

# Classifying Your Deposits into Investment Account



**UNDERSTANDING THE CHANGES AND  
IMPACT OF:**

**RECLASSIFYING YOUR DEPOSITS INTO AN  
INVESTMENT ACCOUNT**

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# Mudharabah in the Year 2015



**THE RE-START OF MUDHARABA-TYPE  
DEPOSITS**

**THE NEW LIFE AS AN INVESTMENT ACCOUNT  
UNDER IFSA 2013**



## The Mudharabah

For many years, the Malaysian public has gotten used to knowing that Mudharabah is usually the Islamic contract for:

*Current Accounts*

*Savings Accounts*

*General Investment Account (Islamic FD)*

This will change come June 2015 as IFSA 2013 redefine Mudharabah into INVESTMENTS

- Islamic Financial Services Act 2013 (IFSA) was introduced where the following was defined:
  - A deposit where the **Principal (equity)** of the depositors are **GUARANTEED** by the nature of the contract will be classified as DEPOSITS
  - A deposit where the **Principal (equity)** of the depositors are **NOT GUARANTEED** by the nature of the contract will be classified as INVESTMENTS
- What does this mean?
  - If a contract by nature **carries some risks of loss in Principal** in its activities, it must be classified as **INVESTMENTS**
  - For example, Unit Trusts and purchase of Shares in Stock Market. At any point of time of redemption, there is a possibility that principal is lost due to market conditions (market price).

Since the Mudharabah do not guarantee Principal, it is classified as Investments (IFSA 2013)

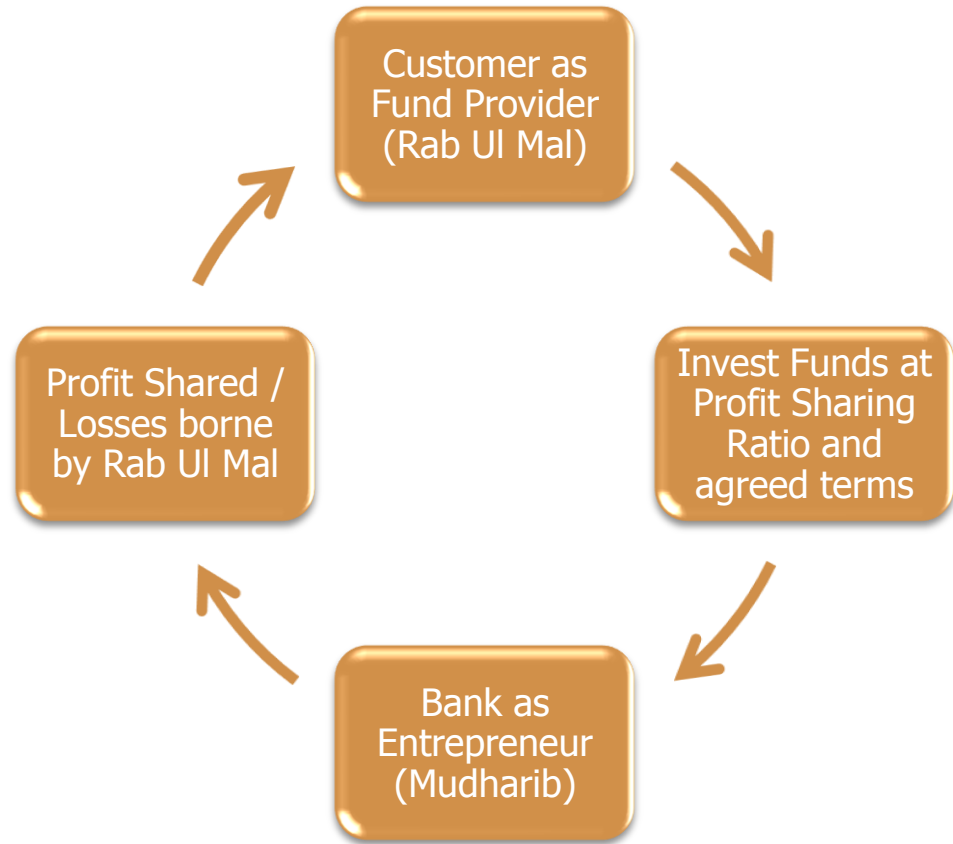
Key features of an Investment Account:

*The investment equity are recognised when received by the Bank*

*At the end of the period, the equity shall be measured by their book value (reflecting actual performance)*

*Profits are allocated based on the contribution or agreed ratio*

*Losses are deducted from investment equity*



## **What is Mudharabah?**

It is an entrepreneurial relationship between the Fund Provider (Customer) and Entrepreneur (Bank) for the purpose of entering into an economic to generate returns. The investment do not guarantee a return but will depend on actual performance at the end of the entrepreneurial relationship. Losses incurred by this effort will be borne solely by the Fund Provider, unless there is case of negligence.

