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**Musharakah Tijarah Cross-Border Financing: Concept, Structure and Salient Features**

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ABSTRACT

**Keywords:** Islamic Finance, Musharakah, Qard, Wakalah, Cross-Border Financing, Project and Contract Financing, Joint Venture.

Musharakah Tijarah Cross-Border Financing ("Product") is the product to enable the Bank to undertake project and contract cross-border financing activities or other identified business ventures on "pure" Joint Venture basis, using the underlying Islamic financing contract of Musharakah. Musharakah concept has a low market share of less than 2.5% in the overall existing Islamic financing products in Malaysia. This product encourages mobilization of idle capital / cash entities and thus provides a basis for economic cooperation between these organizations in the society. The product also is expected to inject greater prosper to the Bank's overall performance and ultimately able to assist small time landowners in a big way through business risk sharing. Musharakah provides an alternative investment, which will cater for Islamic investors and partners, especially from GCC, who may have been reluctant to invest in conventional or current debt-based financing scheme. With Musharakah concept, the most preferred and globally accepted Islamic financing, this can attract these investors to participate on similar risk-sharing arrangements through the creation of Specific Investment Account (SIA) or Islamic Syndication to back financing made into the Joint Venture.

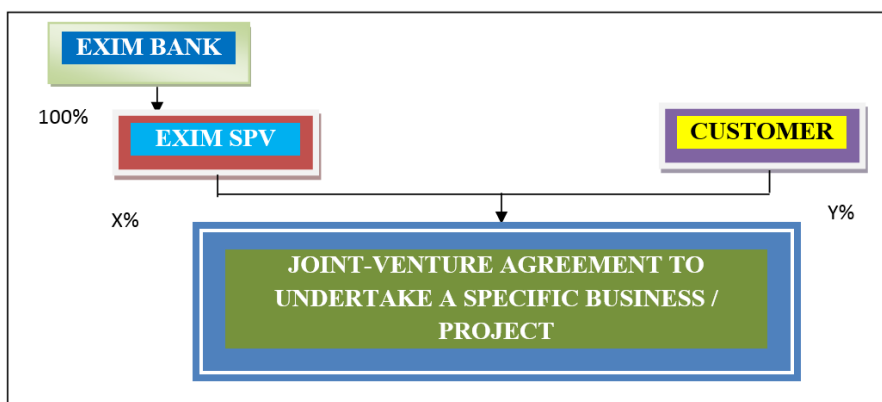
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## 1. Introduction

*Musharakah Tijarah* Cross-Border Financing using the underlying *Shariah* contract of *Musharakah*. *Musharakah* literally means sharing. It is the modern term for *Shirkah Al-Amwal*, one type of Islamic partnership. The capital raised shall be used to finance identified business ventures that generates revenue. The profits generated shall be shared between the Bank and Customer in a pre-agreed profit sharing ratio.

For example, AB Bank, as the financier through AB Special Purpose Vehicle and Customer will contribute capital in the project / business venture which Customer has earlier requested for funding. This joint venture can be done through *Musharakah* Joint Venture (JV Partners) and Joint-Venture Agreement. The capital raised shall be used to finance property development projects and contract financing or other identified business ventures (“the Project”) that generate revenue with the objective of making profit.

The simple product arrangement is shown in **Diagram 1**



Capital Contribution to the Joint Venture (JV) is subject to negotiation, feasibility study, internal policies, Board of Directors approval and project’s meeting the relevant credit risk’s requirements. AB Bank via AB SPV and Customer shall regulate their relationship as the shareholders of *Musharakah* JV in the JV Agreement. Both JV partners shall be represented in the JV’s Joint Management Committee or “JMC”. This arrangement will entail both parties jointly contributing capital in the JV Agreement. AB Bank, through its AB SPV, will take up majority / controlling stake in *Musharakah* JV, with the balance to be contributed by the Customer. The purpose of this financing is to channel the funding direct to the project or business undertaking with AB SPV via JMC having the rights to observe and monitor regarding the business and non-business aspects of the JV and its business.

Based on the simple product arrangement, several benefits already identified from this product are as follows:

### **Possibility of having higher net margin**

The return from *Musharakah*-based products is higher than those provided under the normal debt financing arrangement due to the inherent higher risk involved. We are looking at Risk Rating Method per project benchmark on projects in which we have the option of exercising extensive participation. The Bank shall have share control over the management of the project via representative in JMC.

### **High Return**

The Bank has opportunities to earn higher returns through sharing of the profits as high risk high return.

