# 8th SC-OCIS Roundtable

## CREATING SHARED VALUES THROUGH RISK SHARING

**25-26 March 2017**
**Ditchley Park, Oxfordshire**

**Programme is subject to change and is correct at time of print*

## TOPIC FOR SESSION 1:

## RISK SHARING AT THE CROSSROADS – INVESTMENT OR FINANCING?

Cooperation and trust building is at the core of socio-economic progress for any society and sharing-based financial contracts contribute to promote these features. It was partnerships and innovative contracts that contributed to the expansion of trade and development of Europe in the 14th century. Similarly, venture financing of the start-ups in the Silicon Valley was at the heart of present day progress of information technology. The 14th century Venice saw several financial innovations, such as the introduction of limited liability joint-stock companies which catalysed development of international trade. The *collengaza*[1] or securities issued by these joint-stock companies became a popular contract as it enabled the smaller merchants to gain access to international trade by taking risks on travelling merchants. In the late 19th century stock markets in Germany replaced the loan markets as the major source of capital to the extent that Germany overtook England in terms of industrialization.

However, it was not until the mid-19th century, when the modern company was born, that limited liability acquired its present significance. Large projects, notably the railways, needed equally large capital investment, and limited liability was a useful factor in attracting capital from a large number of investors. There is consensus among medieval historians that the *qirad* which later evolved to *commenda*[2], was of the highest importance and contributed immensely to the rapid growth of trade and investment leading to economic change and development in Europe[3]. *Commenda's* contributions to industrial development of Ruhr Valley in Germany and in building railroads in Europe for example were particularly pronounced.

The rise of stock market is part of the same phenomenon. Venture capital, crowd funding and peer to peer funding are the modern innovations that have potential to contribute positively to risk taking and economic development.
While the pertinent literature on Islamic finance continues to emphasize profit-and-loss sharing (PLS) as the main modes, the present practices of Islamic financial institutions (IFIs including banks, non-banks and capital markets) are such that they have deliberately and systematically avoided PLS modes. This trend towards greater use of debt-creating finance is not necessarily creating the level of cooperation, trust-building and socially beneficial risk-taking that are required for inclusive and

[1] Securitisation of an arrangement between an investor and a travelling merchant. The investor provides goods to the travelling merchant who sailed abroad to sell them, bought new goods with the proceeds, and returned to Venice to sell them. Profits were split in pre-arranged manner.

[2] Commenda is a form of trust in use in the Middle Ages in which goods are delivered to another for a particular enterprise (as for marketing abroad). It embodied borrowings from several sources in different proportions. Professor Udovitch has argued that the source most likely to have contributed to the Commenda was the Muslim *qirad* contract.

[3] Limited Liability and Islamic Law, Nicholas HD Foster, SOAS

sustainable economic growth. It has also contributed to increasingly high focus on short-term gains by the IFIs and the market participants.
With these thoughts, we would like to explore how Islamic finance can help in enhancing economic growth, and what can be done to help Islamic finance sector grow in socially useful ways.

What are the challenges and key success factors for practicing sharing-based finance?

i. **What are the regulatory disadvantages of equity under banking framework?**
   a. Unlike debt instruments, higher regulatory charges are imposed on longer term-duration instruments i.e. regulation weigh risks but not return
   b. Higher capital charge on equity instrument
   c. Little incentive for equity. Dividends are taxable while interest expense is tax deductible making debt cheaper
   d. Fractional banking makes debt cheap through leverage
   e. Are these factors indeed the regulatory disadvantages of equity vs debt?
   f. To what extent they contribute in the decision making of IFIs? In the decision making of the customers of IFIs?

ii. **Equity**
   a. Because of the higher cost, equity attracts higher risks. Profitable companies would most likely want to maximise profits by taking debt
   b. How severe is the adverse selection problem?

iii. **What structures should be incorporated into risk sharing to enable it as an effective capital market tool?**
   a. Dividends vs Profits
   b. Accounting issues
   c. Risk sharing: Using the rate of return from the real economy as sharing formula
   d. Diminishing Musharakah structures for non-housing financing contracts
   e. Managing the issues of control, ownership and risk sharing with contingent control contracts

iv. **What support institutions should be developed to reduce information asymmetry as well as misuse of information to enable risk sharing as an easy to use contract?**
   a. Creation of business rating bureau not simply a credit rating bureau
   b. Rule of law to improve contractual enforcement
   c. Possible role of waqf institutions in supporting PLS contracts
   d. Creation of bankruptcy and dispute settlement regimes

