

Title

Rate of Return

Issuance Date

14-Mar-2014

Effective Date

14-Mar-2014

Applicability

DFIA

FSA

IFSA

Summary

This policy document aims to outline the standard methodology for calculating the rate of return and profit distribution to the IAH consistent with the agreed terms of the investment account.

Queries may be directed to: tpifsa@bnm.gov.my

Issuing Department

Islamic Banking and Takaful

Attachment

[Attachment 1 Reporting requirement.zip](#)



BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Rate of Return

Issued on: 14 March 2014

BNM/RH/STD 033-2	Islamic Banking and Takaful Department	Rate of Return
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PART A OVERVIEW

1. Introduction

1.1 Under the investment account, an investment account holder (IAH) provides capital to the Islamic financial institution (IFI) for investment purposes. The IAH and the IFI share the profits from the investment assets according to the agreed terms of the investment account:

- (a) where the investment account is structured based on *mudarabah* and *musharakah*, a profit sharing ratio (PSR) is applicable to determine the share of profit between the IAH and the IFI; or
- (b) where the investment account is structured based on *wakalah bil istithmar*, a *wakalah* fee and performance incentive fee (if applicable) may be paid to the IFI whilst the residual profit belongs to the IAH.

Losses, if any, will be borne by the IAH, except in cases where there is evidence of negligence by the IFI in managing the IAH's funds.

1.2 This policy document reflects the distinction made in the Islamic Financial Services Act 2013 (IFSA) between Islamic deposit accounts and investment accounts as defined therein under section 2 as well as the priority of payment upon liquidation of the IFI under section 217 in line with the rights and obligations of the IAH and the IFI.

Policy objective

1.3 This policy document aims to outline the standard methodology for calculating the rate of return and profit distribution to the IAH consistent with the agreed terms of the investment account.

1.4 The objectives of this policy document are as follows:

- (a) to establish the requirements for managing the investment account funds that are in line with Shariah and the IFSA including oversight and risk management;

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- (b) to outline the requirements on the method for calculation of the rate of return (ROR) and profit distribution to the IAH; and
- (c) to outline the disclosure and reporting requirements.

Scope of Policy

- 1.5 This policy document sets out:
- (a) requirements on management of funds;
 - (b) calculation method; and
 - (c) disclosure and reporting requirements.

2. Applicability

- 2.1 The policy document is applicable to:
- (a) a licensed Islamic bank under the IFSA;
 - (b) a licensed bank and licensed investment bank under the Financial Services Act 2013 (FSA) and approved by the Bank under section 15 FSA to carry on Islamic banking business; and
 - (c) a prescribed institution under the Development Financial Institutions Act 2002 (DFIA) which is approved under section 129(1) DFIA to carry on Islamic banking business or Islamic financial business.

These institutions are hereinafter referred to as "Islamic financial institutions" (IFI).

3. Legal Provision

- 3.1 The requirements in this policy document:
- (a) are specified pursuant to sections 29(1) and 57(1) of the IFSA, and sections 41(1) and 126 of the Development Financial Institutions Act 2002 (DFIA); and
 - (b) constitute a direction under section 129(3) of the DFIA.

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4. Effective Date

4.1 This policy document comes into effect on 14 March 2014.

5. Transition arrangement

5.1 This policy document shall only apply to investment account products that comply with the policy document on Investment Account.

5.2 For avoidance of doubt, the *Framework on Rate of Return* issued on 13 March 2013 shall continue to be applicable to Islamic deposits on current account, deposit account, savings account or other similar accounts (e.g. general investment account and specific investment account) under any Shariah contract which is non-principal guaranteed products previously approved by the Bank under the repealed Islamic Banking Act 1983.

6. Related Policies

6.1 This policy document shall be read together with but not limited to such documents as specified in Appendix 1.

7. Definition and Interpretation

7.1 The terms and expressions used in this policy document shall have the same meanings assigned to them in the FSA, IFSA and DFIA, as the case may be, unless otherwise defined in this policy document.

7.2 For the purpose of this policy document:

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“**S**” denotes a standard, requirement or specification that must be complied with. Failure to comply may result in one or more enforcement actions; and

“**G**” denotes guidance which may consist of such information, advice or recommendation intended to promote common understanding and sound industry practices which are encouraged to be adopted.

“**Investment account holder**”, refers to a customer with an investment account maintained at an IFI.

