From the establishment of the first Islamic Bank in 1983, Malaysia has long envisaged itself as a significant global player in Islamic Banking.

This vision has been nurtured by BNM for many years which started with the Islamic Financial Masterplan in the early 2000’s with the eventual vision of establishing Islamic Banking at 40% of all banking business by 2020.

Malaysia is now seen as one of the key Islamic Financial centres globally.
BIG CHANGES IN ISLAMIC BANKING

- Support from Government of Malaysia and the Market has been tremendous

- Malaysia aims to increase competitiveness within the region, ultimately grow internationally

- To support the national agenda, strong push for compliance to international standards including Basel requirements

- IFSA is intended to streamline the industry
For the past few years, BNM has re-looked at the Islamic Banking industry vs the development from the middle east

The intention is to continue as a global financial centre in Islamic Banking

Steps are being taken to rationalise existing local contracts to align with international standards

IFSA 2013 combined and updated the individual Acts (IBA, Takaful Act) into one, and made Policies and Guidelines into law
ISLAMIC FINANCIAL SERVICES ACT 2013 (IFSA)

Consolidation of all existing Islamic Banking and Takaful regulations into one
Sec 6 IFSA: The principal regulatory objectives of the Act are to promote financial stability and compliance with Shariah.

- **Sec 28 (1)**
  - IFI shall at all times ensure Shariah Compliance

- **Sec 28 (2)**
  - Shariah Compliance refer to compliance of the SAC

- **Sec 28 (3)**
  - Any incompliance activities needs to be notified to SC, the activities to be ceased, and the activities reported within 30 days

- **Sec 28 (4)**
  - Breach of Shariah Compliance may result in 8 years imprisonment, a fine of RM25 million or both
BEHAVIOUR CHANGE — PRODUCT DESIGN

PRE-IFSA = INNOVATION

- Product by Bank A
  - SC Approvals
  - BNM Approvals
- Product by Bank B
  - SC Approvals
  - BNM Approvals
- Product by Bank C
  - SC Approvals
  - BNM Approvals
- Product by Bank D
  - SC Approvals
  - BNM Approvals

POST-IFSA = COMPLIANCE

- Policy Doc Product A
- Policy Doc Product B
- Product by Bank A
  - SC Approvals
- Policy Doc Product B
- Product by Bank A
  - SC Approvals

Auto Approval
Specific Approval
SIGNIFICANT IMPACT TO ISLAMIC BANKING

ONE OF THE BIGGEST IMPACT IS THE DEFINITION OF DEPOSITS & INVESTMENTS

a) If a deposit, based on the Islamic contract, guarantees the principal amount to customers upon demand, it is classified as DEPOSIT.

b) If a deposit, based on the Islamic contract, do not guarantees the principal amount to customers upon demand, it is classified as INVESTMENT.
DEPOSIT RE-CLASSIFICATION

Classification of Non-Guaranteed Principal Deposits under IFSA 2013

- Mudarabah Account
- Wakalah Account

Re-Classified as Investments

1. Investment type of Disclosure Requirements
2. Risk Sharing infrastructure i.e. Profit Sharing / Loss Sharing
3. Principal Not Guaranteed i.e. No PIDM cover
4. Oversight function on the management of Funds required
5. Investments to be tagged to Specific Assets for performance

Specific Assets requires performance monitoring, capital allocation, portfolio management of a mature portfolio.
ISSUANCE OF INVESTMENT ACCOUNT FRAMEWORK BY BNM

Creating a viable Investment Account framework
INVESTMENT ACCOUNT FRAMEWORK

Governing Regulations

- Investment Account Framework
- Rate of Return Framework
- Liquidity Coverage Ratio
- Mudarabah Standards
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<th>Summary of Related Regulations</th>
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<td>• Defines “Non-Principal Guarantee” as Investment</td>
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<td>• Methodology of Management of Investment Account</td>
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<td>• Use of Unrestricted Account (UA) and Restricted Account (RA)</td>
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<tr>
<td>• Risk Management, Transparency and Disclosure, Liquidity Management and Capital Adequacy</td>
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<tr>
<td><strong>Rate of Return</strong></td>
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<tr>
<td>• Management of Funds</td>
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<td>• Management of UA and RA</td>
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<td>• Disclosure and Reporting</td>
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<tr>
<td><strong>Mudarabah / Musharakah / Wakalah Standards</strong></td>
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<td>• Operational standards</td>
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<td>• Utilisation of Funds</td>
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<td>• Management of Funds</td>
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<td>• Distribution of Profit</td>
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<td><strong>Liquidity Coverage Ratio (LCR)</strong></td>
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<td>• LCR Minimum Requirement (60% for 2015 with yearly increments)</td>
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<tr>
<td>• Stock of High Quality Liquid Asset</td>
</tr>
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<td>• Expected Cash Outflows vs Expected Cash Inflow</td>
</tr>
<tr>
<td>• Investment Account requirements</td>
</tr>
<tr>
<td>• Reporting Requirements</td>
</tr>
</tbody>
</table>
IMPACT OF REGULATORY REQUIREMENTS

Transition plan to opt-in into Investment Account by 30 June 2014 & 2015
OVERVIEW ON DEPOSIT PRODUCTS

- Traditionally, the Islamic Current Account and Savings Account are offered under the contract of Wadiah (Safekeeping) and Mudarabah (Profit Sharing).
RE-CLASSIFICATION OF DEPOSITS

Pre-IFSA: Deposit Classification based on Salient Features

Deposits:
- Current Account
- Savings Account
- Money Market Deposits
- Interbank Placements
- General Investment Accounts
- Special Investment Accounts
- Profit Sharing Investment Accounts
- Structured Investments
- Loan

Post-IFSA: Classification based on Contractual Relationship

Deposits – Principal Protected (Qard, Tawarruq, Wadiah)
- Current Account
- Savings Account
- Interbank Murabahah Placements
- Commodity Murabahah Term Deposit
- Loan

Investments – Principal Non-Protected (Mudharabah, Wakalah Fi Istihmar, Musyarakah)
- Current Account (features)
- Savings Account (features)
- Unrestricted Investment Account
- Restricted Investment Account
- Structured Investments
TRANSITION TO IA

Following the gazette of IFSA 2013, BNM issued the Investment Account guidelines and defined the “Investment” criteria as follows:

“Investments” are non-capital protected instruments which is consistent with the Mudharabah, Wakalah Fi Isthihmar, and Musyarakah deposit contracts.

“Investments” carries an inherent market / investment risks, and customers must understand the structure as an “investor”.

As an “investor”, the customer must understand the risks based on their profile. Customer must expressly accept the risks to enter into an Investment product.

If the Bank is not able to obtain express consent from customer to enter into IA, their accounts must be migrated to a “lower risk” product.
THE TRANSITION POLICY

IA TRANSITION PLAN

CASA

General Investment Account

Introduce IA

Introduce IA Term by 30 June 2014

Convert to Tawarruq by 30 June 2014

Convert to Tawarruq TD

Convert to Tawarruq TD

Offer Term IA (GIA-New)

Did Not Opt In by 30 June 2015

Opt In Obtained by 30 June 2015

Did Not Opt In by 30 June 2015

Did not Introduce IA

Remain Tawarruq TD

Migrate to Conventional

Uplift and close

Force Convert to other contracts

Migrate to Conventional

Reclassify into Investment Acc

Migrate to Conventional

Force Convert to other contracts

Reclassify into Investment Acc

Migrate to Conventional

Uplift and close

Remain Tawarruq TD

Did not Introduce IA

Opt In Obtained by 30 June 2015

Did Not Opt In by 30 June 2015

Offer Term IA (GIA-New)

Convert to Tawarruq TD

Convert to Tawarruq by 30 June 2014

Introduce IA Term by 30 June 2014

Introduce IA
Following the Transition Plan issued by BNM, several Banks had shown interest in pushing for Investment Account to meet the requirements. Each of the 5 Banks submitted proposals to introduce their structures based on their operational capabilities. Approval was obtained and the products became the benchmark for development for other Banks. Currently 8 Islamic Banks are offering IA.
CONVERSION SUCCESS OF INVESTMENT ACCOUNTS (INDUSTRY IN 2014)

FOCUSED ON RETAINING HIGH VALUE CUSTOMERS

GENERAL INVESTMENTS
55% to 64% → TAWARRUQ TD-i
(via forced conversion on maturity and early upliftment)

CURRENT / SAVINGS ACC
7% to 21% → IA
(via opt-in conversion by 30 June 2014, else other contracts)
IA 2 YEARS LATER

STRONG PUSH, INCLUDING AWARENESS INITIATIVES, BY BNM FOR THE IMPLEMENTATION OF INVESTMENT ACCOUNT FOR THE PAST 2 YEARS HAS RESULTED IN SIGNIFICANT GROWTH IN THE INDUSTRY

Source: BNM Statistical Bulletin & BNM Website
Figures excluding IA placed by Financial Institutions
Investment Account

Grow wealth and value through profit sharing

Guide to Consumer on Investment Account

A new product offering that provides you the opportunity to invest and share the profit from Shariah-compliant investment activities.