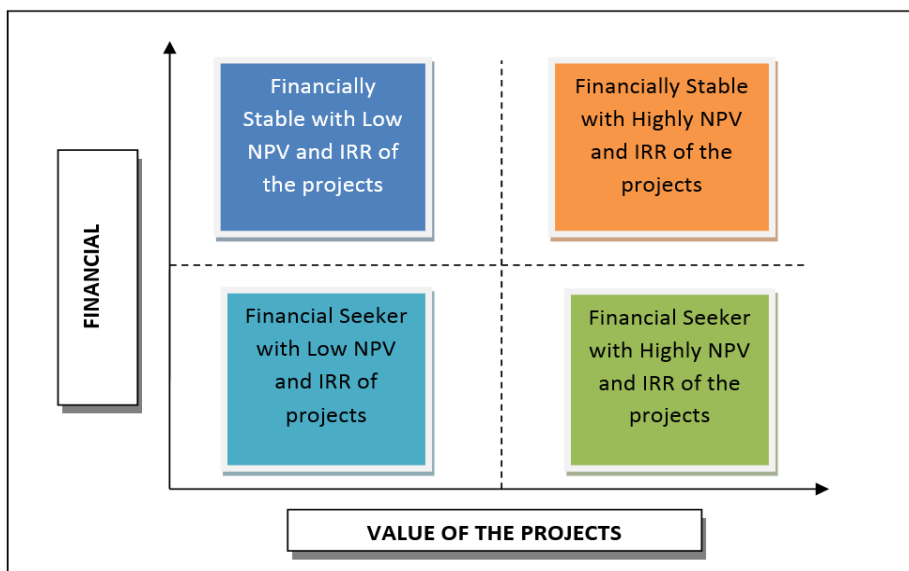
### **Minimization of Capital Leakage**

Compared to the current financing arrangement where financing is extended to the owners of the business venture/projects, direct project/business financing can minimize capital leakage through active participation in the project management.

### **More Acceptable Proposition to investors from Middle East**

*Musharakah* provides an alternative investment, which will cater for Islamic investors and partners, especially from GCC, who may have been reluctant to invest in conventional or current debt-based financing schemes. With *Musharakah*, the most preferred and globally accepted Islamic financing structure, we can attract these investors to participate on similar risk-sharing arrangements through the creation of Islamic Syndication to back the financings made into the JVs.

Since the product requires a degree of sophistication from the investors, it is intended for the product to initially, be marketed to targeted groups of customers as per matrix below:



## 2. Risk Analysis

### 2.1 Market Risk

The utmost challenging issue faced by Islamic Financial Institution in the process of the implementation of the Islamic financial system is the advancement of *Musharakah* instrument that can provide the investors an adequate level of liquidity, security and profitability to support their holding. In Islamic financial system, *Musharakah* is acceptable because it represents a position in real assets and having risk-bearing characteristics whose rate of return is variable and tied to the performance of the asset.

- Risk Mitigation

- Pre-emptive measures:

The financing (credit) proposal paper submitted by EXIM Bank's personnel to Board of Directors should include the project cash-flow evaluation using corporate finance approach (using NPV, IRR, DCF valuation) to investigate its viability breakeven analysis and possible default.

- Post-monitoring measures:

Hedging instruments in the form of currency markets should be put place.

### 2.2 Credit Risk

The Bank limit its role in monitoring the company's performance without intervening the partner's roles in managing and upholding confidentiality which does not relate to the specific joint-venture project for *Musharakah*

financing. The financing provided by banks is also not a part of the permanent capital of a company, though there is no legal restriction for banks to finance the working capital requirement of a company in the form of “equity” or capital participation if it is mutually agreed between the contracting parties. The decision whether to enter into a *Musharakah* arrangement with a company is based on time-honoured and prudent practices observed by banks all over the world. Proficient management, commitment-worthiness and a good performance record are some of the utmost important criteria on which a decision is normally taken.

However, in cases of new companies, banks have to exercise their good judgement. Banks may adopt different techniques in evaluating a *Musharakah* financing proposal. To evaluate the earnings ability of a proposal with objectiveness the under noted exercise will be uncovering helpful in quantifying the profit operation of a company wishing to enter into a profit and departure sharing arrangement with a bank.

The profit projections made by a company in line with its past performance or in the light of its justifiable future plans and the economic climate in general are among the basis used in determining the profit sharing ratios for a *Musharakah* venture. In *Musharakah*, banks only provide funds whereas a company or its directors besides providing capital use their enterprise, energies, skills, expertise and connections in running the business and its affairs.

The drawback is that projects for funding through *Musharakah* are expected to be selected primarily on the basis of both anticipated profitability and the credit-worthiness of the partner. Potential exposure to credit risk became one of the main resistance points for Bank in persuading *Musharakah*.

