



# The Shift of Mudharabah Products into Investment Accounts

*Market Impact and Its Acceptance*

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18 November 2015

INCEIF (Maybank Islamic Auditorium 12.00 noon)

BANK ISLAM

Personal Banking

Business Banking



## Deposit and Investment Products

Personal Banking > Deposit and Investment Products

All Islamic Banks find means to boost deposits via many types of structures and Islamic contract.

## The Importance of building Deposits

Customers goes to the Bank to enjoy the benefits of deposit accounts; either for savings purposes, transactional, returns or even salary purposes

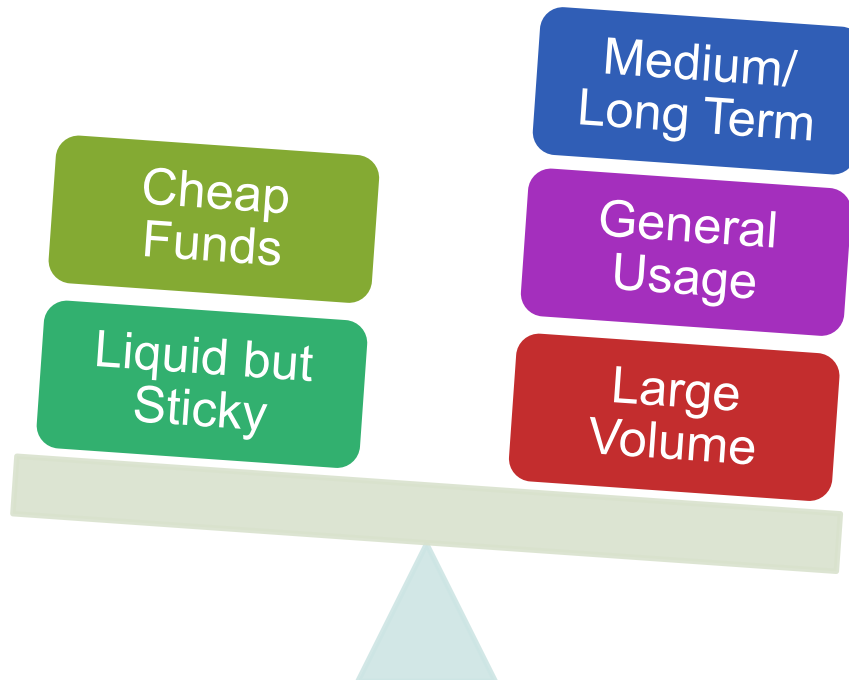
Banks loves deposits because it is a source of cheap funds for its financing activities

# 1. Why do we need Deposits?

Deposit-taking is a key requirement of any business as it provides a proxy to capital and allows for business expansion via managed funds of the depositors.