Key Features of Investment Account

1. Unique
   Exclusively offered by Islamic banks

2. Choice
   Invest in economic sector of your interest

3. Risk-reward principles
   It is not a deposit; thus not protected under Partially Insured Deposit Scheme (PIDM)

4. Profit sharing
   Return on investment will be shared with you as the investor

5. Bank is your Partner
   Your investment is professionally managed by the Islamic banks

Wealth Creation Through Profit Sharing

Interested? Several investment tips:

Compare
Evaluate products offered by Islamic banks as the risks depend on underlying investment activities

Choose
Select the type of investments that suits your financial needs and risk appetite

Track
Monitor progress of your Investment Account on a regular basis

Further Information?
Visit your nearest Islamic banks that offer Investment Account

List of Islamic Banks currently offering Investment Account

<table>
<thead>
<tr>
<th>Islamic Bank Berhad</th>
<th>HSBC Amanah Malaysia Berhad</th>
</tr>
</thead>
<tbody>
<tr>
<td>As at 2016</td>
<td>Bank Negara Malaysia</td>
</tr>
<tr>
<td>Affin Islamic Bank Berhad</td>
<td>Bank Islam Malaysia Berhad*</td>
</tr>
<tr>
<td>Al Rajhi Banking &amp; Investment Corporation (Malaysia) Berhad</td>
<td>CIMB Islamic Bank Berhad*</td>
</tr>
<tr>
<td>Alliance Islamic Bank Berhad</td>
<td>DBS Bank Berhad</td>
</tr>
<tr>
<td>AmBank Islamic Berhad*</td>
<td>EON Bank Berhad</td>
</tr>
<tr>
<td>Asian Finance Bank Berhad</td>
<td>Elit Bank Berhad</td>
</tr>
<tr>
<td>Bank Islam Malaysia Berhad*</td>
<td>エーセンス銀行</td>
</tr>
<tr>
<td>Bank Muamalat Malaysia Berhad*</td>
<td>HSBC Malaysia</td>
</tr>
<tr>
<td>GS Bank</td>
<td>Maybank Islamic Berhad*</td>
</tr>
<tr>
<td>Hong Leong Islamic Bank Berhad</td>
<td>Maybank Islamic Berhad*</td>
</tr>
<tr>
<td>Kuwait Finance House (Malaysia) Berhad*</td>
<td>Maybank Islamic Berhad*</td>
</tr>
<tr>
<td>Maybank Islamic Berhad*</td>
<td>Maybank Islamic Berhad*</td>
</tr>
<tr>
<td>OCBC Al-Amin Bank Berhad</td>
<td>Maybank Islamic Berhad*</td>
</tr>
<tr>
<td>Public Islamic Bank Berhad</td>
<td>Maybank Islamic Berhad*</td>
</tr>
<tr>
<td>RHB Islamic Bank Berhad*</td>
<td>Standard Chartered Saadiq Berhad*</td>
</tr>
</tbody>
</table>

*Islamic banks currently offering Investment Account

Source: BNM Website
SHARIAH STRUCTURES

Impacted structures under IFSA 2013
PRODUCT MAP BASED ON SHARIAH CONTRACT

<table>
<thead>
<tr>
<th></th>
<th>Wadiah</th>
<th>Qard</th>
<th>Tawarruq</th>
<th>Mudarabah</th>
<th>Wakalah</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Account</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
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<tr>
<td>Savings Account</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>Fixed Deposit</td>
<td></td>
<td></td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>Structured Investments #</td>
<td>✔</td>
<td></td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>Interbank Placement / Deposit</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Money Market Deposits</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Excess and Overdraft</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>✔</td>
</tr>
<tr>
<td>Profit Sharing Investment Account (PSIA)</td>
<td></td>
<td></td>
<td></td>
<td>✔</td>
<td>✔</td>
</tr>
</tbody>
</table>

Prior to IFSA 2013, the product map for Deposits are diverse to cater for various requirements.

# Structured Investments are excluded from this IA discussion as approval for such products are given by Securities Commission (not BNM)
IMPACTED CONTRACTS

The essential Shariah requirements under the following contracts are embedded into the operational structure and become law under IFSA 2013.

✓ MUDHARABAH
✓ WAKALAH FI ISTHIHMAR
✓ MUSYARAKAH
## Differences: Deposits vs Investments

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<thead>
<tr>
<th></th>
<th>Deposit Accounts</th>
<th>Investment Accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Type of Shariah Contracts</strong></td>
<td>Wadiah, Qard, Tawarruq</td>
<td>Mudharabah / Musyarakah / Wakalah Fi Isthiham</td>
</tr>
<tr>
<td><strong>Principal</strong></td>
<td>Protected</td>
<td>Not Protected</td>
</tr>
<tr>
<td><strong>Profit</strong></td>
<td>Discretionary / Fixed Contracted</td>
<td>Profit Sharing / Earned Fee</td>
</tr>
<tr>
<td><strong>Loss</strong></td>
<td>Not Applicable</td>
<td>Lower Returns / Loss of Capital</td>
</tr>
<tr>
<td><strong>Treatment on Balance Sheet</strong></td>
<td>On-balance Sheet</td>
<td>Off-Balance Sheet or On-Balance Sheet</td>
</tr>
<tr>
<td><strong>Risk Profile</strong></td>
<td>No Risk</td>
<td>Low/Medium Risk</td>
</tr>
<tr>
<td><strong>Tenure</strong></td>
<td>On Demand</td>
<td>Minimum Investment tenure</td>
</tr>
<tr>
<td><strong>PIDM Coverage</strong></td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td><strong>Disclosure Format</strong></td>
<td>Savings Account / Fixed Deposits</td>
<td>Unit Trust / Structured Investment</td>
</tr>
<tr>
<td><strong>Investment Assets</strong></td>
<td>General Investment Account (Unrestricted)</td>
<td>Defined Investment Account i.e. Unrestricted Investment Account (URIA) or Restricted Investment Account (RIA)</td>
</tr>
<tr>
<td><strong>Customer Documents</strong></td>
<td>Terms and Conditions</td>
<td>PDS, Terms and Conditions, Performance Report and Risk Warning Statements</td>
</tr>
</tbody>
</table>
TYPES OF INVESTMENT ACCOUNTS

- **MUDARABAH** (Profit Sharing)
- **WAKALAH FI ISTIHMAR** (Agency for Investment)
- **MUSYARAKAH** (Partnership)

**INVESTMENT ACCOUNTS**

**UNRESTRICTED INVESTMENT ACCOUNT:**
- General Investment
- Unmatched Balance
- Fixed/Unfixed Tenure
- Easy exit & Redemption
- Mixed Asset Portfolio

**RESTRICTED INVESTMENT ACCOUNT:**
- Specific Investment
- Matched Tenure & Balance
- Penalty on exit & Redemption
- Single Asset Utilisation
PROFIT CALCULATIONS

✓ The Bank will inform the Indicative Profit Rate (IPR) at the point of placement. The actual profit rate shall be determined on maturity.

✓ The Bank will earn a profit for its investment income as entrepreneur for profit, or earn an agreed fee in return for its efforts and expertise.

✓ Distribution of Profit/Fees to be made at maturity.