The credit risk may arise when the counterparty fails to meet its obligations in accordance with the agreed terms and conditions. In event of defaults in debt contracts, the collateral pledged to the bank shall be liquidated to recover the principles. The only way Banks can minimize credit risks in “equity” or capital financing is by aggressively engaging in the improvement of the assets and recovering returns through the sale of its share in the project at the appropriate time. The back side of it, it’s hard to dispose the asset at a fair value and the return of the financier will suffer although stringent monitoring and control are in place. While the banks can sell its shares either to the entrepreneur or other interested parties, one way in which the value of a firm can be enhanced is by by issuing initial public offering (IPO) in the stock market. The latter would be possible if a well-functioning and a proficient stock market exists.

### 2.3 Operational Risk

*Musharakah* structure is document intensive compared to conventional, tedious documentation procedures for financing drawdown, and more *Shariah* audits, time consuming and costlier for issuer. *Musharakah* in particular requires more commitments and effort from the Bank in the aspect of monitoring and supervision as the Bank assumes business as well as credit risks. Given the fact that *Musharakah* is “equity” or capital financing in character, collateral is not prerequisite. This inability to secure a lien on the assets of the business partner would require careful evaluation of the prospects of the business. As the entire business is based on confidentiality, the client entering into *Musharakah* may put a condition that the Bank will not interfere with the management affairs that is not related to the joint-venture project and will not disclose any information about the business to any person without prior permission of the client. However, the extent to which EXIM Bank’s Board Representative may have the access to primary and sensitive information of the invested entity would depend on whether such financing does not rank the same as a debt holder (i.e. first claimant). If the financing does not rank the same as a debt holder, given the higher capital risk exposure, the Board Representative should be allowed to access to primary and sensitive information of the invested entity, including discussion on the company’s exposures with other bank.

### 2.4 Liquidity Risk

In an Islamic Bank, the security is only needed to protect the respective customers from their inability to repay to the bank if they unsuccessfully run their business with the funds provided by the bank. If this happened, and the security is held by the Bank, the customer’s account payable could be settled through the selling of security. The mismatch between the amount money withdrawn and the completed work could happen and which may lead to overspending at the end, especially if the money for the specific project is not efficiently managed and utilized. In such case, the Bank shall intervene to resolve the situation as soon as it notices any indication of such mismatch. The best solution for the Bank is by executing a workable drawdown mechanism that can avoid Capital Leakage. It is imperative that the Bank releases cash orders and direct payments to certain identified beneficiaries. Also, progressive monitoring of assets and liabilities in the JV for construction

projects under JV can be done stringently by using the general formula as per below:

$$\text{Entitlement for Current Disbursement + Outstanding Capital to be redeemed} \leq \text{Current Deposits (payments received in Project Account and Sinking Fund) + Receivables (pending certification and payment receipts)}$$

Returns to the banks are more uncertain as they depend on the performance of the business; in other words, there are no guaranteed annual profits. It is risky to finance medium and long-term projects out of short-term funds. The inappropriate matching between the maturities of the assets and liabilities in the Bank's balance sheet lies at the root of this problem. When there is a mismatch between the two, liquidity risks arise.

- Risk Mitigation

- In order to avoid possible exposure on the liquidity risk, the liability should be in long-term maturity to enable the Bank to finance the assets using "equity" or capital financing. The risk-adjusted profit for the bank increases should the investment made in assets for longer terms (i.e. equities) which are financed by the long-term liabilities.

- As the banks deal mainly with deposits that are short term, the complementarities between assets and liabilities indicate that it is just optimum (in terms of risk-adjusted profits) to use assets that have a relatively short-term maturity. Since the availability of long-term liabilities is limited in many Islamic financial markets, most banks would prefer to engage in short-term fixed income instruments like *Murabahah* and *Ijarah* to avoid liquidity mismatch.

- Under AAOIFI 3/1/5/14, it is permissible, based on the association or a decision of the partners, not to distribute profits of the company from the creation of Sinking Fund. It is also permissible to set aside periodically a certain ratio of profit as solvency reserve or as a reserve for meeting losses of capital (investment risk reserve or as a profit equalization reserve).

## 2.5 Legal Risk

Various regulatory requirements will need to be met when investing directly in a business. The SPV structure will perceive benefits for Bank in terms of "Ring-Fenced" and insolvency-remoteness (such as from some of the extraneous risks associated with the ownership of the asset, example

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environmental liability). The Bank's liability is up to extent of its financing in the specific JV, extended via the SPV if there are liabilities arising, it would "claw" back to the SPV only if the SPV has given a shareholder's guarantee, and otherwise, liability will stop at the JV level. The legal document must clearly stipulate:

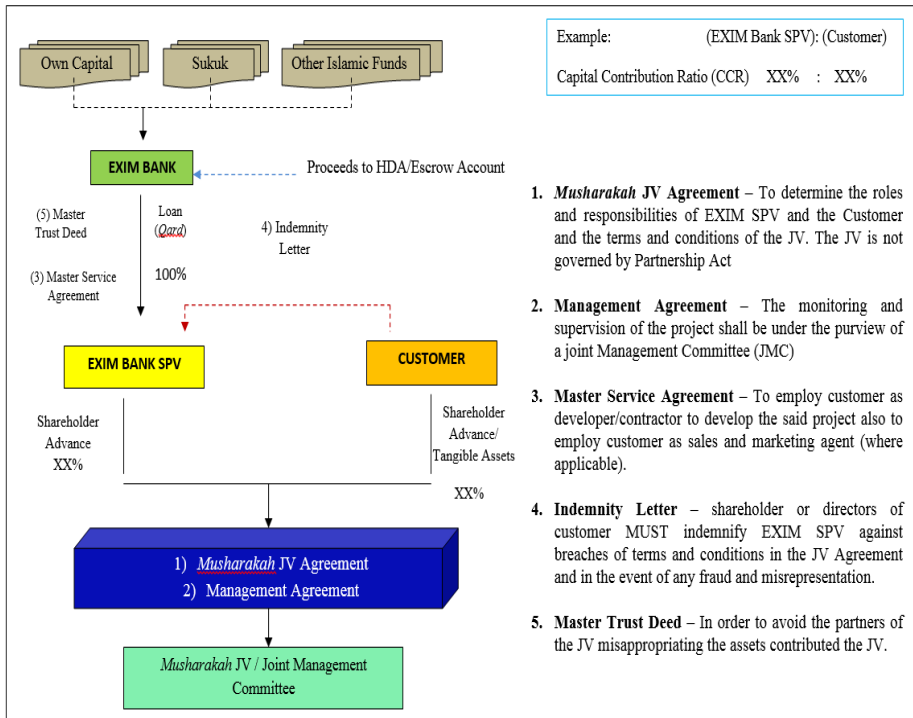
- ✓ Purpose of *Musharakah* venture
- ✓ Relationship between contracting parties
- ✓ Rights, roles and responsibilities of the contracting parties to the *Musharakah* venture
- ✓ Capital contributed by contracting parties
- ✓ Profit Sharing Ratio adopted for the *Musharakah* venture
- ✓ Provision on Loss shall be borne proportionate to the capital contribution
- ✓ Calculation methodologies and timing for profit distribution
- ✓ Specific tenure of venture
- ✓ Pricing or valuation methodology used for underlying asset or shares
- ✓ Reporting of the *Musharakah* performance which include the frequency and the type of information to be include in the report
- ✓ Collateral and guarantees including rights over assets, if any
- ✓ Provision on Terms and Conditions on dissolution, termination, redemption or withdrawal of *Musharakah* venture
- ✓ Fees and charges to be borne or waive by the contracting parties

The JV Agreement should entail the rights and exclusively of each partners. It is also more important to be involved in the day-to-day management as stated in the agreement. The Bank should be watertight in governing the business, and should not just be a JMC Nominee. Thus JV agreement should also focus the legal perspective in Civil Law, necessary undertakings and pre-determination of default / negligence.

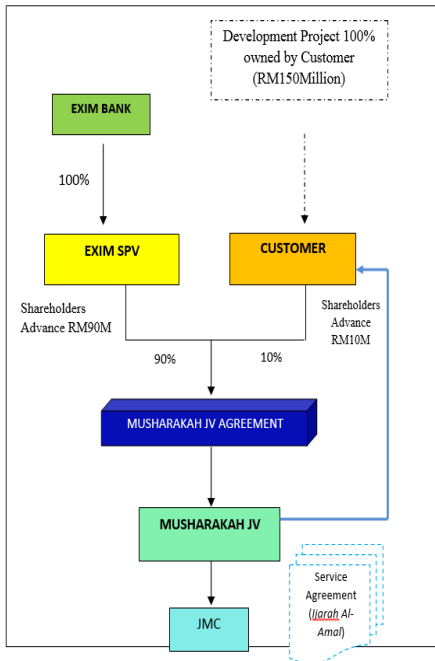


### 3. Salient Features and Product Structures

#### 3.1 Product Legal Structures



### 3.2 Product Mechanism Structure



- Customer as the Developer, to execute Development Project worth RM150.0 million in sales proceeds.
- EXIM SPV injects loan (Qard) of RM90.0 million for working capital of the Project, while Customer's capital contribution is by Land, worth RM10.0 million.
- In order to avoid the partners of the JV misappropriating the assets contributed into the JV, a Master Trust Deed over such assets is to be issued by the JV in trust of each of the partners to the JV. This shall enable a Trust Caveat to be entered and lodged by the JV to acknowledge that the land contributed as "capital" by Customer whereas the beneficial interest of the Land is held by the partners.
- Service Agreement (under *Ijarah Al-Amal* concept) shall state the employment of the Customer by EXIM SPV via the JV as:
  - The developer, to complete the works arising from or in relation to the Project.
  - The Customer will be employed as the Attorney to sign the sale and purchase agreements, pursuant to the Service Agreement, on behalf of the JV
- Capital redemption payment may only commence upon completion of the development project.
- Profit will be shared and distributed upon completion of the project.