“**Mudarabah**”, means a contract between a *rabbul mal* and a *mudarib* under which the *rabbul mal* provides capital to be managed by the *mudarib* and any profit generated from the capital is shared between the *rabbul mal* and *mudarib* according to mutually agreed profit sharing ratio (PSR) whilst financial losses are borne by the *rabbul mal* provided that such losses are not due to the *mudarib*'s misconduct (*ta`addi*), negligence (*taqsir*) or breach of specified terms (*mukhalafah al-shurut*)

“**Musharakah**”, refers to a partnership between two or more parties, which may take effect through contractual relationship (*`aqd*) or by operation of Islamic law, whereby all contracting parties will share the profit and bear loss from the partnership.

“**Restricted investment account or RIA**”, refers to a type of investment account where the IAH provides a specific investment mandate to the IFI such as purpose, asset class, economic sector and period for investment.

“**Tawarruq**”, refers to an arrangement that involves sale of an asset to the purchaser on a deferred basis and subsequent sale of the asset to a third party on a cash basis to obtain cash.

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“**Unrestricted investment account or URIA**”, refers to a type of investment account where the IAH provides the IFI with the mandate to make the ultimate investment decision without specifying any particular restrictions or conditions.

“**Wadiah**”, refers to a contract by which an owned asset is placed with another party on the basis of trusteeship (*amanah*) for safekeeping purposes.

“**Wakalah bil istithmar**”, refers to agency contract entered for the purpose of investment.

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PART B MANAGEMENT OF FUNDS

8. Oversight arrangement

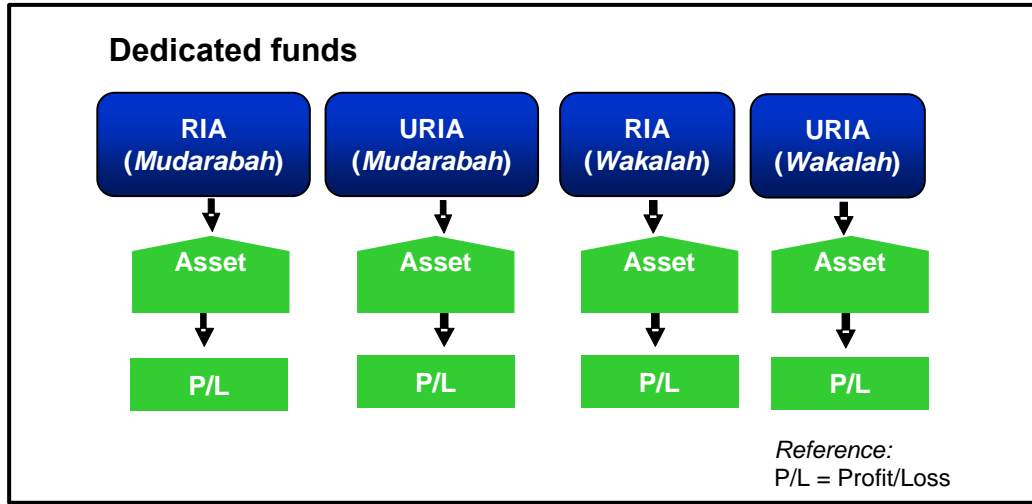
- S** 8.1 The Board of Directors (Board) shall be responsible to establish an effective governance arrangement to facilitate effective monitoring and control of the overall management and conduct of the investment account. The governance arrangement shall, in respect of rate of return calculation also consider the following:
- (a) the duty to maintain complete calculation table (CT) and distribution table (DT) which are endorsed by the relevant approval authority of the IFI for the purposes of examination and supervision by the Bank and external auditor from time to time;
 - (b) identifying the respective personnel who are responsible in the implementation of this policy document and have the capability and knowledge to perform the specified functions; and
 - (c) the roles and responsibilities of the internal control and compliance functions to provide check and balance including identifying non-compliance with this policy document and monitoring rectification measures.