Mudarabah

- Determine the Profit Sharing Ratio (PSR)
- Based on Actual Profit
- Distributed according to PSR
- Principal (P) X Time (T) X Rate (R) x PSR

Wakalah Fi Istihmar

- Determine the Agency Investment Terms
- Based on Actual Profit
- After Agency Fees, Profit belongs to Investor
- Principal (P) X Time (T) X Rate (R) - Fees
## PROFIT DISTRIBUTION MECHANISM

<table>
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<th>DISTRIBUTION TABLE</th>
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<td>MUDARABAH CURRENT ACCOUNT</td>
<td>STATUTORY RESERVES</td>
<td>FINANCING</td>
<td>TOTAL GROSS INCOME</td>
<td>NET DISTRIBUTABLE INCOME DISTRIBUTED AMONG CURRENT, SAVINGS &amp; GENERAL INVESTMENT DEPOSITS, &amp; DETERMINE THE DISTRIBUTION TO DEPOSITORS &amp; BANK ACCORDINGS TO PROFIT SHARING RATIO.</td>
</tr>
<tr>
<td>MUDARABAH SAVINGS ACCOUNTS</td>
<td>LIQUIDITY REQUIREMENT</td>
<td>INVESTMENTS</td>
<td>+(-) PROVISION</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>+(-) IIS</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>+(-) IMPAIRMENT LOSS</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>+(-) DIRECT EXPENSES</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>+(-) PER</td>
<td></td>
</tr>
<tr>
<td>UNRESTRICTED INVESTMENT ACCOUNT</td>
<td>FINANCING &amp; LIQUIDITY REQUIREMENTS</td>
<td>NET TRADING &amp; INVESTMENT INCOME</td>
<td>NET GROSS INCOME</td>
<td></td>
</tr>
<tr>
<td>RESTRICTED INVESTMENTS ACCOUNTS</td>
<td>SPECIFIC FINANCING</td>
<td>NET RADING INCOME</td>
<td>(-) IBCF/SHF</td>
<td></td>
</tr>
<tr>
<td>MUDARABAH INTERBANK ACCEPTANCE</td>
<td>TREASURY INVESTMENTS</td>
<td>OTHER INCOME</td>
<td>NET INCOME</td>
<td></td>
</tr>
<tr>
<td>SALE AND BUY BACK AGREEMENT</td>
<td>TREASURY INVESTMENTS</td>
<td>OTHER INCOME</td>
<td>(-) AMOUNT DUE TO FI</td>
<td></td>
</tr>
<tr>
<td>SHAREHOLDER FUNDS</td>
<td>TREASURY INVESTMENTS</td>
<td>OTHER INCOME</td>
<td>(-) INI</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(-) OTHER DEPOSITS</td>
<td></td>
</tr>
</tbody>
</table>

- **IIS**: Insufficiently Funded Status
- **IBC**: Insufficiently Funded Category
- **SHF**: Substantially Funded
- **PER**: Profit-Related Expenditure
UNRESTRICTED INVESTMENT ACCOUNT (UA)

Low risk investment portfolio aimed at capital preservation
**WHAT IS UNRESTRICTED INVESTMENT ACCOUNT (UA)?**

(i) Unrestricted investment accounts

An unrestricted investment account ("URIA") refers to a type of investment account where the investment account holder ("IAH") provides the Bank with the mandate to make the ultimate decision without specifying any particular restrictions or conditions. The URIA is structured under Mudharabah and Wakalah contracts.

Any impairment allowances required on the assets for investment accounts are charged to and borne by the investors.

1. To build a general pool of funds for investment (funding requirements)
2. Funded by multiple 3rd parties (a group of Investors)
3. Excludes the Capital Cost / Charge of Islamic Bank & from Collective Allowance computation
4. No specific investment mandate by Investors (general mandate)
5. Liquidity reserve requirement to comply with the Liquidity Coverage Ratio framework
6. May be classified as either an on-balance sheet or off-balance sheet items (usually on-balance sheet)
7. Risk of Non-Performing Financing (NPF) passed to Investors
1. Investment Account where activities are based on a portfolio

2. May be segregated into different risk profiles (low/medium/high)

3. Investors enter based on risk profile of pool (suitability assessment required)

4. High Liquidity - Investors easily enter & exit portfolio with minimal / no penalty on redemption. Requires cash buffer/reserves.

5. Returns are based on portfolio performance

6. Profit Sharing Ratio may be changed at each maturity (mutual consent)

7. Tenures of investment varies / flexible / no maturity

Composition can be decided by Board Investment Committee (BIC)
1. Customer has Cash to Invest based on risk profile. Customer given Product Disclosure Sheets and conducts Suitability Assessment
2. Investment into Portfolio is made. Tenure flexible
3. Investor free to redeem or further invest or re-invest into Portfolio
4. On specific valuation period, a blended return on Portfolio is realised. Losses, if any, is also determined
5. If any Profit, it is distributed based on Profit Sharing Ratio or Agreed Fees
6. Investment Asset can be divested or continued for another period
**SOURCES & APPLICATION OF UA**

"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.

**INVESTORS (PSR)**
- CURRENT ACC (10:90)
- SAVINGS ACC (30:70)
- TERM DEPOSITS (80:20)
- INTERBANK INV (25:75)

**Invest**

Unrestricted Investment Pool (Principal)

**Divest / Reinvest**

<table>
<thead>
<tr>
<th>ASSET PORTFOLIO</th>
<th>ROR</th>
<th>BLENDED</th>
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<tr>
<td>40% MORTGAGE</td>
<td>3%</td>
<td>.40%</td>
</tr>
<tr>
<td>30% PERSONAL FIN</td>
<td>8%</td>
<td></td>
</tr>
<tr>
<td>10% VEHICLE FIN</td>
<td>5%</td>
<td></td>
</tr>
<tr>
<td>10% INTERBANK PLC</td>
<td>2%</td>
<td></td>
</tr>
<tr>
<td>10% RESERVES</td>
<td>1%</td>
<td></td>
</tr>
</tbody>
</table>

**Unrestricted Investment Pool (Principal + Profit)**

**INVESTORS (ROR)**
- CURRENT ACC (0.44%)
- SAVINGS ACC (1.32%)
- TERM DEPOSITS (3.52%)
- INTERBANK INV (1.10%)

**ENTREPRENEUR (FEE)**
- BANK (3.01%)
NOTICE OF TRANSITION TO CUSTOMERS: CONSENT & OPT-IN INTO IA

What is IFSA 2013?
It’s The Way Forward Towards More Responsible and Progressive Islamic Banking.

The timely introduction of the Islamic Financial Services Act 2013 (IFSA 2013) fortifies our nation’s dynamic leadership in Islamic finance, as it advances the development of a robust end-to-end Shariah-compliant regulatory framework that will serve as a model for other countries.

Under IFSA 2013, all existing Islamic deposit products that apply the Shariah contracts of Mudarabah, Musharakah and Wakalah will be classified as investment product effective from 30 June 2015.

This transition exercise is currently being carried out by Bank Islam. To the best of its ability, the Bank works to ensure that our customers can convert their accounts at no additional costs, and with minimal inconvenience and change in benefits. Where customers do not wish for their accounts to be converted, customers need to note the changes in contractual obligations and give their signed consent.

This guide has been prepared to help you understand the conversions that have been made to affected products under the Bank’s portfolio.

NOTE:

If you are a business customer holding a Mudarabah and/or Wakalah based account, you are required to choose whether to place your fund in investment account or deposit account. If necessary, you will have to provide a new Board Resolution authorising the placement in the Investment Account.

If you are a retail customer holding a Mudarabah savings account, your account has been successfully converted to Wadiah Savings Account without any change to the account number.

Holders of non-individual accounts (religious bodies, schools, associations, etc) are required to provide extract of the decision at their respective meetings to migrate to investment account.
i. Product Disclosure Sheets (PDS) have become a key requirement for offering Investment Accounts

ii. Just like the general Investment instruments in the market (Unit Trusts / Shares / Structured Investment / Sukuk), sufficient information MUST be provided to investors to allow them to make INFORMED decisions on the investments

iii. The value of investment is based on the trading value / market value / share value / redemption value, which is based on performance and market demand

iv. Information on the investment must be captured and provided to potential investors including expected performance during best market and worst market conditions.

v. These information must be sufficiently conveyed in the PDS and any other information document (such as market outlook report, prospectus, term sheets, analysis and annual statements).
As Investment Accounts are intended to behave as close as possible to "Investments", the Product Disclosure Sheet (PDS) has become a key component for the product.

PDS must clearly highlight:

1. Description of the investment
2. Type of Asset from deployment of the Investment
3. Historical Performance of the Investment
4. Forecast of the Investment performance
5. Other material information / risks on the Investment
Investor must be given information to make the right decision as “Investments” are not principal-protected.
RESTRICTED INVESTMENT ACCOUNT (RA)

Match funding a specific project or financing requirements
WHAT IS RESTRICTED INVESTMENT ACCOUNT (RA)?