The following table shows the product features for *Musharakah Tijarah* Cross-Border Financing:

No.	Item	<i>Musharakah Tijarah</i> Cross-Border Financing Features
1.	<i>Musharakah</i> JV Partners	i. Malaysian Controlled Company; ii. AB SPV
2.	<b>Business Model and Financing Objective</b>	<p>Incorporated partnership governed by JV Agreement under <i>Musharakah</i> concept. Active participation by AB Bank via AB SPV as majority stakeholder. <i>Shariah</i>-compliant financing with the objective of making profits. To bridge finance the Project's working capital and capital expenditure to the completion of the project overseas inclusive but not limited to:</p> <ul style="list-style-type: none"> <li>I. Fixed assets (inclusive of land, vehicles, machinery, equipment and tools);</li> <li>II. Working capital (raw materials, construction material, supplies);</li> <li>III. Labour (payment to sub-contractor);</li> <li>IV. Professional fees;</li> <li>V. Preliminary expenses.</li> </ul>

No.	Item	<i>Musharakah Tijarah</i> Cross-Border Financing Features
3.	Special Purpose Vehicle (SPV)	<p>AB Bank is represented by AB SPV as JV partner. A Master Trust Deed is to be executed in favour of AB Bank over the monies held by AB SPV pursuant to the <i>Musharakah</i> Venture for the purpose of channelling the financing funds to individual JVs.</p> <p><u>Rationale of SPV set-up:</u></p> <ol style="list-style-type: none"> <li>a. AB SPV is “ring-fenced” against liabilities of the JVs.</li> <li>b. SPV is established for the specific venture and terminate upon completion of projects.</li> <li>c. AB SPV has insolvency remote features: specific set-up purpose, sub-contract to AB Bank via Master Agency Agreement, no employees and quantifiable liabilities.</li> </ol> <p>(Note: JV is governed by Contract Act which is based on terms and conditions, instead of Partnership Act that is based on unlimited liabilities (clause in JV Agreement))</p>
4.	Facility Agent	<p>AB Bank (via Master Agency Agreement with AB SPV)</p> <p><u>Roles and Responsibilities</u></p> <ol style="list-style-type: none"> <li>1) Reviewing and approving the construction, progress and execution plan of the Project;</li> <li>2) Determination of fees payable to the consultants and / or professionals appointed for the Project;</li> <li>3) Approving all financial statements prepared and submitted by the Customer</li> <li>4) Reviewing and approving the working budget and working capital requirements proposed or formulated by the Customer in relation to the Project.</li> </ol>

No.	Item	<i>Musharakah Tijarah</i> Cross-Border Financing Features
5.	JMC	Besides covenants, the active monitoring and management of the Project under the purview of the JMC assisted by qualified personnel including RM and/or external PMC for early detection of any problems in Project. All these factors will minimize both performance and capital payment risk.
6.	Sources of Funds	<p>Funding includes</p> <ol style="list-style-type: none"> <li>I. Own Capital</li> <li>II. Sukuk</li> <li>III. Other Islamic Funds</li> <li>IV. Investment Account Platform (issued by BNM)</li> </ol> <p><u>Rationale sukuk and other Islamic funds:</u></p> <ul style="list-style-type: none"> <li>• Back to back funding arrangement with lower cost of fund or issuance of Sukuk (no dividend payment until declaration of profit) carrying zero risk weighted.</li> <li>• AB Bank leverages on external funding arrangement.</li> </ul>
7.	Eligibility	<ol style="list-style-type: none"> <li>1) Malaysian owned / controlled companies registered under Companies Act 1965.</li> <li>2) Customer possesses valid license / permit / contractor registration from the relevant authorities.</li> <li>3) Start-up companies</li> <li>4) No track record</li> <li>5) Lack of capital</li> <li>6) Have viable project and expertise</li> <li>7) No securities</li> </ol>

No.	Item	<i>Musharakah Tijarah</i> Cross-Border Financing Features
		Note: the above list is non-exhaustive in nature and is meant to serve as a guide on the type of companies/business that the Bank should be extending the <i>Musharakah Tijarah</i> Cross-Border Financing-i facilities.
8.	Target Sector	Development Projects Financing.
9.	Tenure of Joint Venture	Min 1 year and Max 7 years.
10.	Currency	The offering of this project is in RM and any other currencies acceptable to AB Bank.
11.	Margin Participation	<p>I. AB SPV's minimum financing size in MTF-i is RM2 million</p> <p>II. The Financing or Capital Contribution is between 70% (minimum) to 90% (maximum) of Project Cost</p> <p>III. However, Project Cost in Development Project Financing must take into account the anticipated minimum sales to complete project based on the Project's cash flow schedule (where applicable)</p> <p><u>Rationale of Capital Contribution of 90%:</u></p> <p>Higher margin will be compensated in the Profit Sharing Ratio. However, this margin would depend on our risk appetite and negotiation with Customer. This is major differential advantage for MTCBF-i. As a JV partner, AB Bank must ensure sufficient capital injection for working capital and CAPEX to avoid non-delivery of project. The delivery of the project will protect AB's capital financing in the JV ultimately.</p>