9. Segregation of funds

- S** 9.1 The IFI shall separate the management and maintenance of records of the investment account and the investment account assets from other funds and assets managed by the IFI.
- S** 9.2 Pursuant to paragraph 9.1, the IFI shall manage the investment account on a “dedicated basis” which means the investment account funds are managed separately in accordance with the nature of the Shariah contract including the loss-bearing feature and the relevant

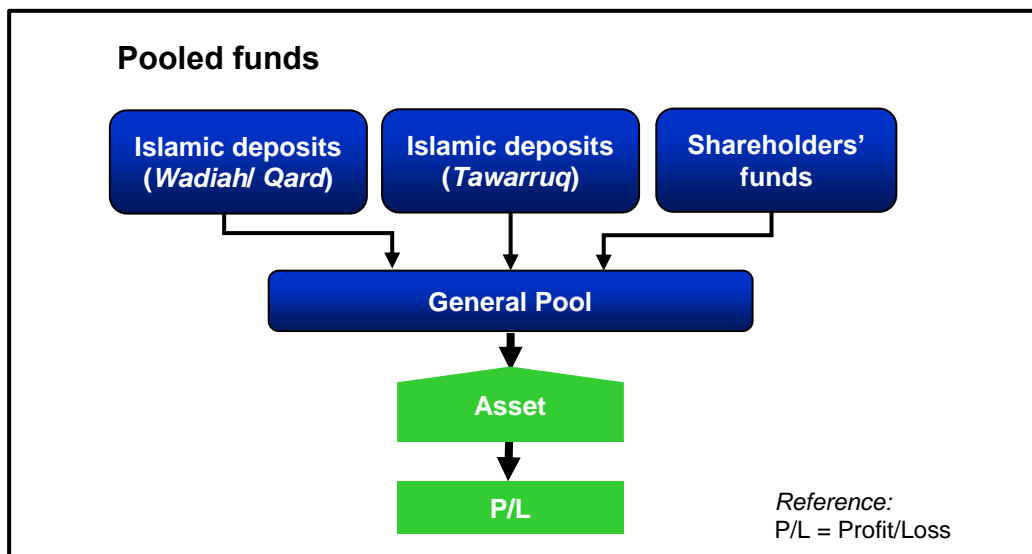
investment mandate. (Refer illustration 1)

Illustration 1:



- S** 9.3 The IFI must not manage investment account on a “pooled basis”. Managing investment account funds on a pooled basis means the investment account funds are combined according to the nature of the Shariah contracts used, where there is explicit consent from the fund provider for the IFI to use the funds for the IFI’s own income generating activity. Such funds include Islamic deposits based on *wadiah*, *qard*, or *tawarruq* which can be managed on a pooled basis with shareholders’ funds. (Refer illustration 2)

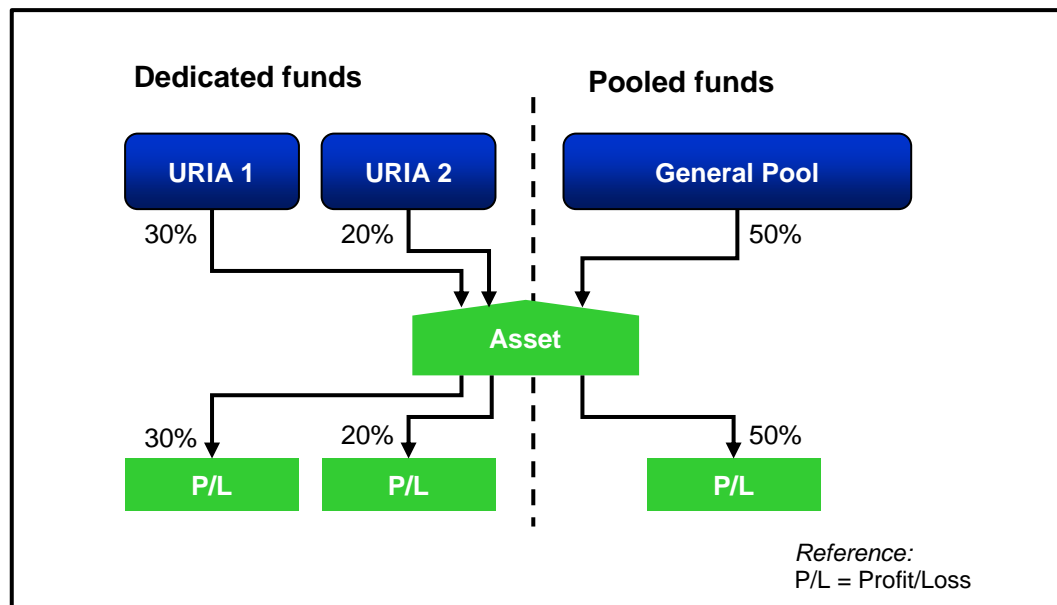
Illustration 2:



Proportionate tagging

- G** 9.4 Notwithstanding paragraph 9.2, the IFI may use URIA to partially fund an investment asset which requires sizeable funding. The investment asset(s) may consist of a single asset or a portfolio of assets of similar and/or different type e.g. trade financing, house financing, securities.
- S** 9.5 In the event that the above is adopted, the IFI shall allocate funds from a dedicated fund (except for RIA) with another dedicated fund and/or pooled fund through proportionate tagging. The proportionate tagging shall be applied to determine the allocation of income generated by the investment assets to the respective investment account funds. (Refer illustration 3)

Illustration 3:



- S** 9.6 The IFI shall also separate the management of foreign currency investment account funds from Ringgit Malaysia (RM) funds if there are significant exposure and risk factor e.g. foreign currency exchange risk, country risk in accordance with the investment mandate.

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PART C CALCULATION METHOD

10. Calculation table (CT)

- S** 10.1 The IFI shall maintain a separate CT in accordance with the manner of which the investment account funds are managed. The format and detailed formula of the CT is provided in Appendix 2.
- S** 10.2 The CT shall specify the list of allowable income and expenses that can be recognised in deriving the net distributable income to the IAH and the IFI. In principle any income, expenses and provisions (net) arising from the utilisation of the investment account funds shall be included in the CT.
- S** 10.3 All trading income, including income arising from intra-day transactions utilising the investment account funds shall be included in the CT. Income generated from primary or originating deals i.e. sell-down activities shall belong to the IFI.
- S** 10.4 Fee-based income shall belong to the IFI given that this income generally does not arise from the utilisation of the investment account funds. Where income generated from fee-based activities that directly or indirectly arise from the utilisation of the investment account funds, such as guarantee and underwriting, it shall be included in the CT unless the IFI can justify to the Bank that these activities are managed separately.

Direct expenses

- S** 10.5 The IFI shall charge direct expenses incurred for the purpose of investment activities (including financing) of the investment account funds in deriving the net distributable income, and be guided by the

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following principles¹:

- (a) the expenses are identifiable and measurable; and
- (b) the expenses are compulsory and must be incurred in order to complete a specific investment activity (including financing).

The examples of direct expenses are brokerage fee payable to the broker in trading Islamic financial instruments and handling fee payable to a third party which is incurred in finalising a financing transaction.

- S** 10.6 The IFI shall develop a list of permissible direct expenses that must be approved by the Board and the Shariah Committee. The list of permissible direct expenses must be reviewed at least annually.
- S** 10.7 General costs that are not identified to a specific investment activity shall not be deducted² from the profit to obtain the net distributable income. The IFI shall observe the list of disallowed items as per Appendix 5.

Impairment allowances and provisions

- S** 10.8 The IFI shall observe all requirements on classification and measurement for impairment allowances and provisions in accordance with the applicable Malaysian Financial Reporting Standards (MFRS) and *Classification and Impairment Provisions for Loans/Financing*.
- S** 10.9 The IFI shall establish an apportionment policy which includes method of apportionment, review and governance process to ensure apportionment of impairment allowance is consistent with the risk of investment assets funded by the respective investment account funds. Such policy shall be established as part fulfilment of the Board and senior management oversight requirement in *Classification and*

¹ Decision of 16th meeting of Shariah Advisory Council (SAC) of BNM on 11 November 2000.

² Decision of 82nd meeting of Shariah Advisory Council (SAC) of BNM on 17 February 2009.

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Impairment Provisions for Loans/Financing.

- S** 10.10 The provision for commitments and contingencies arising from litigation against the IFI shall be borne wholly by the IFI and shall not be deducted in deriving the net distributable income.