1. To fund specific project, asset or portfolio
2. Funded by 3rd party (usually single party)
3. Excludes the Capital Cost / Charge of the Islamic Bank and from Collective Allowance computation
4. Usually used to fund above existing Single Customer Exposure Limit (SCEL)
5. No Liquidity reserve requirement as it is match funded
6. Risk of Non-Performing Financing (NPF) passed to Investors
7. Usually classified as off-balance sheet items

Restricted Profit Sharing Investment Accounts ("RPSIA")

RPSIA placements are used to fund specific financing and are based on the principle of Mudarabah whereby profits will be shared between the Bank as Mudharib and the investors as Rabbul Mal whereas losses shall be borne solely by the investors. These placements and financing are recorded in the Bank's financial statement as its liabilities and assets in accordance with MFRS 139. Any impairment allowances required on the financing are not recognised in the profit or loss of the Bank but charged to and borne by the investors.

All assets financed by the RPSIA are excluded from the computation of Collective Allowance and Capital ratio as disclosed in Notes 8 and 39 respectively.
1. Investment Account where activities are based on specific requirements

2. Risk profile of investor matched to Asset risks. No suitability assessment required

3. Illiquid Investment - Investors enter at start & exit portfolio at maturity with steep penalty on early redemption. Do not require cash buffer/reserves.

4. Returns are based on Asset performance

5. Profit Sharing Ratio must be mutually agreed at start of investment.

6. Tenures of investment fixed (with maturity)

7. The Asset is deemed to be directly financed by the Investor (risk transfer). No specific disclosure requirements

Composition can be decided by Credit Committee with BIC oversight
RA PROCESS FLOW

1. Customer has Cash to Invest based on Specific risk profile. Customer assesses risk.
2. Investment into Asset is made. Tenure fixed
3. No redemption allowed during tenure. If redemption is made, penalty is imposed (unless replacement investor is found)
4. On maturity date, the final return on Asset is realised. Losses, if any, is also determined
5. The Specific Asset is divested / terminated
6. If any Profit, it is distributed based on Profit Sharing Ratio or Agreed Fees
“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.
CHARACTERISTICS & FEATURES

Comparison between Mudarabah & Wakalah Fi Istihmar
DEFINITIONS

The definition of Mudarabah and Wakalah Fi Istihmar has been streamlined by Shariah scholars to be consistent with the classical definition of the 2 contracts.

<table>
<thead>
<tr>
<th>Mudarabah</th>
<th>Wakalah Fi Istihmar</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit Sharing Entrepreneurship / Investment</td>
<td>Agency for the purpose of investment</td>
</tr>
<tr>
<td>Is a contract between two parties, i.e. the Investor (owner of the capital) and the Manager (Mudarib) whom will use capital in income-generating activities</td>
<td>Is a contract between two parties, i.e. the Investor (owner of the capital) and the Agent whom will invest capital on behalf of the principal</td>
</tr>
<tr>
<td>No capital guarantee — loss will be borne by Investor</td>
<td>No capital guarantee — loss will be borne by Investor</td>
</tr>
<tr>
<td>The Bank, as the fund manager, is responsible to provide information to Investor on the profit loss sharing mechanism, as well as investment activities.</td>
<td>The Bank acts in two capacities, i.e. as an agent in accepting deposits from the investor and as an investment manager in carrying out agreed Shariah compliant investment activities.</td>
</tr>
</tbody>
</table>
The types of Mudarabah and Wakalah (both Agency & Agency for the purpose of Investments) was also clearly defined in the Standards.

<table>
<thead>
<tr>
<th>Types</th>
<th>Mudarabah</th>
<th>Wakalah Fi Istihmar</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mudarabah (Profit Sharing Entrepreneurship) refers to the act of investing as fund managers for the Investor, according to any general / specific investment mandate</td>
<td>Wakalah (Agency) is for providing a service for a fee</td>
<td></td>
</tr>
<tr>
<td>Wakalah Fi Istihmar (Agency for Investment) refers to the act of investing funds on behalf of the Investor, according to any general / specific investment mandate</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unrestricted Mudarabah (Mudarabah Mutlaqah) refers to general investment, where tenure and usage of funds are not fixed</td>
<td>Unrestricted Wakalah refers to an arrangement using general mandate, with unknown investment period.</td>
<td></td>
</tr>
<tr>
<td>Restricted Mudarabah (Mudarabah Muqayyadah) refers to specific investment, where amount, tenure and usage of funds are fixed</td>
<td>Restricted Wakalah refer to arrangement using specific mandate, matched amount and fixed investment maturity period</td>
<td></td>
</tr>
</tbody>
</table>
CONTRACTUAL RELATIONSHIP

The Standards issued also clearly outlined the roles and responsibilities of the parties in IA contracts.

<table>
<thead>
<tr>
<th><strong>Mudarabah</strong></th>
<th><strong>Wakalah Fi Isthihmar</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank As Manager (Entrepreneur), Customer as Fund Provider</td>
<td>Bank As Agent, Customer as Investor</td>
</tr>
<tr>
<td>Agreement on the investment period, investment currency, and automatic renewal of investment term unless non-renewal is requested. The customer may cancel the Mudarabah contract prior to the expiry of the agreed period, usually at a penalty.</td>
<td>Agreement on the investment period, investment currency, and automatic renewal of investment term unless non-renewal is requested. The customer is not entitled to cancel the Wakalah contract prior to the expiry of the agreed period.</td>
</tr>
<tr>
<td>The Bank as Manager cannot guarantee the profit as it is based on real performance</td>
<td>The Bank as an Investment Agent cannot guarantee the profit expected from the investment.</td>
</tr>
<tr>
<td>Early exit may result in valuation losses, borne by Fund Provider</td>
<td>Early exit may result in valuation losses, borne by Investor (after Agency Fee deduction)</td>
</tr>
</tbody>
</table>
The usage of the funds with intention to generate profit are captured in the Standards. There is strong emphasis on the treatment and distribution of profit in the Rate of Return Framework and Investment Account Framework, with the warning disclaimers requirements, performance report and distribution tables.

**DEPLOYMENT & PROFIT**

**Mudarabah**
- Contract between the customer as a Capital Provider (Rab Ul Mal) and the bank as an Entrepreneur (Mudarib). The bank will act as fund manager to invest or fund an assets/projects.
- Capital is for investment/financing purposes, based on investor mandate (if any)
- Profit distribution based on pre-agreed Profit Sharing Ratio
- The bank as an Entrepreneur is entitled to receive a share of the profit for managing the funds
- Bank shall not top-up on returns if profit is below expectations

**Wakalah Fi Istihmar**
- Contract between the customer as an investor (muwakkil) and the bank as an agent (wakkil) for the investor. The bank will act as agent to invest funds into various assets/projects.
- Capital is for investment purposes, based on investor mandate (if any)
- Profit distribution based on pre-agreed Agent fee, and the residual profit is paid fully to the Investor
- The bank as an agent is entitled to receive a fee for its services
- Bank shall not top-up on returns if profit is below expectations

**Illustration of warning statement**

**WARNING**

THE RETURNS ON THIS INVESTMENT ACCOUNT WILL BE AFFECTED BY THE PERFORMANCE OF THE UNDERLYING ASSETS. THE PRINCIPAL AND RETURNS ARE NOT GUARANTEED AND CUSTOMER RISKS EARNING NO RETURNS AT ALL. IF THE INVESTMENT IS REDEEMED EARLY, CUSTOMER MAY SUFFER LOSSES IN PART OR THE ENTIRE PRINCIPAL SUM INVESTED.

[WHERE THE INVESTMENT ACCOUNT IS NOT PROTECTED BY PIOM TO ADD: “THIS INVESTMENT ACCOUNT IS NOT PROTECTED BY PERBADANAN INSURANS DEPOSIT MALAYSIA”]
LOSSES ON INVESTMENT

The "potential losses" to the investors' capital on maturity/valuation date, remains one of the key information that needs to be acknowledged by Investors upon entering into the investment. The Suitability Assessment process is key in highlighting the potential risk to Investors' capital.