# Examples of Deposits and Investments



## What are Deposits?

- Your principal funds are **guaranteed** i.e. You will get it back upon demand
- Returns (profit) on your principal, if offered, is **either** guaranteed or based on performance, but will not impair your principal

### Example:

- You deposit RM100,000 with expected return of 3.0% p.a.
- Next month you withdraw the funds i.e. RM100,000. The Bank pays you RM100,000 of your principal & RM250 of profit (where it was declared)

## What are Investments?

- Your principal funds depend on the **prevailing market conditions** i.e. You may get less or more of your principal based on how well the market is doing
- Returns (profit) on your principal is **not guaranteed** and will be based on prevailing market conditions, and may impair your principal. You may also enjoy capital gains.

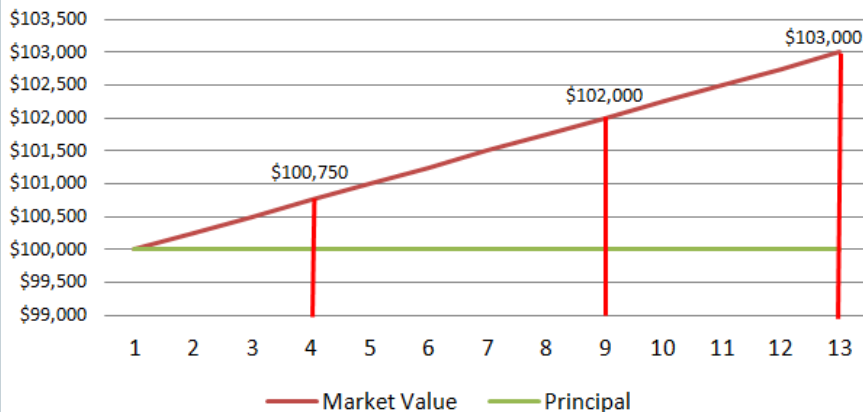
### Example:

- You invest RM100,000 with expected return of 3.0% p.a.
- Next month you redeem the funds. The Bank divest the investment at market value and pays you RM100,000 of your principal & actual profit **IF** the prevailing market is in your favour. Else, Bank pays current value.

# Examples of Deposits and Investments (Contd)

## Deposits Behaviour (Sample)

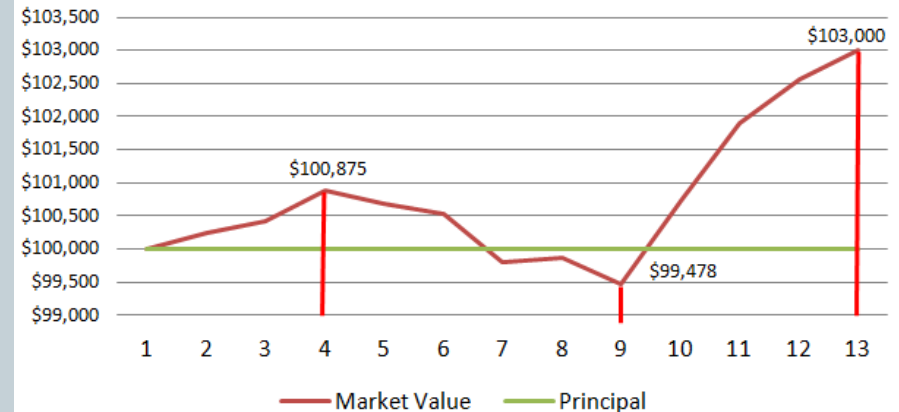
Deposit with Principal Guarantee & Constant Returns (3.00% p.a.)



- Value on Month 4 : RM100,750
- Value of Month 9 : RM102,000
- Value at Maturity : RM103,000
- Annual Return @ Maturity : 3.00% p.a.

## Investment Behaviour (Sample)

Investment with Principal Not Guaranteed & Final Declared Returns (3.00% p.a.)