CASA

GIA



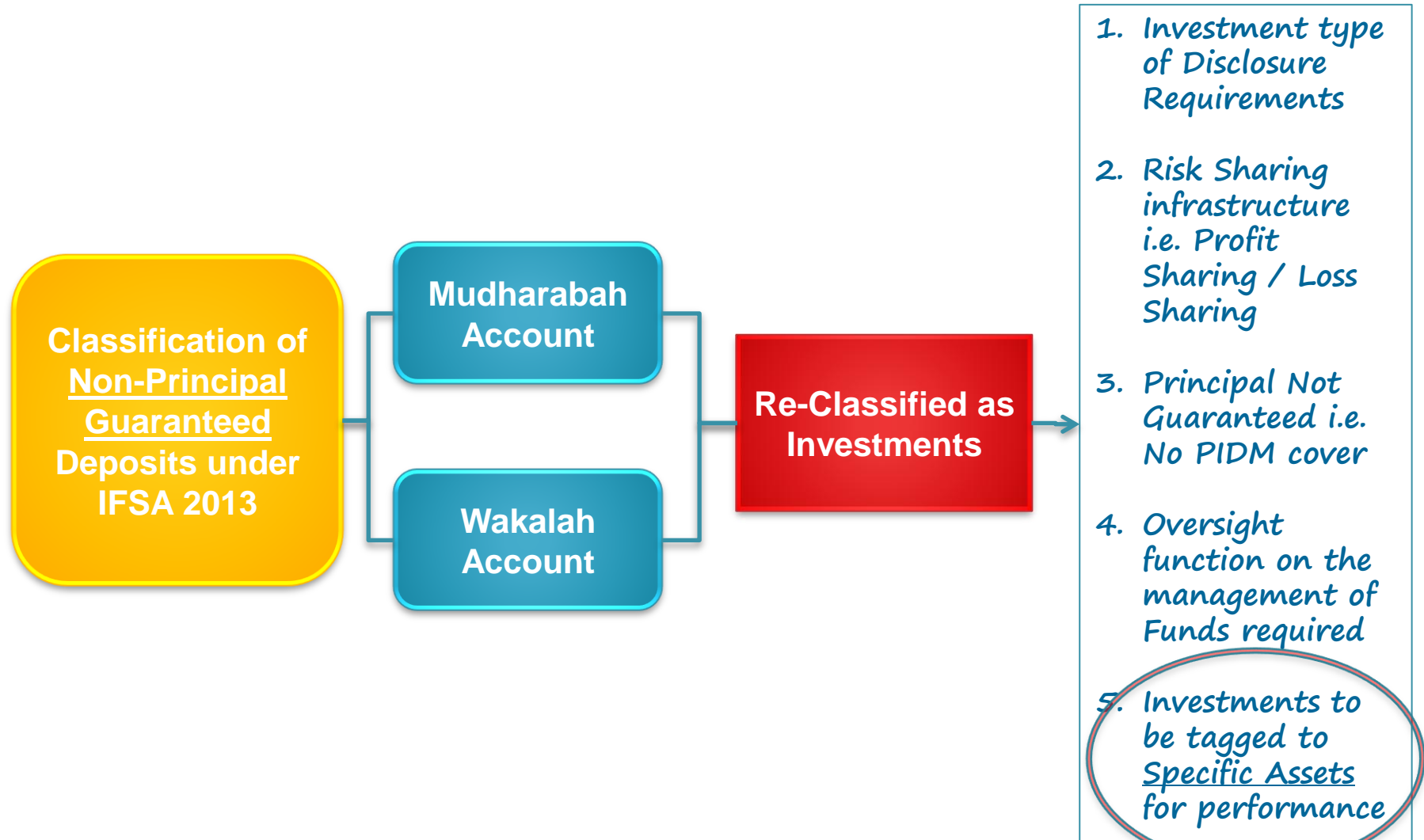
## USES

- Fund the Bank's Asset and Financing Activities
- Deploy to Capture Investment Opportunities
- Statutory Reserves
- Replacement Liquidity
- Financial Ratios & Stability
- Fee Generator

## 2. Impact of IFSA on Deposits

- Islamic Financial Services Act 2013 (IFSA) introduced to replace Islamic Banking Act 1983 has put considerable pressure on deposit-taking activities by Islamic Banks
- The biggest impact of IFSA is the definition of deposits:
  1. If a deposit, based on the Islamic contract, guarantees the principal amount to customers upon demand, it is classified as DEPOSIT
  2. If a deposit, based on the Islamic contract, do not guarantees the principal amount to customers upon demand, it is classified as INVESTMENT

### 3. IFSA Requirements



*Issues: Specific Assets requires performance monitoring, capital allocation, portfolio management of a mature portfolio.*