<table>
<thead>
<tr>
<th>Acknowledgement</th>
<th>Mudarabah</th>
<th>Wakalah Fi Isthihmar</th>
</tr>
</thead>
<tbody>
<tr>
<td>Remarks</td>
<td>Customer, as Capital Provider, bears all the losses on capital,</td>
<td>Customer, as Capital Provider, bears all the losses on capital,</td>
</tr>
<tr>
<td></td>
<td>upon valuation of Assets or Investment maturity</td>
<td>upon valuation of Assets or Investment maturity</td>
</tr>
<tr>
<td></td>
<td>Bank, as Entrepreneur, losses time and effort and do not incur</td>
<td>Bank, as Investment Agent, losses time and effort and do not</td>
</tr>
<tr>
<td></td>
<td>“share of loss”</td>
<td>incur “share of loss”</td>
</tr>
<tr>
<td></td>
<td>As there is no profit, there is no Profit Share of any returns</td>
<td>As there is no profit, Bank may waive its rights to the Agent</td>
</tr>
<tr>
<td></td>
<td>As the Bank does not guarantee the Capital, the Bank shall not</td>
<td>As the Bank does not guarantee the Capital, the Bank shall not</td>
</tr>
<tr>
<td></td>
<td>“top-up” the shortfall</td>
<td>“top-up” the shortfall</td>
</tr>
<tr>
<td></td>
<td>Bank, as Entrepreneur, may be required to compensate loss of</td>
<td>Bank, as Investment Agent, may be required to compensate loss</td>
</tr>
<tr>
<td></td>
<td>capital if proven negligent (Taqsir)</td>
<td>of capital if proven negligent (Taqsir) or acting outside given</td>
</tr>
<tr>
<td></td>
<td></td>
<td>mandate</td>
</tr>
</tbody>
</table>
INVESTMENT ACCOUNT FRAMEWORK

Requirements to comply with the Investment Account Framework and the relevant Standards
To comply with BNM guidelines on Deposits, Banks are required to consider all the other relevant guidelines issued across the years as it is inter-related.
INVESTMENT ACCOUNT FRAMEWORK

To realise BNM’s vision of end-to-end Investment or Fund Management, the Investment Account Framework, together with the Rate of Return Framework, was introduced by BNM in March 2014.

The following are its requirement

i. Redefined certain Deposit classification = Investment

ii. Responsibilities of contracting parties

iii. Redefined Risks – Capital Risks and Valuation Risk i.e. Capital not protected, removal of PIDM cover

iv. Risk and Disclosure Requirement – Similar to Unit Trust on-boarding process, Investor Assessment

v. Pool Management – Combination of Portfolio in a specific pool with different management mandates

vi. Asset Tagging to specific Pool – Actual Performance of Portfolio and no profit smoothing techniques allowed

vii. Liquidity Requirements – High Quality Liquid Asset, Liquidity Buffer, Stress Scenario, Redemption and suspension of profit

viii. Board Investment Committee and Shariah Oversight – Management of pools properly monitored and mandated

ix. Financial Reporting – “Investment” Deposit and corresponding Asset segregated from Asset Deposit Ratio (ADR) calculations
IA REQUIREMENTS

1. MANAGING THE POOL BASED ON USAGE
2. SEPARATE POOL MANAGEMENT
3. PROPORTIONATE MANAGEMENT OF TAGGED ASSETS
4. LIQUIDITY BY FUNDS BASIS
5. BALANCED LIQUIDITY
6. REAL PERFORMANCE
7. LOOK THROUGH APPROACH
8. ON BALANCE SHEET / OFF BALANCE SHEET
9. IA REPORTING
MANAGING THE POOLS BASED ON USAGE

Under the Investment Account Guidelines, each Investment Account type must be managed via a specific pool of funds.

For example, the Current Account under IA may be managed separately from Savings Account under IA, where the assets tagged to the pool is also different (or proportionate).

There must be a separation between pools and the tagged assets must be very transparent to the customer (as Investors).
The Investment Account guidelines also requires the separation between:

1. An Unrestricted investment account (UA) where the Assets tagged may consist of multiple proportionate portfolio, and
2. A Restricted Investment account (RA) where the funds are only tagged to a single portfolio or Asset.
PROPORTIONATE MANAGEMENT OF TAGGED ASSETS

Under the Investment Account guidelines, an Asset portfolio can be shared by a few pools of funds, and the pool of funds can have various components of proportionate Asset portfolio. This will help the Bank (as fund manager) to control the rate of returns.

Proportionate tagging

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.

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)
LIQUIDITY BY FUNDS BASIS

Under IA, the liquidity of the pools must be properly managed, and this can be achieved by having the pools invested into a mix of liquid and illiquid assets.

Subsequently, the component of the pools must contain a good mix of liquid assets as governed under the Liquidity Coverage Ratio guidelines, where High Quality Liquid Assets (HQLA) must be sufficiently provided.
**BALANCED LIQUIDITY**

Any funds shortages in the Investment Account i.e. high redemption in IA will result in shortage of liquidity (since the investment may had been deployed into medium / long term Assets).

The impact of such shortages must be accounted for in the overall liquidity of the Bank and part of the “Net Compliance Surplus/Shortfall” calculations under the Liquidity Framework.

(d) minimum liquidity requirements applied on per fund basis shall be 3% and 5% of that particular investment account fund’s prevailing Net Asset Value for 1 week and 1 month buckets.
REAL PERFORMANCE

Under Investment Accounts:

1. Principal is not protected
2. Profit is not guaranteed and is based on ACTUAL performance

WHAT DOES THIS MEAN?

It means Banks no longer can employ the following Displace Commercial Risk (DCR) techniques to boost returns on the profit:

• Gift (Hibah) from Shareholders Funds
• Waiver of Bank’s profit share / earned fee
• Restricted use of Profit Equalisation Reserves (PER)

1 Refers to the risk arising from the assets managed on behalf of the IAH which maybe borne by the IFI’s own capital, when the IFI foregoes part or all of its share of profits on the IAH funds, and/or make transfer to the IAH out of the shareholders’ fund as a result of commercial and/or supervisory concerns in order to increase the return to the IAH. The profit smoothing techniques are described in GN-3: Guidance Note on the Practice of Smoothing the Profits Payout to Investment Account Holders issued by the Islamic Financial Services Board on December 2010.
Investment Account Holders, in theory, must be considered as owners of the Assets, as the risk on principal is held by the Investment Account holders.

**This is most relevant for Restricted Investment Account holders.**

In such cases, the “Look Through Approach” is adopted where the investors are treated as if the Assets are DIRECTLY held by the investors. This means, valuation and capital risks are directly held by the investors.
ON BALANCE SHEET / OFF BALANCE SHEET

The recording of Investment Accounts in the Balance Sheet (financial statements) is not specifically mentioned in any of the issued Framework.

BNM direction is for individual Banks to obtain independent auditor opinion on how it should be recorded based on the structure.

In general, the opinions received are:

1. Unrestricted Investment Account = recorded as an On-Balance Sheet item in financial statements. However, there are also opinion on some of the decisions on the fund treatment qualifies it as an Off-Balance Sheet item

2. Restricted Investment Account = usually recorded as an Off-Balance Sheet item as the Asset is financed directly by the investor (and therefore carries 100% capital risks)
IA REPORTING

One of the main requirements under the Investment Account Framework is to clearly disclose the breakdown of the Investment Account. The breakdown must clearly show:

1. The sources of the Investment Account funds
2. The profit distributed (or fees earned by Bank) from the income generated by the Assets
3. The components of the Asset portfolio where the Investment Account funds have been deployed into.