No.	Item	<i>Musharakah Tijarah</i> Cross-Border Financing Features
		Capital redemption to AB Bank is subject to satisfactory project completion and sufficient sales proceeds. As a JV partner, both capital redemption and profit payment to AB Bank are directly linked to achievement in sales proceeds. Project completion may be in phases and subsequently sales will materialize.
12.	<b>Qualified Capital &amp; Capital Contribution Ratio (CCR)</b>	<p>i. Initial agreed CCR is (AB SPV) : (Customer), i.e. X% : Y% or other ratio determined by the Bank</p> <p>ii. The quantum and type of Capital Contribution of each party must be clearly stated and agreed upfront</p> <p>iii. The only type of capital accepted is cash in any currencies. Any variation, which includes assets which market value is available and can be valued independently, is subject to AB Bank BOD's approval.</p> <p>iv. All forms of debts shall not qualify as <i>Musharakah</i> capital. Payment due from other partners or third parties is considered as debt and will be treated in a separate contract.</p> <p>v. CCR changes progressively once capital redemption takes place.</p> <p>Note: Proposed Capital Contribution Matrix based on Risk Rating Methods as per <b>Appendix I.</b></p>
13.	<b>Disbursement Procedure</b>	<p>i. This procedure refers to the disbursement of funds to the Project venture</p> <p>ii. Disbursement patterns will mirror the Project's cash flow needs and may not have</p>

No.	Item	<i>Musharakah Tijarah</i> Cross-Border Financing Features
		<p>equal disbursement quantum throughout the tenure of the Project</p> <p>iii. Disbursement is upon fulfilment of all applicable conditions and perfection of all legal documentation to the satisfaction of AB Bank.</p>
14.	<b>Distributable Profits</b>	<p>i. The formula to derive the base of the profit calculation must be agreed upfront by both parties. The projected profit is based on pro-forma figures of both Projected P&amp;L and cash-flow, which may change as revenue and costs elements change. Credit risk is also taken into consideration in determining the formula</p> <p>ii. Distributable Profits (before tax) may be declared at quarterly, semi-annual or annual basis. There are accrued in <i>Musharakah</i> management accounts and later disbursed to Partners upon realization of Cash Surplus (i.e. Sales Proceeds in Cash)</p> <p>iii. AB Bank's Profit portion to be recognized in Customer's accounts as Financial Expenses instead of Dividend Paid, upon disbursement.</p>
15.	<b>Profit Sharing Ratio ("PSR") and Loss Sharing Ratio ("LSR")</b>	<p>i. The Distribution Profit shall be in accordance with the ratio as agreed upfront as (AB SPV) : (Customer), i.e. X% : Y%</p> <p>ii. The determination of PSR is either:</p> <p>a. PSR agreed upfront as fixed throughout Tenure: or</p> <p>b. Present PSR equals to up to beginning CCR of the accounting period, since CCR is subject to change progressively upon capital redemption; or</p>



No.	Item	<i>Musharakah Tijarah</i> Cross-Border Financing Features
		<p><b>c. Profit Sharing Ratio Matrix (Appendix II)</b></p> <p>iii. The loss sharing ratio (LSR) must be equivalent to CCR at any point of time.</p> <p>iv. The PSR may be revised either based on the mutual agreement of the partners or based on a certain benchmark agreed upon by the partners as the case may be. (BNM: Concept Paper – <i>Shariah</i> Requirements, Optional Practices and Operational Requirements of <i>Musharakah</i>)</p> <p>Note: The profit earn from contract awarded will place in Project Account and distribute until end of the project and subject to the IRR of the project.</p>
16.	<b>Profit Distribution Date (Excess Profit Payment)</b>	The date of profit paid to shareholders upon realization of Cash Surplus. AB Bank had the discretion to release profit payment to the partners from the Distribution Profit Account or Escrow Account or hold the payment by transferring the profit to Sinking Fund instead.
17.	<b>Availability Period</b>	Subject to the nature of Project.
18.	<b>Collateral</b>	<p>Nil. However, 3<sup>rd</sup> party's collaterals are allowed to secure AB SPV's Capital Contribution only</p> <p>Note: The collateral can only be liquidated in the event of misconduct (ta'addi) or negligence (taqsir) or breach of specified term (mukhalafah al-shurut) of contract. (BNM: Concept Paper – <i>Shariah</i> Requirements, Optional Practices and Operational Requirements of <i>Musharakah</i>)</p>