- Value on Month 4 : RM100,875 (>gain)
- Value of Month 9 : RM99,476 (loss)
- Value at Maturity : RM103,000
- Annual Return @ Maturity : 3.00% p.a.

*If you redeem your Investment on Mth 4, you gain, but redemption on Mth 9 = Principal Losses*



# Types of Investment Account

There are various types of investments that carries different risks, depending on the Investment Assets.

In general, the Bank's retail products (Current / Savings Account), are LOW RISK structures, where Principal (equity) are stable and non-volatile

Medium-risk structures are Unit Trusts or high-return Term Deposits, and Sukuk

High-risk structures are Structured Investments, Dual Currency Investments, and shares in the stock market

## Low Risks

- Invest in short term, stable investment instruments
- High liquidity investment, easily redeemed
- Returns are low, minimal
- Low chance of capital gains
- Low potential for losses

## Medium Risks

- Invest in short/medium term investments instruments
- Fairly liquid structures, no/little penalty for redemption
- Returns are low, with potential upside based on market conditions
- Has some potential for capital gains or losses

## High Risks

- Invest in medium/long term sophisticated investments
- Partially liquid and high penalties for early redemption
- Returns are potentially high, based on market conditions. Also potentially zero returns
- Has high possibility of capital gains or losses



## All Impacted Islamic Contracts

There are several Islamic Banking contracts that has the feature of risks to the Principal (equity).

*Mudharabah*

*Wakalah (Wakalah fi Isthihmar)*

*Musyarakah*

Products offered under these contracts will be reclassified as INVESTMENTS

### Mudharabah

Entrepreneurial relationship

Bank Manages Customer funds

Profit Sharing of declared investment returns (if any)

Losses, if any, borne by Customers

### Wakalah Fi Isthihmar

Agent of Customer to Invest

Bank as Agent invest customer funds

Profit, if any, earned by Customer, Bank earn Agency Fee

Losses, if any, borne by Customers

### Musyarakah

Partnership in investment

Bank and customer puts in equity and Bank manage funds

Profit, if any, is shared based on equity ratio

Losses, if any, shared based on equity ratio (up to equity amount)



# So What Happens after June 2015?



**ONCE THE MUDHARABAH IS CLASSIFIED AS  
INVESTMENT ACCOUNT, DOES IT MEAN MY  
DEPOSITS ARE NOW AT RISK?**

**WILL I LOSE MY MONEY?**



## Mudharabah Investment

Technically, your Mudharabah-based account has always been an INVESTMENT account.

The relationship between Bank and You is an Entrepreneurial Relationship. You place funds with the Bank to manage it, just like you invest in a Unit Trust Fund Manager.

The investment risk has always been there, available in the Terms and Condition.

- **Managing your Investment**
  - The Bank manages the “Investment” the same way it expertly **manages** your “Deposits”.
- **Profit on Your Investments**
  - The profit on Your Investments will be derived the **same way** as your Mudharabah Deposits i.e. Actual Performance of Asset declared and distributed by Profit Sharing Ratio
- **Principal Protection**
  - While there will be a change as PIDM will no longer guarantee your “Investments”, the way the Investments are managed means it is **low risk structure** where loss of principal is unlikely
- **Additional Disclosure & Warnings**
  - Greater **transparency** is expected as Banks are required to declare where the funds are Invested into, with the forecast performance (and potential risks) are clearly informed.



## What are my Options?

Different banks will approach the changes differently.

Some banks are not offering Mudharabah Investment Accounts to replace Mudharabah Deposits, due to various reasons.

However, Banks offering Investment Accounts would retain its attractiveness with potential to earn higher returns on better Asset performance.

- **Stay with Mudharabah Investment Account**
  - Operationally, there is **no change** to the account. Most likely, **additional documents** will need to be signed for Investment Account, outlining the risks that you may face. However, you will also be **given detailed information** on how your “Investment” is to be managed by the Bank for your decision-making
- **Change to another Deposit Structure**
  - There will be other structures that may be introduced by certain banks, but it will be a **new way** of banking which may/may not suit your understanding / use
- **Get converted into a Wadiah / Qardh type of Account**
  - Wadiah / Qardh type of accounts **offers principal protection**, but usually is less robust on the returns to your deposit. The returns may be **minimal, discretionary** and may **not offer additional benefits** compared to other types of account. Suitable as a transactional account

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