## SESSION 1:

## RISK SHARING AT THE CROSSROADS – INVESTMENT OR FINANCING?

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|---|---|---|
| **Presentation 1** | **:** | **Risk Sharing: Myth or reality?**<br>• Is risk shifting sustainable?<br>• How can risk sharing be translated into new realities? |
| **Presenter** | **:** | **Dr Adam Ng, SC-OCIS Scholar-in-Residence 2014/2015** |
| **Respondent** | **:** | **Aamir A Rehman, Fajr Capital** |
| **Presentation 2** | **:** | **Limited Partnership and Shariah**<br>• Is Limited Partnership a true Shariah compliant contract?<br>• True partnership vs Limited Liability. Is it compatible?<br>• Possible models to facilitate risk sharing |
| **Presenter** | **:** | **Neil D Miller, Linklaters LLP** |
| **Respondent** | **:** | **Professor Dr Mehmet Asutay, Durham University** |

## TOPIC FOR SESSION 2:

## INCORPORATING SHARED VALUE OBEJECTIVES THROUGH RISK SHARING

Economic partnerships structured as an essential mechanism to achieving sustainable development outcomes could lead to the creation of lasting prosperity. The concept of shared value forms the basis of *maqasid shariah* that commercial transactions can deliver sustainable social impact while achieving commercial returns.

A notable observation is that the objectives, interests and values between social objectives and business; based on trust and a sense of shared objectives is now reaching an intersection. At the same time it is increasing access to capital for smaller social and environmental impact issuers, such as through crowd funding and other capital market products.

This is a logical route as the capital market has knowledge, ideas, capabilities and structures as well as effective governance in the form of policies, institutions and functioning economies that can help improve the effectiveness of achieving sustainability. What needs to be further explored is to balance the agenda further through peer regulation and government regulation.

**Areas for Discussion:**

**A. Maqasid of Risk Sharing**

- Patient capital vs short term investment
- Risk perspective – Linking risk sharing to social objectives
- True profit distribution: Interim vs upon project termination
- Instilling the spirit of cooperation and competition for good

**B. How Can Law Help?**

- What is risk sharing?
- Why the disparity between aspiration and practice in IF?
- How did we get here? Ie, what happened in conventional finance?
- Role and limitations of law in the facilitation of risk sharing.
- How to develop the Financial Shariah to support risk sharing? Delinking it from debt.

## SESSION 2:

## INCORPORATING SHARED VALUE OBEJECTIVES THROUGH RISK SHARING

**Presentation 1** : **Maqasid of Risk Sharing**

- Defining Values
- How do we reflect the maqasid in equity based financing?
- Patient capital vs short term investment
- Risk perspective – Linking risk sharing to social objectives
- True profit distribution: Interim vs upon project termination

**Presenter** : **Datuk Dr Mohd Daud Bakar, Amanie Group**
**Respondent** : **Mushtak Parker, Islamic Banker**

**Presentation 2** : **Rethinking Debt-based Musharakah Model**

- Clarify equity structures in fund raising
- True equity based participatory structures by removing the debt component. How can we manifest musharakah and mudharabah structures into real equity structures and not linked to debt?
- Some analysis of the current notable musharakah sukuk

**Presenter** : **Professor Nicholas Foster, School of Law, SOAS University of London**

**Respondent** : **Dr Salman Syed Ali, SC-OCIS Scholar-in-Residence 2016/2017**

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***Dress code: Smart Casual***

## AGENDA

| ***Day 1 – Saturday, 25 March 2017*** | |
|---|---|
| 12.00pm–2.00pm | Arrival at Ditchley<br>• Group Photography Session<br>• Luncheon |
| 2.00pm-2.10pm | Opening Address by Dr Farhan Nizami, Director of the Oxford Centre for Islamic Studies |
| 2.10pm–2.20pm | Welcome Remarks by Tan Sri Dato' Seri Ranjit Ajit Singh, Chairman of the Securities Commission Malaysia |
| 2.20pm–2.40pm | Special Address by HRH Sultan Nazrin Muizzuddin Shah, Sultan of Perak, Malaysia and Royal Patron for Malaysia's Islamic Finance Initiative<br>• Departure of HRH Sultan Nazrin Muizzuddin Shah |
| 2.40pm–2.50pm | Update Session on issues raised at 7th SC-OCIS Roundtable<br>Presentation: Zainal Izlan Zainal Abidin, Securities Commission Malaysia |
| 2.50pm–3.40pm | **Session One: Risk Sharing at the Crossroads – Investment or Financing?**<br><br>Chairman : Tan Sri Zarinah Anwar, Visiting Fellow OCIS<br>Rapporteur : Datuk Noripah Kamso, Visiting Fellow OCIS<br><br>**Presentation 1 : Risk Sharing: Myth or reality?**<br>• Is risk shifting sustainable?<br>• How can risk sharing be translated into new realities?<br><br>Presenter 1 : Dr Adam Ng, SC-OCIS Scholar-in-Residence 2014/2015 |

