard such as the Basel Committee on Banking Supervision (BCBS)'s documents pertaining to sound practices and principles of credit, market, liquidity and operational risks of financial institutions which may be applicable to Islamic banking institutions.

appetite of the banks and changes that take place in the Islamic banking industry.

5.6 Based on the materiality or significant involvement of the Islamic banking institutions in *musharakah* and *mudharabah,* the Islamic banking institutions may establish a dedicated committee or unit to oversee *musharakah* and *mudharabah* exposure[7]. Members of this committee or unit shall comprise of people with adequate knowledge and understanding on *musharakah* and *mudharabah* contracts and the risks associated with such exposures. The committee or unit shall be responsible for the off-site monitoring of the *musharakah* and *mudharabah* contract exposures that include the identification, measurement and management of the risks inherent in *musharakah* and *mudharabah* contracts.

Valuation and Measurement Methodology

5.7 To mitigate various risks embedded in *musharakah* and *mudharabah* contracts, the Islamic banking institutions must ensure that their valuation methodologies on profit calculation and allocation are appropriate, consistent and mutually agreed upon by both contracting parties at the inception of the contract. The potential impact of their valuation methods on profit calculations and allocations must be properly assessed, particularly with regard to the risk of potential manipulation on the reported earning results leading to overstatements or understatements of *musharakah* and *mudharabah* earnings.

5.8 Islamic banking institutions must have in place a sound impairment provisioning methodology that is able to detect and provide best estimates of losses and determine prudent level of provisions for the exposures to *musharakah* and *mudharabah* contracts.

[7] Bank Negara Malaysia reserves the right to require establishment of dedicated unit or committee if it is deemed necessary based on the materiality of *musharakah* and *mudharabah* exposures.

5.9 Subject to mutual consent, the contracting parties may appoint an independent party to carry out audit and valuations on *musharakah* and *mudharabah* contracts to ensure transparency and objectivity in the valuation and distribution of profits as well as in determining the redeemed amounts.

Exit Strategies and Mechanisms

5.10 The Islamic banking institutions must identify and establish the exit strategies, including the extension and redemptions conditions for *musharakah* and *mudharabah* contracts. The strategies may include the alternative exit routes and timing of the exits. For example, if the *musharakah* or *mudharabah* business incurs losses but there is an improved business prospects for that particular exposure[8], the Islamic banking institutions may allow an extension period to the *musharakah* and *mudharabah* contracts. In this case, the extension period given must be based on the plausible ground that there will be a business turnaround, which could result in the recovering and yielding of profits. Proper assessments of the financial position of *musharakah* and *mudharabah* partners and the business prospects for a turnaround need to be done to avoid the ever-greening of financing/investments.

5.11 The Islamic banking institutions may employ guarantors to mitigate risk exposure in *musharakah* and/or *mudharabah* contracts. This may include a third-party guarantor to secure the return of the contributed capital in *musharakah and mudharabah* financing in the event of fraud or negligence on the part of the customer.

5.12 The mechanism on exit strategies must be specifically and appropriately documented in *musharakah* and *mudharabah* contracts. In this regard, any dissolution issues shall be based on the pre-agreed terms and conditions by the contracting parties upon inception of the *musharakah* and *mudharabah* contracts. Exit strategies features may include, among others, the following:

[8] Another example is where there has been a breach in the contracted repayment schedule but the business prospect is still bright. Islamic banking institutions may still extend the *musharakah* or *mudharabah* exposures subject to proper assessment of the exposures.

(i) Contract period of the *musharakah* and *mudharabah* contracts,

(ii) Liability of the Islamic banking institutions;

(iii) Conditions and mechanism for early termination of contracts;

(iv) The rights of the Islamic banking institutions and the customer upon early termination of contracts; and

(v) The situation and conditions in the case of *musharakah* and *mudharabah* partner wishes to continue the business after the termination of *musharakah* and *mudharabah* contract.

5.13 Apart from the appointment of board representatives and other risk mitigants, Islamic banking institutions may adopt a mechanism to oversee and monitor the progress on the project financing or investment by having bank representative for a specific project, for example a dedicated project level committee. There is no restriction for Islamic banking institutions to have bank representative for project financing based on *musharakah* and *mudharabah* contracts.

