

## **Resolution of OIC Fiqh Academy (related to Islamic Economics and Finance)**

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ

### **Resolution No. 212 (8/22)**

#### **Provision of Guarantee by Bank against Mal Investment Decisions and Compensation of Clients for Consequent Losses**

The Council of the International Islamic Fiqh Academy (IIFA), of the Organization of the Islamic Cooperation (OIC), in its 22<sup>nd</sup> Session, held in Kuwait (State of Kuwait), during the period 2 – 5 *Jumada-II, 1436H* (March 22 – 25, 2015).

Having reviewed the research papers submitted to IIFA on “*Provision of Guarantee by Bank against Mal Investment Decisions and Compensation of Clients for Consequent Losses*”, and listened to discussions on the subject,

#### **Resolved the following:**

**Firstly:** Provision of guarantee by bank, in this context, means that the bank bears total or partial loss of depositors and owners of investment accounts’ funds.

**Secondly:** The capacity in which the bank holds deposits funds has two forms:

- (1) **Holding under Guarantee:** which means holding the funds as an owner, or to its own benefit as a holder, such as: holding by purchaser, or recipient of purchase price; or holding by mortgagee, extorter, owner and borrower. Bank accounts that fall under guarantee holding are demand deposits (current accounts). In this regard the Council reiterates what has been stated about deposits in its Resolution No. 68 (9/3), Clause (Firstly) that “*Demand (current) deposits with Islamic banks are loans in the Fiqh perspective, because the receiving bank holds them under guarantee, and is committed, according to Sharī‘ah, to repay them on demand*”.

- (2) **Holding under Trusteeship:** which indicates holding the funds on behalf of rather than in the capacity of an owner. Holding of the funds in this case is permitted by the owner, and it includes holding of the: deposit keeper, lessee, partner, *muḍārabah* worker, *waqf* supervisor, guardian and the like. Islamic Bank accounts that fall under this type of holding are investment deposits. In this connection the Council reconfirms what has been stated in Clause [Secondly/ (b)] of its Resolution referred to in point (1) above “Deposits delivered to banks that are committed to rules of Islamic Sharī‘ah, based on an investment contract and for a share in profit, are *muḍārabah* capital and subject to *muḍārabah* (*qiradh*) rulings in Islamic *Fiqh*, which include – among others – impermissibility of guaranteeing *muḍārabah* capital by the *muḍārabah* worker/*muḍārib* (the bank in this case).

**Thirdly:** The bank when assuming the role of the *muḍārib* should not guarantee total or partial loss of investment accounts, except in case of transgression negligence or breach of contract, as indicated by general rules of Sharī‘ah. Among cases of transgression are the following:

- (1) Noncompliance of the bank with Sharī‘ah controls stipulated in contracts and agreements of opening the different types of investment accounts.
- (2) Violation of banking and commercial regulations, laws, or practices issued by supervisory bodies responsible of regulating banking business, unless such regulations, laws and practices contradict with rules and principles of Islamic Sharī‘ah.
- (3) Slackness in preparation of adequate feasibility studies for investment operations.
- (4) Selection of the wrong operational modes and mechanisms.
- (5) Violation of internal directives and operational controls.
- (6) Failure to obtain sufficient collaterals, as per normal practice in the industry.

**Fourthly:** It is impermissible to stipulate provision of guarantee by the bank as a *muḍārib*, because such stipulation contradict with the essence of the *muḍārabah* contract. Therefore the Council reconfirms what has been stated in its Resolution No. 86 and its Resolution No. 30 (5/4) on *Muḍārabah šukūk*, which indicates that “*Muqāraḍah šukūk or prospectus should not include any text indicating that muḍārabah worker is to guarantee the capital or any lump sum or percentage return on capital. When such stipulation is implicitly or explicitly introduced the guarantee becomes invalid and the muḍārib becomes entitled to profit of similar muḍārabah transactions*”.

**Fifthly:** When the bank claims loss, the burden of proofing shifts - contrary to the case in principle - to the bank, provided that there is evidence contradicting with the bank's claim of not committing transgression. Among the factors that support resorting to this procedure are the following:

- (1) If traditionally people do not accept such claim of the *muḍārib* (the bank) unless it provides an evidence validating the claim of not committing transgression or negligence.
- (2) Certitude of accusation against trustee: which means preponderance of suspicion about the trustee's (the *muḍārib*) honesty in denial of transgression and negligence, because the *muḍārib* is normally expected to preserve invested capital amounts against loss and achieve profits.
- (3) Certitude of interest in shifting of burden of evidence to *muḍārib* (the bank) in order to shield investors' funds against loss, in case of *muḍārib*'s claim or loss of investor's funds.

**Sixthly:** It is permissible for the bank to donate part of its profit share without stipulating that in the contract.

**Seventhly:** Several bodies are normally entrusted with determination of responsibility of the bank towards abuse of the funds of investment accounts holders including the following:

- (1) Supervisory bodies like central banks, whether a full-fledged Islamic regulatory body or a traditional body with committees specialized in Islamic Banking.
- (2) Centers of reconciliation, arbitration and conflict resolution such as the Islamic International Center for Reconciliation and Arbitration in Dubai.
- (3) Auditors as per the generally accepted practices of the profession. According to Accounting Standard No. (5), issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) – Bahrain this responsibility is considered to constitute part of the responsibilities of the external auditor. This task can also be assigned to the Sharī'ah Supervisory Board.

**Eighthly:** Compensation for losses in investment accounts should be confined to actual harm - whether loss is total or partial – without guaranteeing probable profit that has not been realized (opportunity cost), because it is nothing more than an unrealized expectation.

And recommends the following:

- (1) Islamic banks should be keen while investing depositors' funds to pursue methods and mechanisms that would mitigate investment risks and safeguard these funds against loss. Suitable arrangements in this regard may include establishment of special funds and allocation of necessary reserves.
- (2) Islamic countries are called upon to enact laws for establishment of institutions for deposits insurance, or introduce amendments in the existing laws and regulations to cater for cooperative insurance funds to be established by Islamic financial institutions, and managed in view of the rulings stated in IIFA's Resolution No. 200 (6/20) on "*Bases of Cooperative Insurance: Shari'ah Rulings and Controls*".