# 4. Complying to Requirements



 **BANK NEGARA MALAYSIA**  
CENTRAL BANK OF MALAYSIA


**Investment Account**

 **BANK NEGARA MALAYSIA**  
CENTRAL BANK OF MALAYSIA


**Rate of Return**

 **BANK NEGARA MALAYSIA**  
CENTRAL BANK OF MALAYSIA


**Liquidity Coverage Ratio  
Concept Paper**

 **BANK NEGARA MALAYSIA**  
CENTRAL BANK OF MALAYSIA

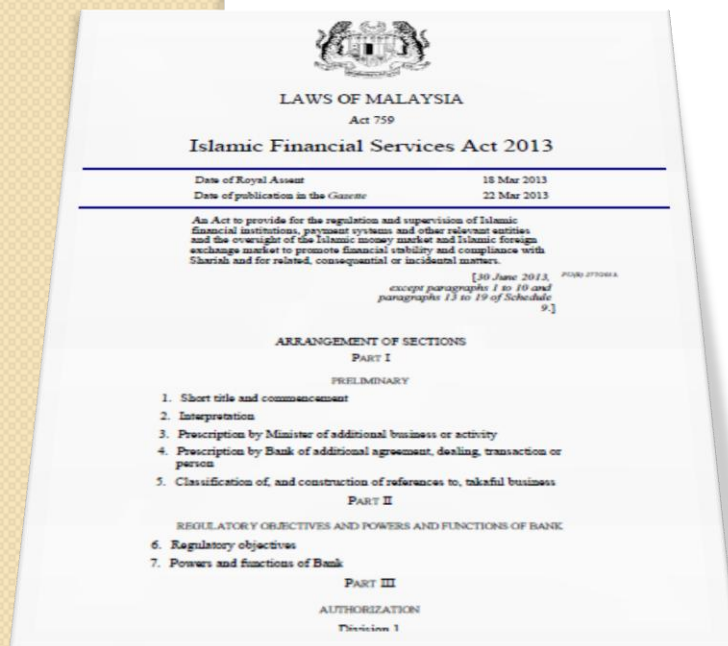
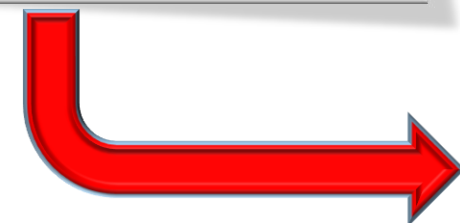
**Concept Paper  
Shariah Requirements,  
Optional Practices and  
Operational Requirements of *Mudarabah***

 **BANK NEGARA MALAYSIA**  
CENTRAL BANK OF MALAYSIA

**Wadi'ah  
(Shariah Requirements and Optional Practices)  
Exposure Draft**

 **BANK NEGARA MALAYSIA**  
CENTRAL BANK OF MALAYSIA

**HIBAH  
(Shariah Requirements and Optional Practices)  
Exposure Draft**





# 5. Key Summary of Regulations

## Investment Account

- Defines “Non Principal Guarantee” as Investment
- Methodology of management of Investment Account
- Use of UA and RA
- Risk Management
- Transparency and Disclosure
- Liquidity Management
- Capital Adequacy

## Rate Of Return

- Management of Funds
- Management of UA and RA
- Proportional Tagging
- Distribution of Profit
- Disclosure and Reporting
- Calculation Table

## Mudharabah Standards

- Operational standards
- Utilisation of Funds
- Valuation of Investment Pool
- Management of Funds
- Distribution of Profit