6. PRUDENTIAL LIMIT

6.1 *Musharakah* and *mudharabah* financing shall be subject to the Guidelines on Credit Limit to a Single Customer[9] specified by Bank Negara Malaysia.

6.2 For investments undertaken based on *musharakah* and *mudharabah* contracts, Islamic banking institutions are required to observe the prudential limit specified in the Guidelines on Investment in Shares and Interest-in-Shares.

6.3 However, *musharakah* and *mudharabah* exposures funded by **specific investment account** (SIA) shall be exempted from these prudential limits if the Islamic banking institutions can satisfy governance and disclosure

9 Subject to subsequent updates by Bank Negara Malaysia.

requirement as specified in the Guidelines on the recognition and measurement of profit sharing investment account (PSIA) as risk absorbent[10].

7. CAPITAL ADEQUACY REQUIREMENT

7.1 The capital adequacy requirement for exposures based on *musharakah* and *mudharabah* contracts shall be subject to the capital adequacy frameworks issued by Bank Negara Malaysia[11].

7.2 In the case where Islamic banking institutions undertake direct exposures in property development and investment activities under *musharakah* and *mudharabah* contracts, the computation of capital adequacy requirement shall be guided by Bank Negara Malaysia's Guidelines on Property Development and Property Investment Activities[12]:

8. FINANCIAL DISCLOSURE

8.1 In enhancing the transparency of Islamic banking business, Islamic banking institutions are required to disclose the risk management policies and practices of *musharakah* and *mudharabah* contracts in managing equity investment risk (including the role of board representative, where applicable[13]) under the risk management section of the Islamic banking institutions' financial statement.

[10] The Guidelines for the recognition and measurement of profit sharing investment account (PSIA) as risk absorbent will be issued by Bank Negara Malaysia at a later date.

[11] The computation of capital adequacy requirement would depend on the approaches adopted by Islamic banking institutions and shall be guided by the corresponding guidelines issued by Bank Negara Malaysia.

[12] Subject to subsequent updates by Bank Negara Malaysia.

[13] Applicable to Islamic banking institutions that has appointed board representative as a form of risk mitigant for their *musharakah* and *mudharabah* exposures.

8.2 Disclosure of Islamic banking institution’s risk management policies and practices for managing and controlling risks associated with *musharakah* and *mudharabah* contracts may include:

(i) Description of the nature of risk, composition of risk and activities within Islamic banking institution that gives rise to such risk;

(ii) Description of the methods used to identify, monitor, manage and control risk (e.g. requirement to mitigate the equity investment risk);

(iii) Presence of any risk that could materially impair Islamic banking institution’s ability to meet its corporate objectives and responsibilities; and

(iv) Nature and frequency of review/ assessment conducted in respect of Islamic banking institution’s risk management system, including a statement on whether such reviews/ assessment are conducted by external party that does not have any connection to the Islamic banking institution, as well as outlining key recommendations of the review.

8.3 Other financial disclosures shall be subject to the Bank Negara Malaysia’s Guidelines on Financial Reporting[14] and all applicable accounting standards[15]. It is important to ensure that all disclosures are provided in a comprehensible, understandable, relevant and reliable form.

8.4 The Islamic banking institutions shall maintain all records on *musharakah* and *mudharabah* exposures, including the particulars of invested entities, amount of investment and the board representative appointed in the invested entities. These internal records must be updated regularly and should be available for inspection by Bank Negara Malaysia and/or external auditors as and when required from time to time.

[14] Either Revised Guidelines on Financial Reporting for Licensed Institutions (GP8) or Guidelines on Financial Reporting for Licensed Islamic Banks (GP8-i), or any subsequent updates.

[15] As approved Malaysian Accounting Standard Board.

PART C: APPENDICES

Appendix I: Definition and Concept of *Musharakah* and *Mudharabah* Contracts

1. This appendix provides **generally accepted** definition and concept of *musharakah* and *mudharabah* contracts in Islamic finance. All examples on the structures of *musharakah* and *mudharabah* contracts are non-exhaustive and should not be construed as the only structures available in Islamic finance.