Notes to Account

<table>
<thead>
<tr>
<th>Amount funded by:</th>
<th>Mudarabah</th>
<th>Wakalah</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unrestricted Investment Accounts (URIA)</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Restricted Investment Accounts (RIA)</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Shareholders’ fund</td>
<td>X</td>
<td></td>
</tr>
</tbody>
</table>

### Investment Account

<table>
<thead>
<tr>
<th></th>
<th>Mudarabah</th>
<th>Wakalah</th>
</tr>
</thead>
<tbody>
<tr>
<td>As at 1 January 20XX</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unrestricted investment account</td>
<td>123,400</td>
<td>65,720</td>
</tr>
<tr>
<td>Restricted investment account</td>
<td>30,500</td>
<td>8,884</td>
</tr>
<tr>
<td>Total</td>
<td>153,900</td>
<td>74,604</td>
</tr>
</tbody>
</table>

### Funding inflows/outflows

<table>
<thead>
<tr>
<th></th>
<th>Mudarabah</th>
<th>Wakalah</th>
</tr>
</thead>
<tbody>
<tr>
<td>New placement</td>
<td>33,550</td>
<td>28,395</td>
</tr>
<tr>
<td>during the year</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Redemption</td>
<td>(23,555)</td>
<td>(20,766)</td>
</tr>
<tr>
<td>during the year</td>
<td>(4,987)</td>
<td>(48,884)</td>
</tr>
<tr>
<td>Income from</td>
<td>18,021</td>
<td>8,884</td>
</tr>
<tr>
<td>investment</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Company’s share of profit

<table>
<thead>
<tr>
<th></th>
<th>Mudarabah</th>
<th>Wakalah</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit distributed</td>
<td>(7,779)</td>
<td>(1,454)</td>
</tr>
<tr>
<td>to mudarib</td>
<td>(999)</td>
<td>(1,454)</td>
</tr>
<tr>
<td>Wakalah fee</td>
<td>-</td>
<td>(351)</td>
</tr>
<tr>
<td>Wakalah</td>
<td></td>
<td></td>
</tr>
<tr>
<td>performance fee</td>
<td></td>
<td></td>
</tr>
<tr>
<td>incentive fee</td>
<td></td>
<td></td>
</tr>
<tr>
<td>As at 31 December 20XX</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>143,047</td>
<td>80,428</td>
</tr>
</tbody>
</table>

### Investment asset:

<table>
<thead>
<tr>
<th></th>
<th>Mudarabah</th>
<th>Wakalah</th>
</tr>
</thead>
<tbody>
<tr>
<td>House financing</td>
<td>33,039</td>
<td>18,499</td>
</tr>
<tr>
<td>Hire purchase</td>
<td>20,111</td>
<td>11,260</td>
</tr>
<tr>
<td>receivables</td>
<td></td>
<td>31,371</td>
</tr>
<tr>
<td>Trade financing</td>
<td>43,094</td>
<td>24,128</td>
</tr>
<tr>
<td>Other term financing</td>
<td>31,602</td>
<td>17,694</td>
</tr>
<tr>
<td>Marketable securities</td>
<td>15,801</td>
<td>8,847</td>
</tr>
<tr>
<td>Total investment</td>
<td>143,047</td>
<td>80,428</td>
</tr>
</tbody>
</table>

Total investment: 223,463
ISSUES ON INVESTMENT ACCOUNTS

Complying with the Investment Account Framework and the Rate of Return Framework
Under the PREVIOUS Mudharabah ROR Calculation, Customer deposits goes into GENERAL pool and deployed into General Investments.

Customer INVESTMENT goes into specific INVESTMENTS assets, which must be clearly disclosed to Customer (historical performance, expected returns, terms).

There are challenges to track the Sources and Application of Funds to suit the new ROR Framework and Asset Tagging via system.
There are various types of investments that carry different risks, depending on the Investment Assets.

In general, the Bank’s retail products (Current Account & Savings Account) are LOW RISK structures where Principal (Capital) are stable and non-volatile. The expectation is that the Principal amount is protected.

Profiling the risks takes the product out of the traditional banking space into the “investment” category.
PROFILING RISKS

The Investment Account Framework outlined the requirement to protect consumers from the risks inherent in non-principal protected Investments.

Customers are required to undertake a similar process for Unit Trusts i.e. understanding the risk profile of the customers and matching it to suitable investments.

Investors are assessed to determine the risk tolerance of the investors.
Once the risk profile of an Investment Account Holder is ascertained, a “suitable” investment will be offered to “Investors”.

The Investment Account is designed to offer low risk investment to Investors.

Completing the Suitability Assessment forms qualifies the Investors to subscribe to Investment Account Products, or Deposit Products, but it may just be a paper exercise.
TAGGING ASSETS

One of the challenges of IA is to have a system that is able to link and tag identified (allocated) Assets to the sources of funds (Investment Account). This needs accuracy & intelligence similar to fund management.

Asset Allocation

The fund is invested in a portfolio of the Bank’s retail and non-retail assets¹ and the asset allocation for the past two quarters is as per the table below. The asset allocation is within the stated investment objective and strategy.

<table>
<thead>
<tr>
<th>Type of Assets</th>
<th>GIA-i</th>
<th>GIA-i Campaign</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail Financing</td>
<td>Dec 2016: 88%</td>
<td>Mar 2017: 88%</td>
</tr>
<tr>
<td>Non-Retail Financing</td>
<td>Dec 2016: 12%</td>
<td>Mar 2017: 12%</td>
</tr>
<tr>
<td>Marketable Securities</td>
<td>Dec 2016: 11%</td>
<td>Mar 2017: 10%</td>
</tr>
</tbody>
</table>

Notes:
¹Retail assets consist of Unit Trust, Automobile, Home, Personal and Credit Card Financing while non-retail assets consist of SME Term and BB Term Financing

Fund Investment Objectives

- The Fund’s objective is to preserve capital while providing stable returns through low to moderate risk investments.

Fund Investment Strategy

- The Fund will be invested in a blended portfolio of the Bank’s assets.
- This is a low to moderate risk investment to achieve capital preservation and steady returns.
Glimpse of the requirements under the Standards of the various Investment Account contracts
RELEVANT SHARIAH-RELATED GUIDELINES

1. Investment Account
2. Rate of Return
3. Liquidity Coverage Ratio
4. Shariah Requirements, Optional Practices & Operational Requirements of Mudarabah
5. Shariah Requirements, Optional Practices & Operational Requirements of Musharakah
6. Wakalah Policy Document
MUDARABAH STANDARDS & OPERATIONAL REQUIREMENTS

Ensuring compliance to the basic nature of Mudarabah
GUIDANCE ON MANAGING MUDARABAH

10. Management of Mudarabah

10.1 Mudarib shall have the right to manage mudarabah venture.

10.2 Mudarib is responsible to ensure proper management of the mudarabah venture and acts in the interest of the rabbul mai.

10.3 Mandate of the mudarib shall be provided under the terms and conditions of the contract.

10.4 Mudarib may assign mudarabah capital under his management to another mudarib in another mudarabah (mudarib yudarib) or to another manager (wakil) subject to the condition that the consent of rabbul mai is obtained.

10.5 Rabbul mai shall not involve in managing mudarabah venture but shall have a right of access to reasonable information regarding the mudarabah venture.

8. Definition and Nature of Mudarabah

8.1 Mudarabah⁴ is a contract between a rabbul mai and a mudarib under which the rabbul mai provides capital to be managed by the mudarib and any profit generated from the capital is shared between the rabbul mai and mudarib according to mutually agreed profit sharing ratio (PSR) whilst financial losses are borne by the rabbul mai provided that such losses are not due to the mudarib’s misconduct (ta’addî), negligence (taqṣîr) or breach of specified terms (mukhala‘ah al-shurûf).

8.2 Mudarabah is a contract based on fiduciary relationship (aqd al-‘amanah). Under this principle, mudarib manages the mudarabah asset in trust and is not liable for the impairment of the asset except for impairment which is a result of the mudarib’s misconduct (ta’addî), negligence (taqṣîr) or breach of specified terms (mukhala‘ah al-shurûf).

8.3 Any of the contracting parties has the right to terminate the contract unilaterally except in the following conditions:

a) The mudarib has commenced the work relating to the management of the capital of the rabbul mai, or

b) Contracting parties have agreed to enter into a mudarabah for a specified time or have agreed not to terminate the contract within a specified time.
EMPHASIS ON PROFIT AND LOSS TREATMENT

13. Loss

13.1 A loss is depletion from the value of capital.
13.2 Loss shall be borne by the rabbul mal up to the capital value.
13.3 The mudarib shall not be liable for any impairment of asset unless such loss is due to the mudarib’s misconduct (ta’add), negligence (taqsiir) or breach of specified terms (mukhalatiah al-shurur) of the contract.
13.4 Notwithstanding paragraph 13.3, in the case of loss the mudarib shall furnish the reason for the occurrence of loss.
13.5 In the case of multiple rabbul mal in a single mudarabah, the loss shall be borne by each rabbul mal proportionate to his capital contribution.
13.6 In the case where mudarib commingled or injected his own fund to the mudarabah, the loss shall be borne based on the proportion of the mudarib’s capital contribution in the commingled fund.
13.7 The mudarib may voluntarily absorb the loss upon the maturity or dissolution of mudarabah.