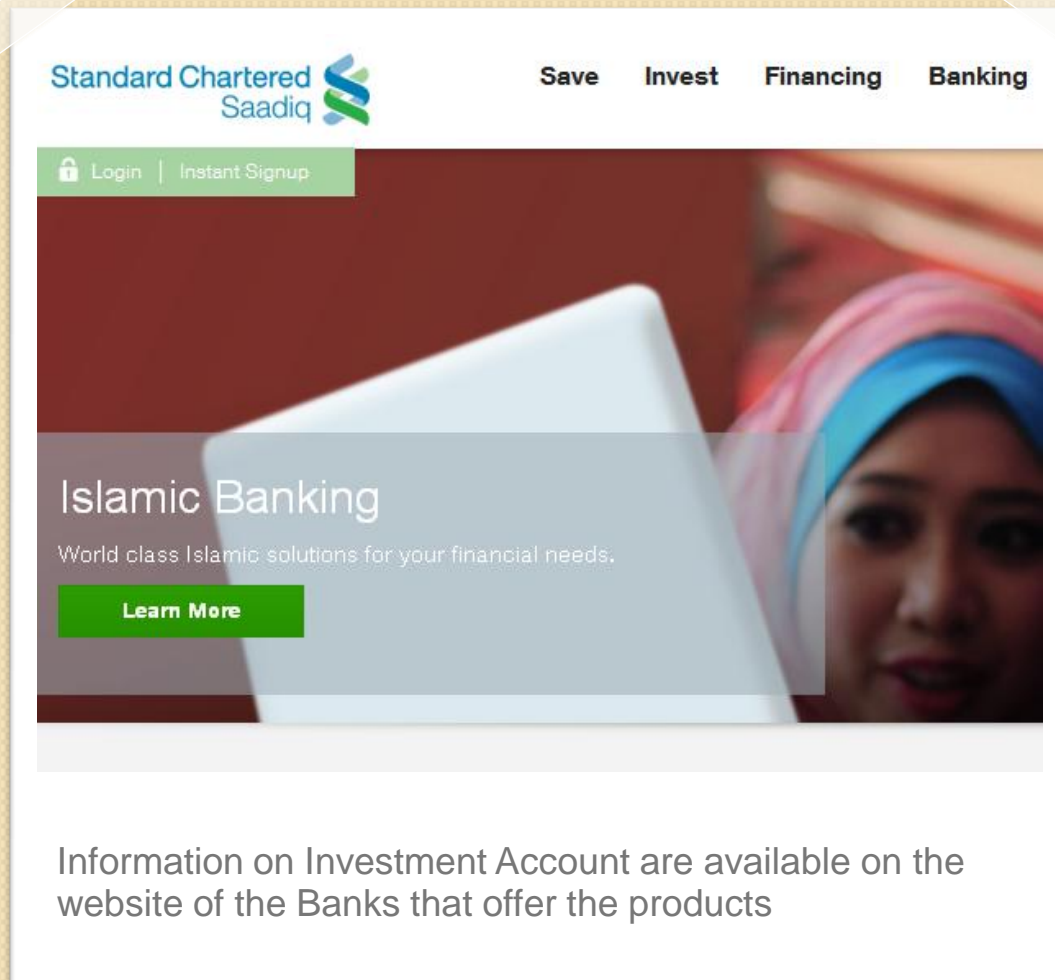
## Liquidity Coverage Ratio

- LCR Minimum Requirements (60%)
- Stock of High Quality Liquid Asset
- Expected Cash Outflows
- Expected Cash Inflows
- Investment Accounts
- Reporting Requirements

## 6. Meeting Requirements

- Under IFSA 2013, the reclassification of all Mudharabah-based accounts from “Deposit” classification into “Investments” must be complied with by 30 June 2015.
  - Most Banks convert CASA Mudharabah to Wadiah and GIA to Commodity Murabahah Term Deposit (CMTD-i)
  - Saadiq decided to launch:
    1. **CMTD-i to replace GIA**
    2. **Investment Account to replace Mudharabah CASA**
- ✓ *Mudharabah and Wakalah Deposits classified as Investments*
  - ✓ *Customer to complete the Customer Investment Profile (CIP) before signing up and Risk Rating issued*
  - ✓ *Bank to inform the specific Asset the investment is tagged to, and the expected performance of the Asset*
  - ✓ *Distribution of Profit is based on Actual returns, with no profit smoothing done to the returns*
  - ✓ *New ROR Framework and Liquidity Coverage Ratio (LCR) Guidelines to comply*
  - ✓ *Bank to provide clear terms and conditions for investment and send annual performance reports*





The screenshot shows the Standard Chartered Saadiq website. The header includes the bank's logo and navigation links for 'Save', 'Invest', 'Financing', and 'Banking'. A green bar contains 'Login' and 'Instant Signup' links. The main banner features a woman in a pink and blue hijab looking at a laptop, with the text 'Islamic Banking' and 'World class Islamic solutions for your financial needs.' Below this is a green 'Learn More' button.