No.	Item	<i>Musharakah Tijarah</i> Cross-Border Financing Features
19.	Guarantee	Nil. Guaranteed profit and principle are not allowed. Performance Guarantee from shareholders or directors of Customer or third party allowable.
20.	Indemnity	The directors or shareholders of Customer must execute Indemnity Letter to indemnify AB SPV against breaches of terms and conditions in the Joint-Venture Agreement and in the event of any fraud and misrepresentation.
21.	Periodic Review	AB Bank's Credit Committee will be updated by JMC on a annual basis.
22.	Exit Plan	<p>i. Form of the <i>Musharakah</i> JV Share Certificate</p> <p>AB SPV's commitment will be in cash and shall be represented by this share certificate. This form is issued by Customer to certify AB SPV shares in the project or business referred to in the Joint-Venture Agreement</p> <p>ii. Form of the Sale of <i>Musharakah</i> JV Share Certificates Agreement</p> <p>This form gives AB SPV the right at its absolute discretion at any time to sell the Share Certificate on a staggered basis as set out in the Joint-Venture Agreement</p> <p>iii. There are 3 events of sale of <i>Musharakah</i> JV Share Certificates:</p> <p>a. AB SPV to exit early from JV in the event of non-default</p>

No.	Item	<i>Musharakah Tijarah</i> Cross-Border Financing Features
		<p>b. Prepayment by Customer (own means, exclusive from JV's revenue and returns) in the event of non-default</p> <p>c. AB SPV to exit from JV in the event of default</p> <p>Formula for determining sale price of <i>Musharakah</i> JV Share Certificates must be agreed upfront as follow:</p> <p><b>Selling Price = P + Premium</b></p> <p><b>Where;</b></p> <p><b>P = Outstanding Capital</b></p> <p><b>Premium = P x Y x (n/365)</b></p> <p><b>Y = Negotiated % agreed by partners</b></p> <p><b>n = Number of days elapsed from the date of disbursement to the date of divestment.</b></p> <p>The formula applies for situations in which there has been no prior redemption of capital or payment of profit. Otherwise, it will be adjusted due to effects of these payments accordingly.</p> <p>Or</p> <p><b>Market Value x Capital Contribution (whichever is higher)</b></p> <p>iv. AB SPV may deliver a Notice of Sale of <i>Musharakah</i> JV Share Certificates to a 3rd party, other than Customer, at a negotiated market value.</p>
23.	<b>Designated Accounts</b>	Project a/c, Escrow a/c, Sinking Fund and Distribution a/c where applicable. AB SPV's representatives will act as the sole signatory to all the accounts.

No.	Item	<i>Musharakah Tijarah</i> Cross-Border Financing Features
24.	<b>Documentation</b>	<p><u>Mandatory documentation are:</u></p> <ul style="list-style-type: none"> <li>i. Letter of Engagement</li> <li>ii. Joint-Venture Agreement / Co-Ownership Agreement</li> <li>iii. Indemnity Letter</li> <li>iv. Form of the <i>Musharakah</i> JV Share Certificate; and</li> <li>v. Form of the Sale of <i>Musharakah</i> JV Share Certificates Agreement</li> </ul> <p>Additional documentations are need to be considered:</p> <ul style="list-style-type: none"> <li>I. Management Agreement</li> <li>II. Service Agreement</li> <li>III. Letter of Undertaking by the partner to utilize the facility strictly for the purpose of the financing</li> <li>IV. Declaration of Trust</li> <li>V. Deposit of Land Title</li> <li>VI. Companies Act 1965 related documents and forms</li> </ul> <p>Other relevant documents as advised by AB Bank's legal advisor and management as long it is <i>Shariah</i> Compliant.</p>
25.	<b>Capital Adequacy Requirement</b>	<p>AB Bank's capital base erosion treatment at single tier level; minor investment in AB SPV, together with 150% risk weight on the financing amount. (BNM Guidelines on Property Development and Property Investment Activities by Islamic Banks).</p>
26.	<b>Termination</b>	<p>Upon expiry of the <i>Musharakah</i> Tenure and project completion, the <i>Musharakah</i> joint</p>

No.	Item	<i>Musharakah Tijarah</i> Cross-Border Financing Features
		venture is terminated, unless extended with the mutual consent of the JV partners. EXIM SPV may undertake recovery actions via disposal of the Project Land / Asset after all creditors' obligations have been honoured.