12. Profit

12.1 Profit sharing is the primary motive of the mudarabah contract and therefore it is a fundamental component of the contract.
12.2 Profit is the value created over and above the mudarabah capital which is determined based on profit determination method acceptable by market standard or practices.
12.3 The mudarib shall not guarantee any profit.
12.4 Rabbul mal and mudarib shall share profit based on a ratio mutually agreed between them.
12.5 PSR shall be determined at the inception of the contract. Nonetheless, PSR may be revised during the tenuro of the mudarabah subject to mutual agreement.
12.6 Mudarabah contract shall not stipulate a pre-determined fixed amount of profit to one contracting party which deprives the profit share of the other contracting party.
12.7 The profit in the form of certain percentage shall not be linked to the mudarabah capital amount.
12.8 Notwithstanding paragraph 12.7, the ex-post performance profit amount (based on the PSR which had been mutually agreed upon between the rabbul mal and the mudarib) may be translated into a fixed percentage yield of the mudarabah capital amount.
MUSHARAKAH STANDARDS & OPERATIONAL REQUIREMENTS

Ensuring compliance to the basic nature of Musharakah
GUIDANCE ON MANAGING MUSHARAKAH

10. Management of Musharakah

10.1 A Musharakah venture may be managed in the following manner:
(a) Management by all partners; or
(b) Management by certain partners or a single partner; or
(c) Management by a third party.

10.2 The appointment of a third party as the manager shall be executed in a separate contract.

10.3 The appointment of a manager may be executed based on wakalah (agency), ijarah al-ashkhas (employment contract) or Musharakah.

10.4 A managing partner may be entitled to an agreed remuneration and/or any incentive as agreed by the partners for his services as manager in addition to his share in profit sharing as a partner.

10.5 A managing partner shall be liable for any loss caused by his misconduct (ta’addul), negligence (taqsiir) or breach of specified terms (mukhalafah al-shurut).

8. Definition and Nature of Musharakah

8.1 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.

8.2 Generally, there are two types of Musharakah (shirkah), namely:

(a) Shirkah al-Milk (Partnership in joint ownership)
Partnership in joint ownership refers to possession of an asset by two or more persons with or without prior arrangement to enter into a sharing in joint ownership. Under shirkah al-milk, the partner’s ownership are mutually exclusive. In this regard, one partner cannot deal with other partner’s asset without his consent.

(b) Shirkah al-‘Aqd (Contractual Partnership)
Contractual partnership refers to a contract executed between two or more partners to venture into business activities to generate profit. Under shirkah al-‘aqd, the partner is an agent to the other partners. In this regard the conduct of one partner in the ordinary course of business represents the partnership.
EMPHASIS ON PROFIT AND LOSS TREATMENT

13. Loss

13.1 Loss is depletion from the value of capital.

13.2 Loss shall be borne by the partners proportionate to the capital contribution and the loss is limited to the capital.

13.3 Upon realisation of loss, any partners may voluntarily absorb such loss.

13.4 Loss due to misconduct (la’add), negligence (taqsim) or breach of specified terms (mukhalafah al-shurut) by a partner shall be borne by that partner.

12. Profit

12.1 Profit is the value created over and above the Musharakah capital which is determined based on a method acceptable by market standard or practices.

12.2 The partners in a Musharakah venture shall share profit based on a mutually agreed ratio among them.

12.3 Profit sharing ratio (PSR) shall be based on proportionate capital contribution by the partners unless mutually agreed otherwise at the inception of the contract.

12.4 The PSR may be revised during the tenure of the Musharakah subject to mutual agreement between the partners. 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.

12.5 The partners may agree on a PSR for a certain threshold of profit. In the event that the actual profit exceeds the threshold, the excess amount may be distributed based on a different PSR agreed by the partners or be paid to any of the partners as per agreement. In the case of profit generated is below the threshold, the profit is shared based on the PSR.

12.6 Musharakah contract shall not stipulate a pre-determined fixed amount of profit to any partners which may deprive the profit share of the other partners.

12.7 The expected return in the form of percentage which is attributed to the Musharakah capital amount is only permissible in the form of indicative profit rate.
WAKALAH STANDARD (POLICY DOCUMENT)

Ensuring compliance to the basic nature of Wakalah Fi Istihmar
GUIDANCE ON MANAGING WAKALAH FI ISTHIHMAR

20. Application of wakalah bi al-istithmar

20.1 A wakalah contract may be entered into for the purpose of investment (wakalah bi al-istithmar).

20.2 In accordance with paragraph 18.3(c), the agent must not guarantee the capital or return on the investment in any form.

20.3 In the event of agent’s misconduct, negligence, or breach of specified terms that results in a lower profit rate than the expected profit rate of such investment, the agent shall:
   (a) repay the investment capital;
   (b) pay the actual profit up to the event of breach; and
   (c) compensate such loss and damage which the principal is entitled to in accordance with paragraph 14.11.

20.4 For the avoidance of doubt, breach of specified terms referred to in paragraph 20.3 includes, but not limited to, breach of the following terms:
   (a) the fund shall be invested in such a manner that generates a certain expected profit rate and the agent breaches that condition which results in a lower profit rate than the expected profit; or
   (b) the fund shall be invested only in a specific instrument or portfolio and the agent breaches the condition by investing in another instrument or portfolio which results in a lower profit than the expected profit of the specified instrument or portfolio.

20.5 In the event a breach of condition results in profit to be higher than the agreed expected profit, the excess profit shall be treated in accordance with the agreed terms and conditions of the performance fee. If the terms and conditions are not stipulated, the principal shall have the discretion to grant the performance fee.

20.6 The principal under the wakalah bi al-istithmar contract may require the agent to arrange for an independent third party guarantee on the capital.

20.7 For the purpose of paragraph 20.6, the following requirements must be observed:
   (a) the guarantee shall be executed as a separate contract to guarantee loss or depletion of capital; and
   (b) where the third party guarantor is an entity, it shall not be a related party to the agent.

20.8 The principal may agree to the agent retaining all or part of the excess profit as performance fee if the actual profit is higher than the agreed expected profit.

20.9 In the event that the actual profit is lower than the agreed expected profit, the agent may give hibah to the principal to compensate for the difference.

20.10 In connection with paragraph 20.9, such hibah must not be made obligatory on the agent.

20.11 The agent may initiate the investment by advancing his own funds with the consent of the principal.

20.12 In connection with paragraph 20.11, such advancement by the agent must not be made as a pre-condition for entering into the wakalah contract.

20.13 If the agent sets aside a portion of the investment profit as reserves for the principal:
   (a) the agent must obtain the principal’s prior consent; and
   (b) all profit retained in such reserves belongs to the principal.

20.14 If the capital provided under wakalah bi al-istithmar contract is to be invested together with other pools of funds having similar mandates, the capital must be able to be segregated from the other pools of funds.
The growing child with its tantrums, insecurities and pains
WHY DEPOSITS ARE IMPORTANT?

USES OF DEPOSITS

- Fund the Bank’s Asset and Financing Activities
- Deploy to take advantage of Investment Opportunities
- Statutory Reserves
- Replacement Liquidity
- Financial Ratios and Stability
- Fee Generator
- Cheap source of funding
IMPACT OF INVESTMENT ACCOUNTS

- Unsuitable Needs – Customer seeking CASA but faced with additional requirements and terminologies. A lot of effort required for awareness

- Deposit Flight – CASA has been associated with Principal Guarantee, resulting into movement into other “protected” contracts

- Product Change – Some features changes and more similar to Unit Trusts

All the above has resulted in challenges for Islamic Banks to grow deposit to fund the financing activities.
FEATURES SUMMARY

CASA/FD Investment Account
- Classification: Investment
- Doc: T&C, PDS, Performance Report
- Guidelines: Liquidity Coverage Ratio
- No DCR methods for Profit Smoothing
- Suitability Assessment Required (CIP)
- Specific Pool of Investment

CASA/FD Mudarabah / Wakalah Fi Istihmar
- Shariah Contract: Mudarabah
- Returns: Agreed Profit Sharing Ratio
- Product Benefits allowed up front
- Principal: Not Guaranteed
- Guidelines: ROR Framework
- General Pool of Investment