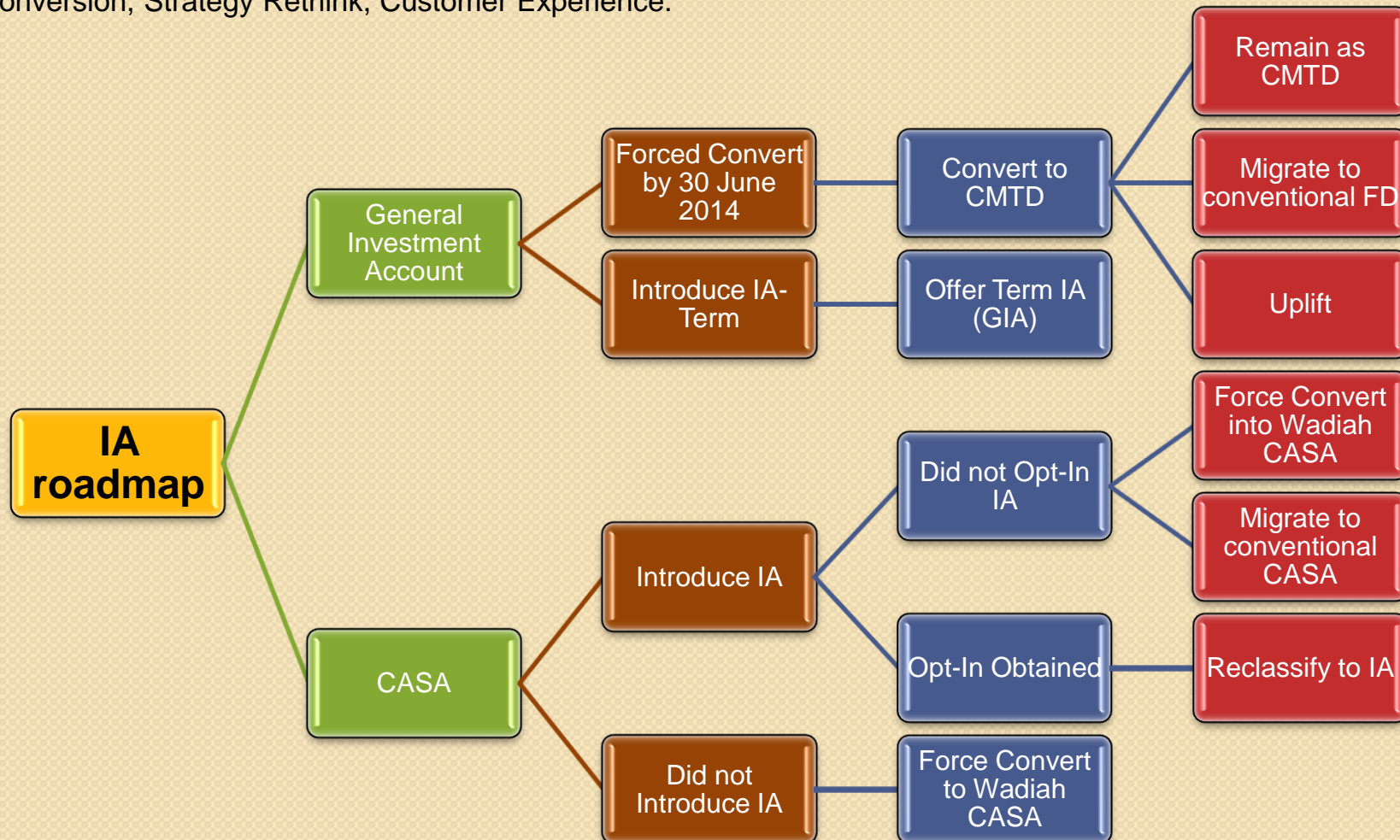
Information on Investment Account are available on the website of the Banks that offer the products

## So what is Investment Account?

How will it behave for General Investment Accounts, Current Account and Savings Account?