#### 4. Conclusion

In this paper, we have examined the concept, structure and salient features of *Musharakah Tijarah* Cross-Border Financing is the product to enable the Bank to undertake project and contract cross-border financing activities or other identified business ventures on “pure” Joint Venture basis, using the underlying Islamic financing contract of *Musharakah*. Same time, we have discussed the risks associated with the proposed product such as market risk, credit risk, operational risk, liquidity risk and legal risk. Additionally, the current most of products are offered by Islamic banks based on sale-based contracts such as *Murabahah*, *Tawarruq*, *Ijarah*, *Salam*, *Istisna*, etc., which trigger some issues from *Shariah* perspective such as benchmarking of interest rate. This product encourages mobilization of idle capital / cash entities within cross-border financing activities and thus provides a basis for economic cooperation between these organizations in the society. The product also is expected to inject greater prosper to the Bank’s overall performance and ultimately able to assist small time landowners in a big way through business risk sharing or profit and loss sharing (PLS) mechanisms. *Musharakah* provides an alternative investment vehicle, which will cater for Islamic investors and partners, especially from Gulf Cooperation Council (GCC), who may have been reluctant to invest in conventional or current debt-based financing schemes. With *Musharakah* concept, the most preferred and globally accepted Islamic financing mode, this can attract these investors to participate on similar risk-sharing arrangements through the creation of Specific Investment Account (SIA) or Islamic Syndication to back financing made into the Joint Venture. Premised on the above, *Musharakah Tijarah* Cross-Border Financing provides the Bank wider customer experience for markets that are still largely untapped. It also provides opportunities to expand the investment choices / opportunities available to the Bank clients and allow them to execute alternative investment strategies. Customer also may leverage on market reputation as a JV partner to the Bank.

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## Appendix 1

Capital Contribution Matrix (Based on Risk Rating)

Possibility of Default	Explanation	Capital Contribution Ratio (Bank:Customer)
1 (Highest Credit Quality)	Rating 1 denotes lowest expectation of default risk. Rating 1 is only assigned where customer is expected to have strong capabilities to fulfil financial obligation. Payment capacity is highly unlikely to be adversely affected by foreseeable event.	90% : 10%
2 (Very High Credit Quality)	Rating 2 denotes expectation of very low default risk. Strong capacity fulfilment of financial commitments is expected. The customer is expected to withstand potential adverse market condition. Capacity of payment financial obligation is most significantly vulnerable to foreseeable event.	85% : 15%
3 (High Credit Quality)	Rating 3 represent expectation of low risk of default including in the event of adverse market condition.	
4 (Good Credit Quality)	Rating 4 indicates expectation of default risk is currently low. Payment capacity of financial obligation is deemed adequate. Adverse market or economic conditions however are more likely to	

	impair the financial capacity for payment.	
5 (Higher Credit Risk)	Rating 5 indicates higher vulnerability to default risk, particularly in the event of adverse changes in business or economic condition over time.	
6 (Significant Credit Risk)	Rating 6 indicates significant credit risk. The customer is currently to meet financial commitment, but adverse financial or economic condition will likely impair capacity to meet financial commitment.	70% : 30%
7 (Substantial Credit Risk)	The customer is currently vulnerable and payment capacity hinges on favourable financial and economic condition. Default is a real possibility.	
8 (Very High Credit Risk)	Customer is highly vulnerable to adverse financial and economic condition. Default appears probable.	
9 (Exceptionally High Level of Credit Risk)	Default is imminent and inevitable or customer is in standstill.	

**Note:** Advance margin will be compensated in the Profit Sharing Ratio. However, this margin would depend on our risk appetite and negotiation with Customer. This is major differential advantage for JV. As a JV partner, Bank must ensure sufficient capital injection for working capital and CAPEX to avoid non-delivery of project. The delivery of the project will protect Bank's capital financing in the JV ultimately. Capital redemption to the Bank is subject to satisfactory project completion and sufficient sales proceeds. As a JV partner, both capital redemption and profit payment to the Bank are



directly linked to achievement in sales proceeds. Project completion may be in phases and subsequently sales will materialize.

## Appendix II

### Profit Sharing Ratio Matrix (Based on Risk Rating)

Possibility of Default	1 – 2 YEARS TENURE OF JV	2 - 5 YEARS TENURE OF JV	5 - 7 YEARS TENURE OF JV
	(Bank : Customer)	(Bank : Customer)	(Bank : Customer)
1	30% : 70%	35% : 65%	40% : 60%
2	35% : 65%	40% : 60%	45% : 55%
3	35% : 65%	40% : 60%	45% : 55%
4	35% : 65%	40% : 60%	45% : 55%
5	35% : 65%	40% : 60%	45% : 55%
6	40% : 60%	45% : 55%	50% : 50%
7	40% : 60%	45% : 55%	50% : 50%
8	40% : 60%	45% : 55%	50% : 50%
9	45% : 55%	50% : 50%	55% : 45%

Low Risk

High Risk

Low Return

High Return

**Note:** This matrix based on simple percentage benchmark to determine the Profit Sharing Ratio (PSR). The PSR will increase accordingly base on tenure (5%) of the project.