11. Distribution table (DT)

- S** 11.1 The IFI shall maintain a separate DT in accordance with the manner of which the investment account funds are managed. The format and detailed formula of the DT is provided in Appendices 3 and 4.
- S** 11.2 The application of weightage to represent the varying risk and reward attached to the different tenures **is not permitted** in the determination of the net income allocation to the different tenures of the respective investment account funds.
- S** 11.3 For investment account based on *wakalah bil istithmar*, the performance incentive fee to the IFI as specified in the terms of the investment account shall be computed based on net distributable income.
- S** 11.4 The IFI is required to accrue the net distributable income to the IAH in accordance with applicable MFRS and terms of the investment account.
- G** 11.5 For the purpose of monthly accruals, the IFI may adopt one of the following methods:
- (a) **actual method** – recognise the actual ROR for the particular month which is derived from the monthly DT; or
 - (b) **average accrual method** – recognise the average actual ROR

of the preceding number of months according to the respective tenure. For example, the accrual of profit on an investment account with 3-month maturity which is accepted in April is calculated based on the average of actual ROR of the preceding three months i.e. January, February and March. The IFI shall at the date of profit distribution to the IAH, make adjustment for the actual ROR. (Refer to illustration 4)

Illustration 4:

The profit accrued for investment account with 3-month maturity accepted in April:

Month	Actual ROR (annualised)
January	3%
February	4%
March	5%
April	6%
May	6%
June	6%

Rate to be accrued in April based on average accrual method

$$= \frac{3\% + 4\% + 5\%}{3} = 4\%$$

Comparison of profit recognition based on actual and average accrual methods:

Month	Actual ROR	Average accrual method
April	6%	4%
May	6%	5%
June (Adjusted)	6%	9%*
Final profit distribution on 3-month	6%	6%

*Average accrual method in June (Adjusted)

= Actual ROR for the month + adjustments (under/over-accrual in prior months)

= 6% + 3%

= 9%

PART D DISCLOSURE AND REPORTING

12. Board rates

- S** 12.1 The IFI shall disclose the ROR of the respective investment account funds as part of its board rates.
- S** 12.2 At minimum, the IFIs shall prominently display the following:
- investment period from which the ROR are based on;
 - types of investment account funds;
 - PSR for investment accounts based on *mudarabah* or *musharakah*; and
 - ROR (in percentage) for respective investment account funds. The ROR reflects the net ROR to the IAH based on the preceding month's net ROR declared and distributed to the IAH. (Refer to illustration 5)

Illustration 5:

ABC Bank						
Investment from:		To:				
Types of investment account	PSR	ROR (%)				
		1-Mth	3-Mth	6-Mth	9-Mth	12-Mth
URIA <i>mudarabah</i>						
Fund 1	XX:XX	X.XX	X.XX	X.XX	X.XX	X.XX
Fund 2	XX:XX			X.XX	X.XX	X.XX
RIA <i>mudarabah</i>						
Fund A	XX:XX	X.XX	X.XX	X.XX		
Fund B	XX:XX			X.XX	X.XX	X.XX
URIA <i>wakalah</i>		X.XX	X.XX	X.XX	X.XX	X.XX

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13. Reporting requirements

- S** 13.1 The IFI shall submit the reporting requirements specified in Attachment 1 at every month end. The deadline of the submission shall be 15 days from the month end. The IFI is required to submit the softcopy of the reporting form through e-Survey.

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APPENDICES

Appendix 1 Related Policy Documents

- (i) Shariah Standard on Mudarabah (BNM/RH/GL 012-4) and Shariah resolutions;
- (ii) Investment Account (BNM/RH/STD 029-4);
- (iii) Guidelines on the Recognition and Measurement of Profit Sharing Investment Account (PSIA) as Risk Absorbent (BNM/RH/GL 007-11); and
- (iv) Classification and Impairment Provisions for Loans/Financing (BNM/RH/GL 007-17)

Appendix 2 Template of Calculation Table for Investment Account (URIA or RIA)

The components of the CT comprise:

- (a) income generated from assets funded by the respective investment account funds such as financing, trading and other income;
- (b) provision items, such as impairment allowances and provisions;
- (c) expenses items, such as direct expenses and other expenses; and
- (d) other items, such as net income attributable to the IAH and the IFI.

For clarity purposes as specified in paragraph 10.1, the IFI is required to maintain separate CT for each investment account fund.