Musharakah

2. Basic tenets of *musharakah* contracts:

   (i) Both partners contribute a portion of capital which may not necessarily be equal. The contributed capital can be either in the form of cash or assets with an ascribed monetary value;

   (ii) While both partners may undertake the management of the business, if a partner chooses to withdraw from the management to become a sleeping partner, such arrangement is allowed. The partner is also allowed to appoint a third party to manage the business on behalf of the *musharakah* partnership;

   (iii) The project or business must be permissible by *Shariah*;

   (iv) The proportion of profit to be distributed between the partners must be mutually pre-agreed upon inception of the contract; and

   (v) Any losses shall be distributed between the partners according to the capital contribution ratio. However, if the loss is due to the negligence of the managing partner or management team, such losses shall be borne by the respective partner or the management team.

Musharakah Investment

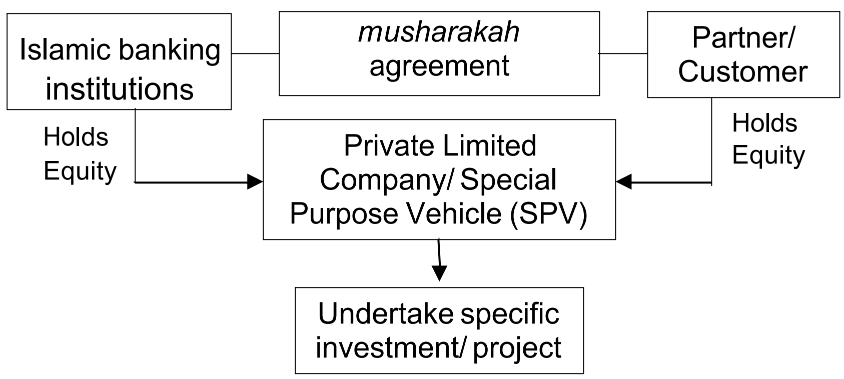
3. A *musharakah* investment occurs when an Islamic banking institution becomes one of the shareholders in a newly set-up or an existing company. Under *musharakah* investment, an Islamic banking institution may enter into a *musharakah* agreement to acquire some shares from a separate legal entity that undertake *Shariah*-compliant activities. *Musharakah* investment may occur in the following circumstances:

   (i) The Islamic banking institutions hold equity in another entity for investment purposes; or

   (ii) The Islamic banking institutions acquire a proportion of shares in another entity as a risk mitigant to the financing facilities extended to the entity.

4. The structure of the *musharakah* investment is exemplified by the following diagram:

Diagram 1: Example of *Musharakah* Investment



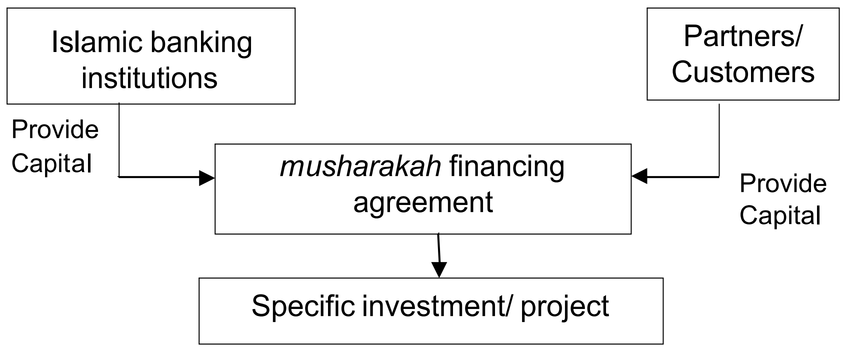
Musharakah Financing

5. *Musharakah* financing facility may be provided by an Islamic banking institution to their customers based on a partnership arrangement through the execution of contracts such as *musharakah* financing agreement. Both partners mutually agree to contribute capital for a specific project, and share

any profit or loss arising from the business activities according to a pre-agreed ratio. The financing can be disbursed either progressively or in a lump sum, depending on the agreement.