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| | Respondent 1 : Aamir A Rehman, Fajr Capital |
| 3.40pm–4.30pm | **Presentation 2 : Limited Partnership and Shariah**<br>• Is Limited Partnership a true Shariah compliant contract?<br>• True partnership vs Limited Liability. Is it compatible?<br>• Explore possible models to facilitate risk sharing<br><br>Presenter 2 : Neil D Miller, Linklaters LLP<br>Respondent 2 : Professor Dr Mehmet Asutay, Durham University |
| 4.30pm–4.45pm | Tea Break |
| 4.45pm–5.35pm | **Session Two: Incorporating Shared Value Objectives through Risk Sharing**<br><br>Chairman : Dato' Dr Afifi al-Akiti, Oxford University<br>Rapporteur : Nash Jaffer, Afkar Consulting Ltd<br><br>**Presentation 1 : Maqasid of Risk Sharing**<br>• Defining Values<br>• How do we reflect the maqasid in equity based financing?<br>• Perpetual capital vs short term investment<br>• Risk perspective – Linking risk sharing to social objectives<br>• True profit distribution: Interim vs upon project termination<br><br>Presenter 1 : Datuk Dr Mohd Daud Bakar, Amani Group<br>Respondent 1 : Mushtak Parker, Islamic Banker |
| 5.35pm–6.25pm | **Presentation 2 : Rethinking Debt-based Musharakah Model**<br>• Clarify equity structures in fund raising<br>• True equity based participatory structures by removing the debt component. How can we manifest musharakah and mudharabah structures into real equity structures and not linked to debt?<br>• Some analysis of the current notable musharakah sukuk<br><br>Presenter 2 : Professor Nicholas Foster, School of Law, SOAS University of London<br>Respondent 2 : Dr Salman Syed Ali, SC-OCIS Scholar-in-Residence 2016/2017 |
| 7.15pm–8.30pm | Dinner |

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## AGENDA

| *Day 2 – Sunday, 26 March 2017* | |
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| 8.00am – 8.45am | Breakfast |
| 9.00am-10.30am | **Session Three: Innovative Models in Risk Sharing and Sustainable Finance**<br>Chairman : Dato' Mohamed Rafique Merican, Maybank Islamic<br>Rapporteur : Badlishah Bashah, Securities Commission Malaysia<br><br>Presentation 1 : The JAK Bank Model<br>Presenter 1 : Sammy Almedal, JAK Bank<br><br>Presentation 2 : Pursuing Sustainable Finance: A Proposed Framework<br>Presenter 2 : Rafe Haneef, CIMB Islamic Bank<br><br>Presentation 3 : Sustainable & Responsible Investment (SRI)<br>Presenter 3 : Omar Selim, Arabesque Asset Management |
| 10.30am-11.00am | **Presentation on Research by Visiting Fellow**<br><br>Presenter : Arshad Mohamed Ismail, SC-OCIS Scholar-in-Residence 2015/2016; and<br>: Associate Professor Lena Rethel, University of Warwick |
| 11.00am -11.30am | Tea Break |

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| 11.30am –12.15pm | **Session Four: Conclusions & Recommendations**<br><br>Chairman : Dr Basil Mustafa, Senior Bursar OCIS<br>Rapporteur 1 : Datuk Noripah Kamsoo, Visiting Fellow OCIS<br>Rapporteur 2 : Nash Jaffer, Afkar Consulting Ltd<br>Rapporteur 3 : Badlishah Bashah, Securities Commission Malaysia |
| 12.15pm –12.30pm | Closing Remarks by Tan Sri Dato' Seri Ranjit Ajit Singh, Chairman of the Securities Commission Malaysia<br>• End of the 8$^{th}$ SC-OCIS Roundtable |
| 12.45pm – 2.00pm | Luncheon |

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