CALCULATION TABLE <TYPE OF INVESTMENT ACCOUNT>

Item	30.06.XX (RM '000)
A1 Income from Loans/Financing and Advances	41.91
A2 Income from Amount Due from Financial Institutions	40.64
A3 Income from Financial Assets Held for Trading	669.10
A4 Income from Held to Maturity Investments	-
A5 Income from Available for Sale Financial Assets	-
A6 Income from Financial Assets Designated as Fair Value Through Profit or Loss	
A7 Other Finance Income	19.63
A8 Other Income	-
A9 Total Gross Income	771.28
A10 (±) Collective Impairment Provision	(37.50)
A11 (±) Individual Impairment Provision	(10.00)
A12 (±) Impairment Loss from Held to Maturity Investment	-
A13 (-) Direct Expenses	(57.00)
A14 (-) Agency fee	-
A15 Net Distributable Income	666.78
of which: Amount Attributable to IAH	510.04
Amount Attributable to IBI	156.74

Definition

- 1 Income from Loan/Financing and Advances (A1), Income from Amount Due from Financial Institutions (A2), Income from Financial Assets Held for Trading (A3), Income from Held to Maturity Investments (A4), Income from Available for Sale Financial Assets (A5), Income from Financial Assets Designated As Fair Value Through Profit or Loss (A6) and Other Finance Income (A7)

Refers to the finance income generated by investment account assets for the month.

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- 2 Other Income (A8)
Refers to all other income related to the investment account fund generated during the reporting month that are not classifiable under A1 to A7.
- 3 Total Gross Income (A9)
Derived from total of items A1 to A8.
- 4 Collective Impairment Provision (A10)
Refers to the net collective impairment provision provided during the month.
- 5 Individual Impairment Provision (A11)
Refers to the net individual impairment provision provided during the month.
- 6 Impairment Loss from Held to Maturity Investment (A12)
Refers to the amount of impairment loss or reversal made from held to maturity investment during the month.
- 7 Direct Expenses (A13)
Refers to the expenses directly related to investment activities (including financing) of the of investment account fund as per Para 10.5.
- 8 Agency fee (A14)
Refers to the amount due to IFI as agent for managing the investment account fund agreed in the terms of the investment account.
- 9 Net Distributable Income (A15)
Derived from total of items A9, A10, A11, A12, A13 and A14.

Appendix 3 Template of Distribution Table for Investment Account Based on *Mudarabah/Musharakah*

The DT represents the apportionment of the net distributable income between the IAH and the IFI according to the terms of the investment account. The components of the DT comprise:

- (a) net distributable income derived from the CT;
- (b) contractual PSR; and
- (c) net ROR which is calculated from the net distributable income (ROR).

For clarity purposes as specified in paragraph 11.1, the IFI is required to maintain separate DT for each investment account fund based on *mudarabah/musharakah*.

DISTRIBUTION TABLE FOR MONTH ENDED 30 JUNE 20XX <TYPE OF INVESTMENT ACCOUNT BASED ON *MUDARABAH/MUSHARAKAH*>

Types of investment accounts	ADA	Distributable Profit							
		Net Distributable Income (ROR)		IAH			IFI		
				Contractual PSR	Net ROR		Contractual PSR	Net ROR	
		(a)	(b)	(c)	(d)	(e)=(b)*(d)	(f)	(g)=1-(d)	(h)=(b)*(g)
(RM '000)	Amount (RM '000)	Rate (%)	(%)	Amount (RM '000)	Rate (%)	(%)	Amount (RM '000)	Rate (%)	
<URIA or RIA>									
1-month	25,000.00	165.87	8.07	0.75	124.40	6.05	0.25	41.47	2.02
	20,000.00	132.69	8.07	0.80	106.15	6.46	0.20	26.54	1.61
3-month	10,000.00	66.35	8.07	0.75	49.76	6.05	0.25	16.59	2.02
6-month	10,000.00	66.35	8.07	0.75	49.76	6.05	0.25	16.59	2.02
	10,000.00	66.35	8.07	0.80	53.08	6.46	0.20	13.27	1.61
12-month	20,000.00	132.69	8.07	0.75	99.52	6.05	0.25	33.17	2.02
15-month	5,500.00	36.49	8.07	0.75	27.37	6.05	0.25	9.12	2.02
	100,500.00	666.78	8.07		510.04	6.17		156.74	1.90

(b) = (a) / $\sum(a) * \sum(b)$; given $\sum(b)$ = Net Distributable Income which can be derived from CT

(c) = [(b) / 30 * 365] / (a) * 100

(f) = [(e) / 30 * 365] / (a) * 100

(i) = [(h) / 30 * 365] / (a) * 100

Calculation for 3-month Investment Account based on *mudarabah* (75:25 PSR) for month ended 30 June 20XX