6. The ownership may be subdivided among partners as long as the transfer of ownership is made with the agreement of all partners[16]. A supplement agreement between the transferor and the transferee may be allowed so long it does not affect the contract such as *musharakah* financing agreement. An example of such arrangement is as follows:

Diagram 2: Example of *Musharakah* Financing



Musharakah Mutanaqisah **Financing**

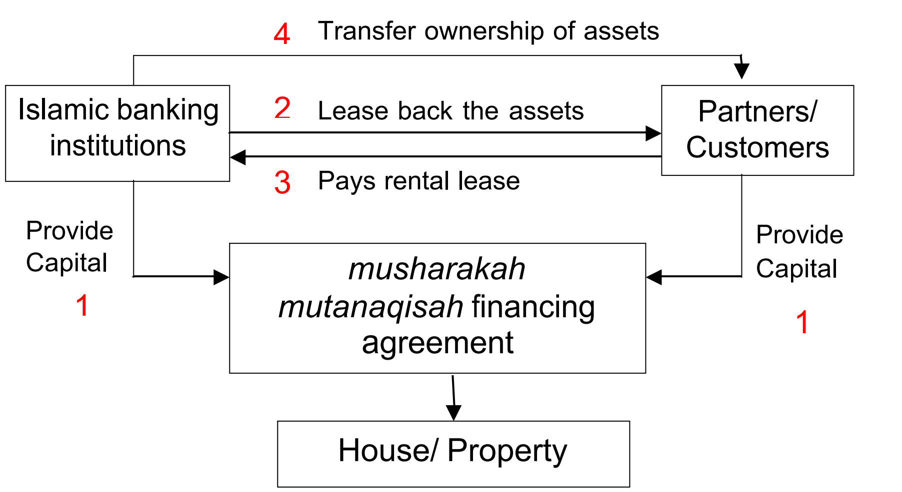
7. In *musharakah mutanaqisah* (diminishing *musharakah*) home or property financing, the customer and Islamic banking institution jointly acquire and own the property. The Islamic banking institution then leases its share of property to the customer on the basis of *ijarah* (lease). The customer, as an owner-tenant, promises to acquire periodically the Islamic banking institution's ownership in the property. The customer pays rental to the Islamic banking institution under *ijarah*, which partially contributes towards increasing their share in the property. In other words, the portion of the payment proceeds or monthly installments received from the customer shall be used towards the gradual acquisition of the Islamic banking institution's share in the jointly

[16] It is also essential to note that *musharakah* financing can also be in the form of *musharakah mutanaqisah* (diminishing ownership) financing, in which one party gives the right to the other party to gradually acquire his equity or capital throughout the contracted period.

owned property. At the end of the *ijarah* (lease) term and upon payment of all lease rentals, the customer would have acquired all the financier's shares and the partnership will come to an end with the customer being the sole owner of the house.

8. The following diagram illustrates an example of home or property financing under *musharakah mutanaqisah* contract:

Diagram 3: Example of *Musharakah Mutanaqisah* Financing



Mudharabah Financing

9. A *mudharabah* financing contract refers to a partnership between an Islamic banking institution that assume the role as capital provider (*rabbulmal*), and the customer who assume the role as manager of funds (*mudharib*) who is expected to perform the best of his ability to translate the capital provided into profit. Basic tenets of the *mudharabah* contract:

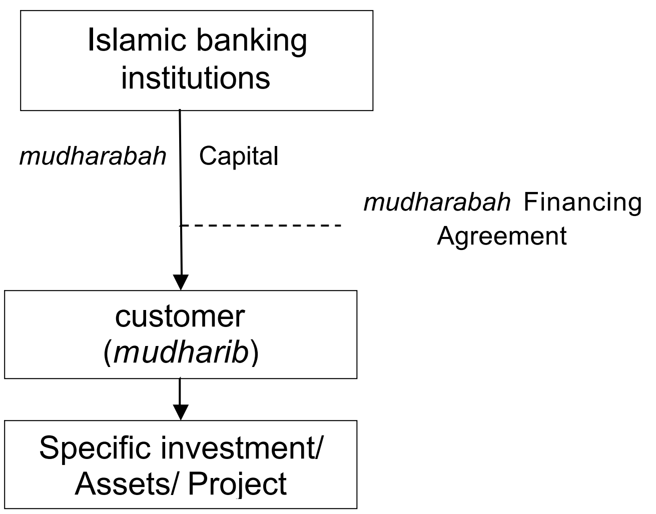
(i) There are two contracting parties to a *mudharabah* financing, i.e. the provider of funds (*rabbulmal*) and the entrepreneur (*mudarib*). The latter does not contribute any form of capital, otherwise the venture will fall into the category of *musharakah*; and