CASA Qard
- PIDM COVER
- Doc: T&C
- Classification: Deposit
- Shariah Contract: Qard
- Returns: Discretionary
- Product Benefits Not allowed
- Principal: Guaranteed

Musharakah
No offering yet
# Adverse Customer Experience

| No simple CASA solution | • Mudarabah / Wakalah Fi Istihmar CASA now heavily governed  
|                         | • Explore Tawarruq CASA or remain in generic CASA deposit-types (Qard / Wadiah) |
| PIDM Impact             | • Removal of PIDM became a key loss proposition for IA, underestimated by many Islamic Banks  
|                         | • To explore “3rd party” deposit guarantee |
| Conventional Banking push | • Opportunity for Conventional Banks to promote their products  
|                         | • Simple easy conversion techniques used |
| Awareness Building      | • Contract now = Investments which requires understanding of risks and additional disclosures on the principal amount and performance |
| Customer Profile        | • Alternative “Risk taking products” such as unit trust or mutual fund more suitable for profiling |
### DEPOSITS

<table>
<thead>
<tr>
<th>Types of Contract</th>
<th>Wadiah / Qard / Tawarruq</th>
<th>Mudharabah / Wakalah fi Istihmar / Musharakah</th>
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<tr>
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<td>Low Return or Principal Loss</td>
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<td>No</td>
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<tr>
<td>Disclosure Format</td>
<td>Savings Account</td>
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<tr>
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<td>General</td>
<td>Defined Investments (UA) or Specific Investment (RA)</td>
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<tr>
<td>Customer Documents</td>
<td>Terms and Conditions</td>
<td>PDS, Terms and Conditions, Performance Report, Risk Profiling</td>
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</table>
What other alternative deposit raising structures are available if:

1. Qard-based structures are a challenge to promote
2. Tawarruq CASA structures are a challenge due to high operational costs (commodity trading fees)
3. Investment Account under Mudarabah and Wakalah Fi Istihmar structures are a challenge due to the compliance and reporting requirements

Is there a space to use Musharakah structures for raising deposits?
THE WAY FORWARD

INVESTMENT ACCOUNT PLATFORM (IAP)
BUILDING DEPOSITS

**Basic**
- Current Account and Savings Account based on Wadiah or Qard i.e. Principal protection and preservation
  - Unattractive proposition for deposit building due to limitation to promote products.
  - Low Risk and Low Returns on Deposits

**Term**
- Structured term placements with defined returns on the deposits.
  - Sale-based structure using the Tawarruq Arrangement (Commodity Murabahah) to provide stability of returns and Principal protection.
  - Low to Medium Risk with relevant fixed returns on Deposit

**Investment**
- Savings Account with a more aggressive stance towards the investment assets and specific performance of these assets.
  - Risk Sharing contracts such as Mudarabah
  - Requires detailed disclosures on performance to mitigate higher risks.
  - Medium to high risk products with potentially higher sharing of returns to reflect the level of risk.

**Direct Funding**
- Deployment of deposit into pure investment structures where Investors take direct risks on performance.
  - Equity Risk Sharing contracts such as Musharakah
  - Requires significant level of disclosure and risk warnings, as well as performance forecasts.
  - High risks with potentially highest returns, on a profit sharing model but also potentially having a risk on capital
## Positive Industry Development

<table>
<thead>
<tr>
<th>Category</th>
<th>Benefits</th>
</tr>
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<tbody>
<tr>
<td>Increase in Sophistication</td>
<td>• Good platform to move into pure Investment Account by understanding the disclosures</td>
</tr>
<tr>
<td>Understanding Risks</td>
<td>• Better understanding between the risks and rewards pay-off in an Investment-type account</td>
</tr>
<tr>
<td>Potentially Higher Returns</td>
<td>• Returns tagged to actual performance which potentially may be higher</td>
</tr>
<tr>
<td>Active Management of Funds</td>
<td>• Better understanding of performance of the investment markets, returns and risks</td>
</tr>
<tr>
<td>Shariah consistent</td>
<td>• Consistent with the real contract for investments</td>
</tr>
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</table>
WHY INVESTMENT ACCOUNTS HAVE A GOOD FUTURE?

Investment Accounts can provide flexibility to open opportunities to invest in various levels of Risk instruments for better returns.

However, most structures aims to provide:

1. Capital preservation
2. Mitigated / controlled risks
3. Maximum returns

Not many participative structures of sharing of risks
INVESTMENT ACCOUNT PLATFORM (IAP)

Rethinking the way the Banks support customers who seek “Investments” and companies that seek “funding”, riding on the expertise of Islamic Banks. Investors take on acceptable risks for rewards. This is a significant shift from the Basic Deposit way of raising funds.

Vision
To be the leading multibank platform for Shariah compliant capital mobilisation, supported by a conducive ecosystem.

Mission
To provide a tech-driven avenue of choice for fund raising and investment in support of real economic growth.

Objectives
To provide an enabling environment with different value propositions to accommodate the following stakeholders:
- **Sponsoring Bank**: Efficient capital management and sustainable source of fee-based income
- **Investor**: Wider range of Shariah-compliant investment options in various types of economic activities
- **Venture**: Greater access to business financing
FEATURES OF IAP

i. Investment Accounts are being promoted by BNM to “match make” Banks and potentially good ventures via Investment Account Platform (IAP).

ii. The intention if to link between the retail / corporate “investors” directly with companies seeking funding for their businesses.

iii. This model is similar to crowd funding, but without the business having to surrender their equity to their “investors”
ONE OF THE INNOVATION OF ISLAMIC BANKING IS THE INTRODUCTION OF INVESTMENT ACCOUNT PLATFORM (AIP). THE IAP AIMS TO TAKE ADVANTAGE OF THE ISLAMIC PRINCIPLES OF RISKS AND PROFIT SHARING TO THE NEXT LEVEL

Benefits:

1. **Encourages Profit Sharing, Risk Taking, and Strong Governance**
2. **Minimum Funding Size RM500,000 up to 5 years financing**
3. **Companies and SMEs with a 3-5 years financial track record**
4. **Rides on existing Bank credit infrastructures and assessment expertise**
5. **Pushes companies to become more transparent and competitive**
IMPACT OF IAP

1. Bank is no longer a Bank, but a equity funding facilitator. Bank will utilise its expertise to assess the viability of the investment

2. Direct funding from public investors to entrepreneurs or business partners. Funding not from Bank

3. Familiarise with structures similar to Venture Capitalist

4. Bank may provide Rating of the entrepreneurs and feasibility assessment to the Investors for a fee

5. Investors need to be more savvy to understand the behaviour of investment

6. The ownership of the Investment need to be clear ie it is taken by fund provider into their portfolio as direct investor

7. No capital charge or impairments to the Bank
INTRODUCED IN 2015, IAP HAS TAKEN OFF ON A LOW-PROFILE MANNER AS THE MARKET FAMILIARISE WITH THE CONCEPT OF EQUITY SHARING AND MEDIUM/HIGH RISK INVESTMENT VENTURES.

QUESTION: IS THE MARKET READY FOR MUSHARAKAH ACCOUNTS, AND ITS RISKS?

- Redemption = Replacement of Investment with other similar profile Investors
- Difficulty in Valuation for Investment (MTM) & methodology
- Operating, Credit, Market, Ownership Risks borne by Investors
- Investment for project life, illiquid investments
- Returns = Actual Performance, Payback Period, Dividend Pay-out cycles
- Cash Flows not retained by Bank i.e. not able to benefit core deposits.
SUMMARY: INVESTMENT ACCOUNTS

Key takeaways from the introduction of IFSA 2013 and its impact on Deposits into Investment Accounts
SUMMARY
FUTURE OF DEPOSITS UNDER IFSA 2013

✓ Options under Qard and Wadiah expected to be restrictive
✓ Investment Accounts offers a viable way to build deposits by offering potential benefits from investments
✓ Market is slowly moving to IA as it provides differentiation opportunities
✓ Acceptance and awareness on IA is key for growth
✓ There are operational challenges for IA to comply with the strict requirements by BNM
✓ Failure to build deposits via IA will result in stress for the Islamic banking industry
✓ IAP, although different from IA, will provide a financing / funding avenue for clients to obtain capital while participating in the sharing of risks and returns.
THANK YOU FOR YOUR ATTENTION

ISLAMIC BANKERS RESOURCE CENTRE
https://islamicbankers.me
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