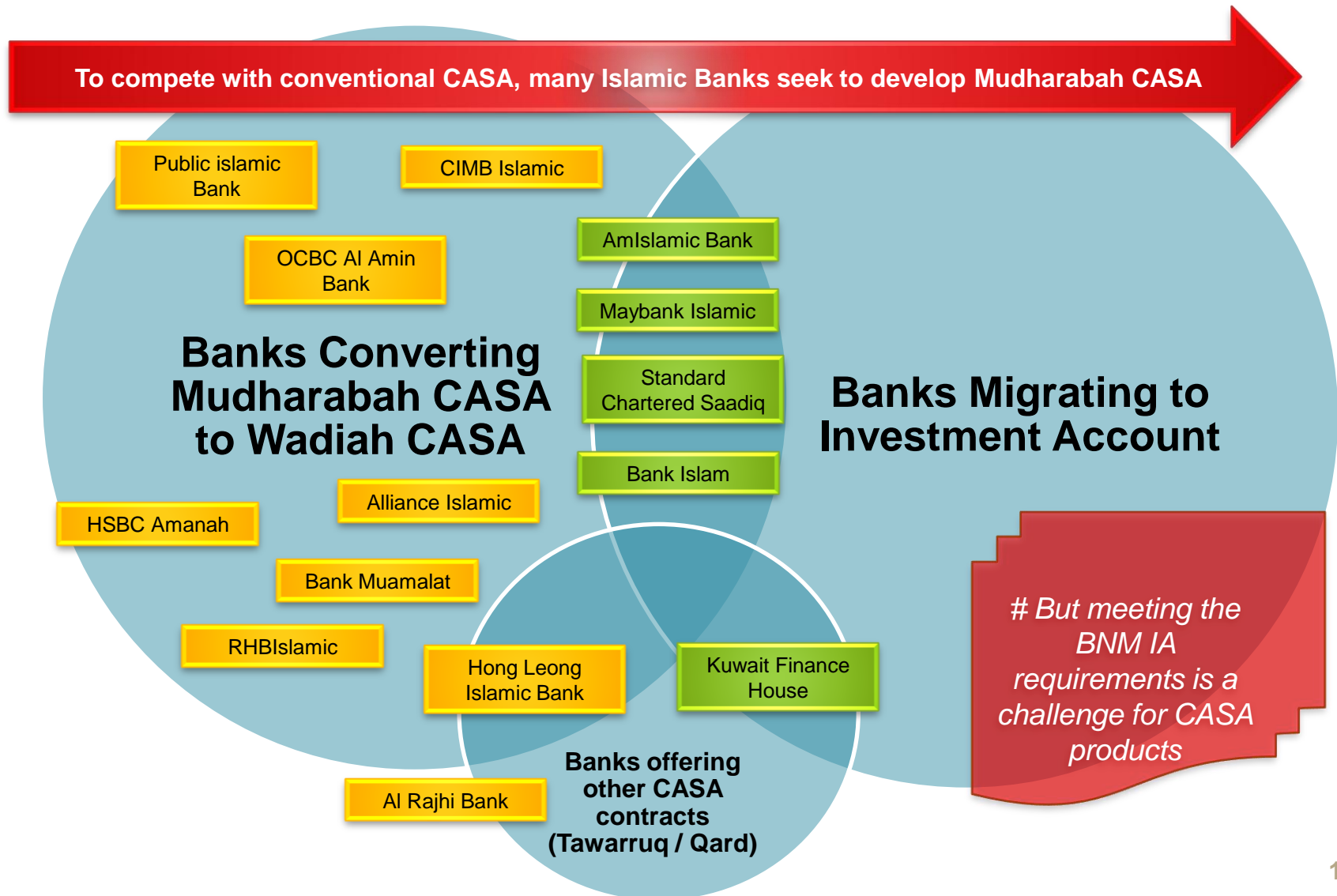
# THE GREAT MUDHARABAH CONVERSION EXERCISE

For the past 2 years, Islamic Banks have been scrambling to comply with IFSA 2013. Re-shuffle, Conversion, Strategy Rethink, Customer Experience.



Does not include the Re-Conversion exercises

# 7. Industry Movements towards IA



# 8. Investment Accounts

## Product Structuring

- Investment Objectives / Minimum Amount of Investment / Investment Tenure / Redemption of Investment / Profit Sharing & Agency Fee / **Product Approval**

## Management of Investment Account

- **Separate Management of Investment Account / Valuation of Investment Account**

## Oversight Arrangements

- Role of the Board (Board Committee) / Shariah Committee /Senior Management

## Risk Management & Internal Control

- Policies and Procedures / Investment Concentration Risk Limit / Single Counterparty Exposure Limit / Liquidity Risk Management / Audit Function

## Business & Market Conduct

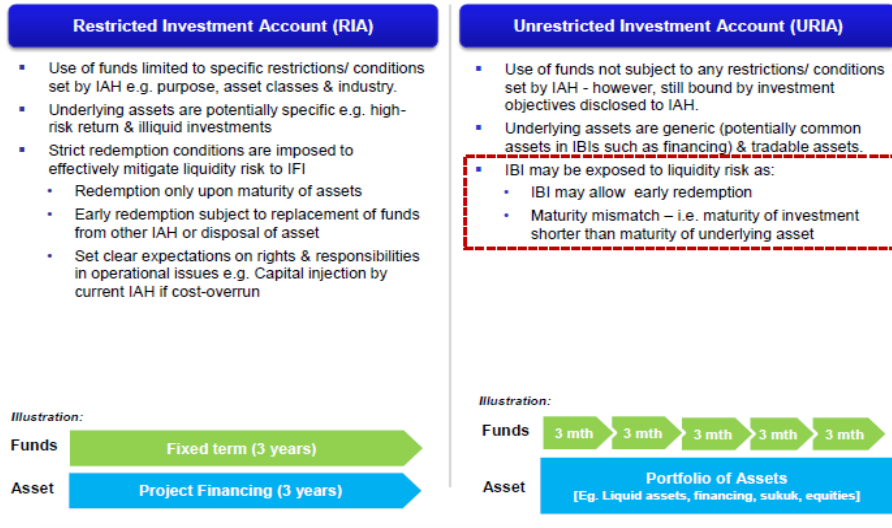
- Suitability and Fair Dealing Practices