(ii) Profit is shared between the capital provider and the entrepreneur according to a pre-determined profit sharing ratio. The profit sharing ratio has to be mutually consented upon and explicitly stated at the time of contracting (*aqad*) and has to be a proportion/ percentage of the profits.

10. In principal, any financial loss under *mudharabah* financing must be borne by the Islamic banking institution. However, if the loss is caused by negligence, mismanagement or breach of contracted terms by the customer, then the customer is liable for the loss.

11. The diagram below illustrates an arrangement under *mudharabah* financing:

Diagram 4: Example of *Mudharabah* Financing



12. *Mudharabah* financing can be divided into two main types, i.e. restricted *mudharabah* (*mudharabah muqayyadah*) and unrestricted *mudharabah* (*mudharabah mutlaqah*). Under restricted *mudharabah*, the Islamic banking institution may specify certain terms and conditions, for example stipulate a particular business or particular place for the customer to invest the capital. The customer is bound by all these restrictions and any violation of these restrictions may make the customer liable for the loss, if any. This type of

mudharabah financing may be used for contract financing of a specific project awarded to the customer.

13. Under unrestricted *mudharabah*, an Islamic banking institution does not impose any limitation on the customer/ partner, for example, on the type of business, place of business, methods of payment from the customers and period of investment. In this case, the Islamic banking institution will not have any recourse to the customer should the business incur losses due to the investment policy as there would have been no such policy prescribed by the Islamic banking institution in the first place. This type of *mudharabah,* for example, may be used towards financing a customer's working capital requirements.

Appendix 2: Illustration examples of Board Representative

1. This appendix provides two examples on the mechanism for appointment of Board representative in *musharakah* or *mudharabah* investment and/or financing by the Islamic banking institutions. These examples are provided for illustrative purpose and should not be construed as the only mechanism available for the appointment of board representative.

Illustration 1: Appointment of Board Representative for *musharakah* investment and financing

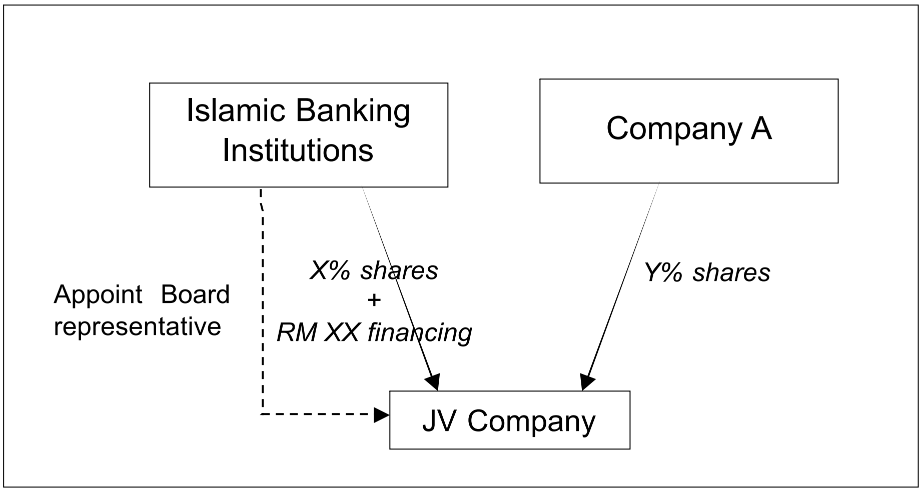


Illustration 2: Appointment of Board Representative for *musharakah* or *mudharabah* financing