1. (a) Average Daily Amount (RM '000)
= $\frac{\text{Total daily investment account balances}}{30 \text{ days}}$

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2. (b) Net Distributable Income (ROR) (RM '000)

$$\begin{aligned}
 &= \frac{\text{ADA}}{\text{Total ADA}} \times \text{Total net distributable income} \\
 &= \frac{10,000}{100,500} \times 666.78 \\
 &= 66.35
 \end{aligned}$$

3. (e) Net ROR to IAH

$$\begin{aligned}
 &= \text{Net distributable income} \times \text{contractual PSR} \\
 &= 66.35 \times 0.75 \\
 &= 49.76
 \end{aligned}$$

4. (h) Net ROR to IFI

$$\begin{aligned}
 &= \text{Net income distributable} \times \text{contractual PSR} \\
 &= 66.35 \times 0.25 \\
 &= 16.59
 \end{aligned}$$

Appendix 4 **Template of Distribution Table for Investment Account Based on *Wakalah***

The DT represents the apportionment of the net distributable income between the IAH and the IFI according to the terms of the investment account. The components of the DT comprise:

- (d) net distributable income derived from the CT;
- (e) agency fee; and
- (f) net ROR which is calculated from the net distributable income (ROR).

For clarity purposes as specified in paragraph 11.1, the IFI is required to maintain separate DT for each investment account fund based on *wakalah bil istithmar*.

DISTRIBUTION TABLE FOR MONTH ENDED 30 JUNE 20XX
<TYPE OF INVESTMENT ACCOUNT BASED ON *WAKALAH BIL ISTITHMAR*>

Types of Deposit/ Investments	ADA	Distributable Profit					
		Net Distributable Income (ROR)		IAH		IFI	
				Net ROR/ Expected Return		Performance incentive fee	
		(a)	(b)	(c)	(d)	(e)	(f)=(b)-(d)
(RM '000)	Amount (RM '000)	Rate (%)	Amount (RM '000)	Rate (%)	Amount (RM '000)	Rate (%)	
URIA							
1-month	50,000.00	212.11	5.16	212.11	5.16	0.00	0.00
	30,000.00	127.26	5.16	127.35	5.16	0.00	0.00
3-month	25,000.00	106.05	5.16	79.54	3.87	26.51	1.29
6-month	28,000.00	118.78	5.16	89.08	3.87	29.69	1.29
	20,000.00	84.84	5.16	67.87	4.13	16.97	1.03
12-month	40,000.00	169.69	5.16	169.70	5.16	0.00	0.00
15-month	12,500.00	53.03	5.16	53.03	5.16	0.00	0.00
	205,500.00	871.76	5.16	798.69	4.73	73.07	0.43

- (b) $= (a) / \sum(a) * \sum(b)$; given $\sum(b)$ = Net Distributable Income which can be derived from CT
- (c) $= [(b) / 30 * 365] / (a) * 100$
- (d) Refers to residual profit distributed to the IAH or the expected return as agreed in the terms of the investment account.
- (e) $= [(d) / 30 * 365] / (a) * 100$
- (f) Refers to profit distributed to the IFI in addition to agency fee if performance of the investment account funds exceed the expected return agreed in the terms of the investment account.
- (g) $= [(f) / 30 * 365] / (a) * 100$

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**Calculation for 3-month Investment Account based on *wakalah bil istithmar*
for month ended 30 June 20XX**

1. (a) Average Daily Amount (RM '000)

$$= \frac{\text{Total daily investment account balances}}{30 \text{ days}}$$

2. (b) Net Distributable Income (ROR) (RM '000)

$$= \frac{\text{ADA}}{\text{Total ADA}} \times \text{Total net distributable income}$$

$$= \frac{25,000}{205,500} \times 871.76$$

$$= 106.05$$

3. (f) Performance incentive fee to IFI

$$= \text{Net distributable income} - \text{expected return}$$

$$= 106.05 - 79.54$$

$$= 26.51$$

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Appendix 5 Expenses Not Recognised as Direct Expense

The negative list refers to the expenses which are not allowed to be deducted from the profit to obtain the net distributable income amount in the CT. The expenses include but not limited to the following:

- (a) overheads expenses (e.g. utilities);
- (b) salary expenses;
- (c) depreciation of assets and amortisations expenses;
- (d) general and administrative expenses;
- (e) general marketing expenses; and
- (f) general information technology (IT) expenses.