## Transparency & Disclosure

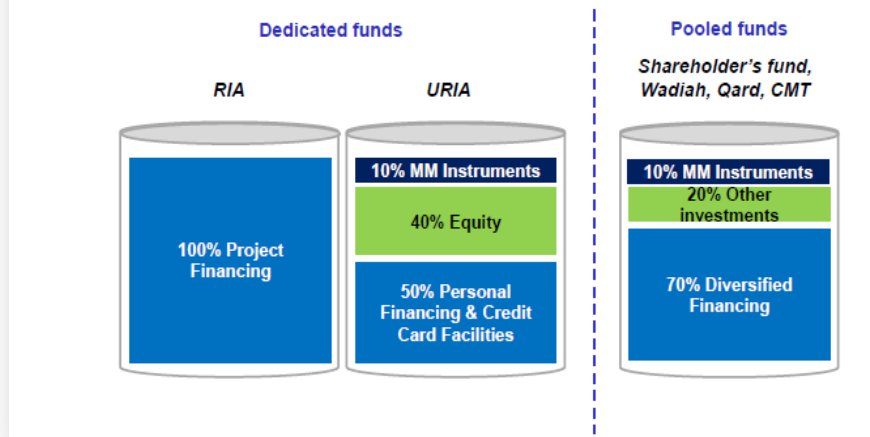
- **General Principles / Product Disclosure Sheet / Terms and Conditions of agreement / Investment Account Performance Report / Financial Reporting**

# 9. Specific Instructions by BNM

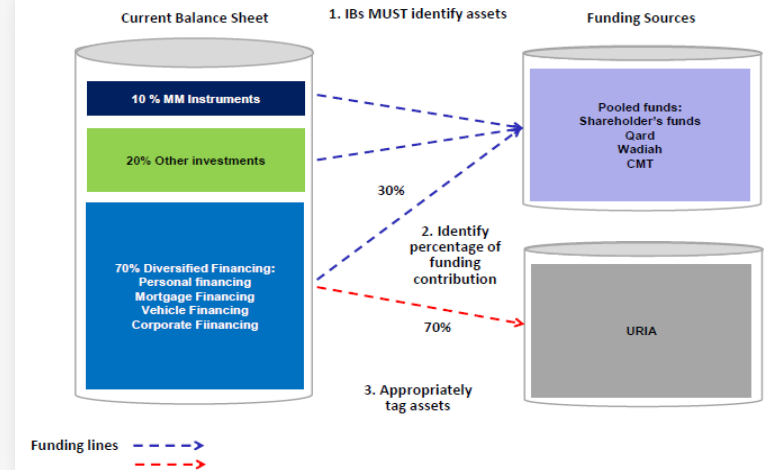
## Differences between RIA & URIA



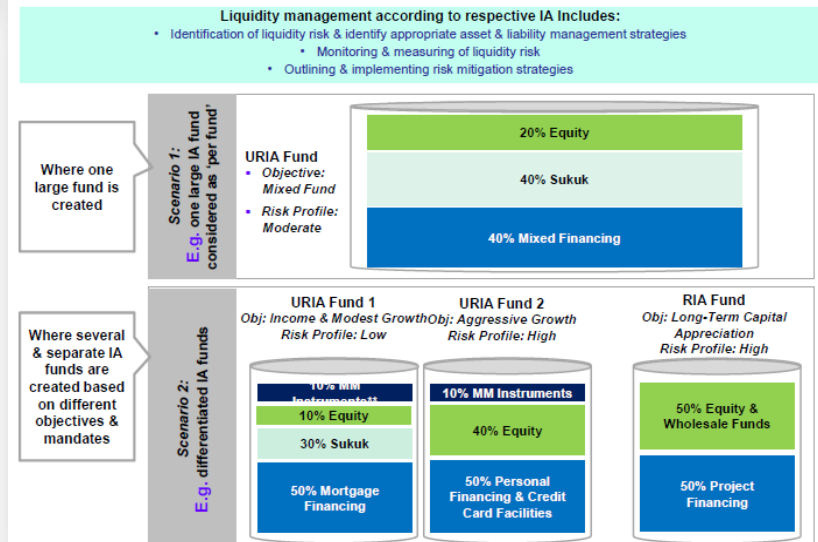
## Separate management requirement under Revised ROR



