

Investor Guide - Modarabas



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN



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INVESTORS' GUIDE - MODARABAS

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1. What is Modaraba

'Modaraba' is a kind of partnership, wherein one party provides finance to other party for the purpose of carrying on business. The party that provides the finance is called the "*rabb-ul-maal*" (the provider of capital), whereas the other party who puts in his expertise and management skills is called the "*modarib*" (manager).

Modaraba is one of the prime modes of Islamic Financial System. The concept of Modaraba was given over 1400 years ago by our Holy Prophet Hazrat Muhammad (Peace be upon him).

2. Background

In order to initiate process of Islamization of economy in the country, the Government of Pakistan promulgated the Modaraba Companies and Modaraba (Floatation & Control) Ordinance in 1980 (the Ordinance). The Ordinance provides for an interest free business method termed as Modaraba in which funds are obtained from one or more subscribers/modaraba certificate holders (Rab-ul-Maal) for a business to be managed by other individuals/Modaraba Company (Modarib), who participate in it with their skill or efforts or both. The profits earned from investments out of Modaraba Fund are distributed among the holders of the Modaraba Certificates and the management in accordance with the formula agreed before floatation of the Modaraba.

A Modaraba may be either for a fixed period or for an indefinite period. There are two types of Modarabas multi-purpose Modarabas having multiple purposes or objectives; and specific purpose Modarabas.

3. **Benefits attached to Modaraba**

- (i) **Halal Business:** Modaraba has a special and unique corporate identity as no such example is found in the rest of the world. It is the only business model in the financial sector that is based on true Islamic practices duly scrutinized and approved by the members of the Religious Board appointed by the Federal Government. It provides profitable investment opportunities to the stakeholders who are looking for Halal profits on their investments according to the Islamic Shariah.
- (ii) **Tax Benefit:** The income earned by the Modarabas is fully exempted from income tax provided they distribute 90% of their profits among the certificate holders.
- (iii) **Maximum Distribution of Profits:** As an Investor of a Modaraba you may expect getting maximum dividends as 90% of the income/profits of the Modaraba are distributed to the certificate holders in order to avail themselves of the benefit of tax exemption.

4- **Business Model/Structure of the Modaraba**

The Companies incorporated under the Companies Ordinance, 1984 and registered with the Registrar (Modarabas), SECP are eligible to undertake floatation and management of Modarabas.

The Modaraba or Modaraba Fund (pool of funds) is created through public subscription (IPO) and listed on stock exchange(s). Generally, a Modaraba can undertake virtually any business activity that is not repugnant to Islam. The Federal Government has constituted a Religious Board comprising two Shariah scholars and a Judge of High Court which certifies that the business to be undertaken by a Modaraba is not against the tenets of Islamic Shariah.

The Modaraba Companies and Modaraba (Floatation and Control) Ordinance, 1980, Modaraba Companies and Modaraba Rules, 1981 and Prudential Regulations for Modarabas can be visited at the following web links:

http://www.secp.gov.pk/corporatelaws/pdf/jun_26_1980.pdf

http://www.secp.gov.pk/corporatelaws/pdf/jan_26_1981.pdf

http://www.secp.gov.pk/corporatelaws/pdf/Jan_28_2004_PrudentialRegulationsForModarabas.pdf


5- Major Business Activities of a Modaraba

Generally, a Modaraba can undertake virtually any business activity that is not repugnant to Islam and it is approved by the Religious Board. A Modaraba can invest through Islamic Finance Instruments like Murabaha, Musharakah, Ijarah or Modaraba and similar profit and loss sharing schemes. It can also trade in listed and other non-interest bearing securities, project financing, venture capital, export financing, trading, import, export, services, or manufacturing enterprises of any nature and act as an agent or distributors etc.

6. How to invest in Modaraba or in the investment schemes issued by Modarabas

(i) Investment in Certificates of Modaraba:

- (a) Initial Public Offering: The general public, after carrying out due diligence of management and prospectus may subscribe to certificates of Modaraba when these are first time offered by the Modaraba Company in primary market.
- (b) Direct Buying from the Stock Market: One may also invest in the Modaraba Certificates through buying them from registered stock broker (secondary market). The Modaraba



Certificates are quoted and traded on the stock exchange(s) like shares of other listed companies.

(ii) Investment in non-interest bearing finance instruments /schemes issued by Modarabas:


Modarabas offer various non-interest bearing certificates ,i.e., Certificates of Musharakah, certificates of Modaraba, Term Finance Certificates on Musharakah basis, Sukuk etc. approved by the Religious Board and the Registrar Modarabas. These investment schemes are launched by Modarabas on profit and loss sharing basis and rate of return varies based on the periodic profitability of the project/business of the Modaraba. With the approval of the Registrar (Modarabas), advertisements for such investment schemes are published in which all the information about the scheme, the mechanism of distribution of profit and loss and credit rating of the issuing Modaraba etc. are disclosed. No Modaraba can offer such schemes unless it has obtained a minimum investment grade rating ,i.e., 'BBB' from a registered credit rating agency.

7. Investment Risk Involved in Modaraba Business

Like every other business, Modaraba is also exposed to various risks that may have impact on the operation and profitability of the Modaraba. These risks might be internal and external including the market, operational, credit or management risk. The potential investors while making investment must keep in mind the above noted risks.

8. Consequences of non-compliance of the Regulatory framework by Modarabas

In case a Modaraba Company does not carry out the business of the Modaraba in accordance with its prospectus or violates the provisions of the Modaraba Companies and Modaraba



(floatation and control) Ordinance 1980, Modaraba Companies and Modaraba Rules 1981, Prudential Regulations for Modarabas or acts against the interest of the modaraba certificate holders, the Registrar after completing the due process of law as prescribed under the Modaraba Ordinance may impose penalty on the Modaraba Company and its Chief Executive, Directors and officers as per legal provisions. In case of serious contravention/mismanagement of Modaraba's fund, the Registrar may cancel the registration of the Modaraba Company or may take action for change of management of the Modaraba or may order to wind up the operations of a Modaraba.



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