## Identification of investment assets



## Liquidity management of IA – by funds basis



## Reclassification of Mudharabah Savings and/or Current Account(s)

Dear Valued Customer,

Kindly be informed that we are going to reclassify your current and/or savings accounts from an Islamic deposit account to an Islamic investment account effective 1 July 2015. This is in line with recent regulations issued under the Islamic Financial Services Act 2013 (IFSA) which distinguishes accounts by the nature of its Syariah principles.

*Above: Sample letter that customers get to encourage them to convert to Investment Account*

## Reclassification of CASA to IA

Saadiq introduced Investment Account (CASA-equivalent) beginning May 2015 and completed the conversion to IA in July 2015

Total number of customers impacted : Approx 65,000



## 10. Conversion Success (Industry)

Success by Islamic Banks has been mixed and more focus in retaining selected High Value customer segments rather than conversion for mass market accounts.

### GENERAL INVESTMENTS

**55% to 64% → CMTD-i**

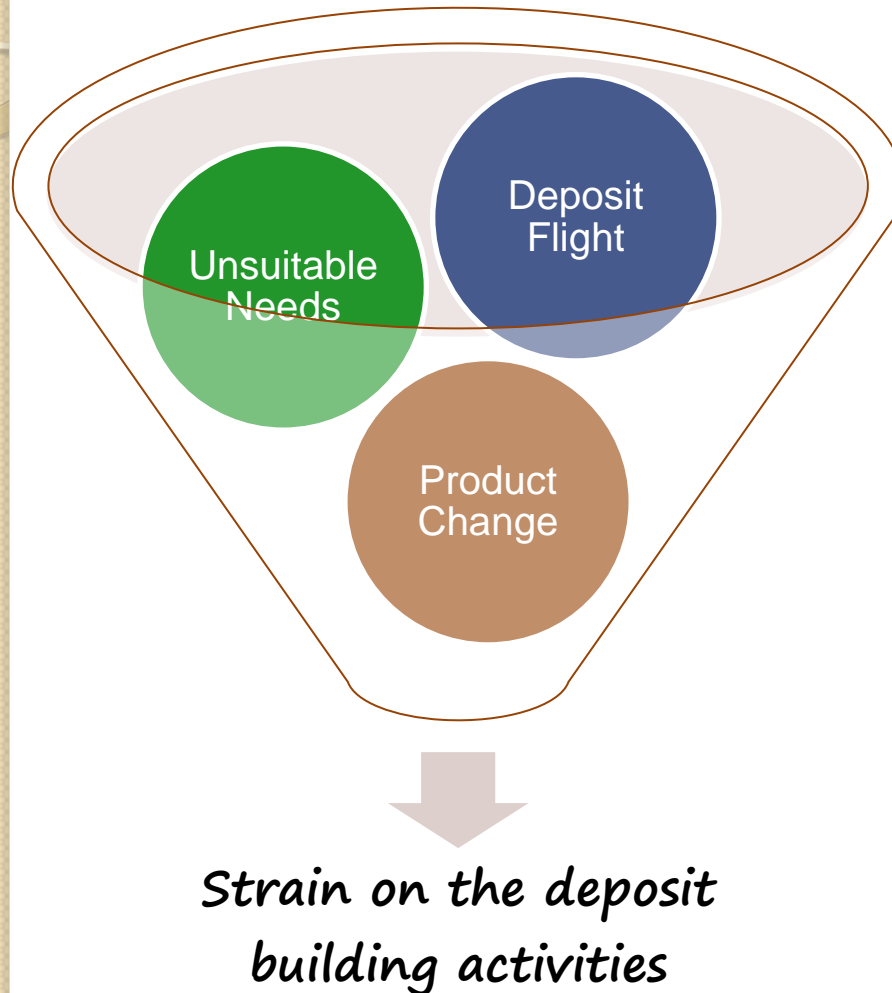
(via forced conversion on maturity or early upliftment)

### CURRENT / SAVINGS ACC

**7% to 21% → IA**

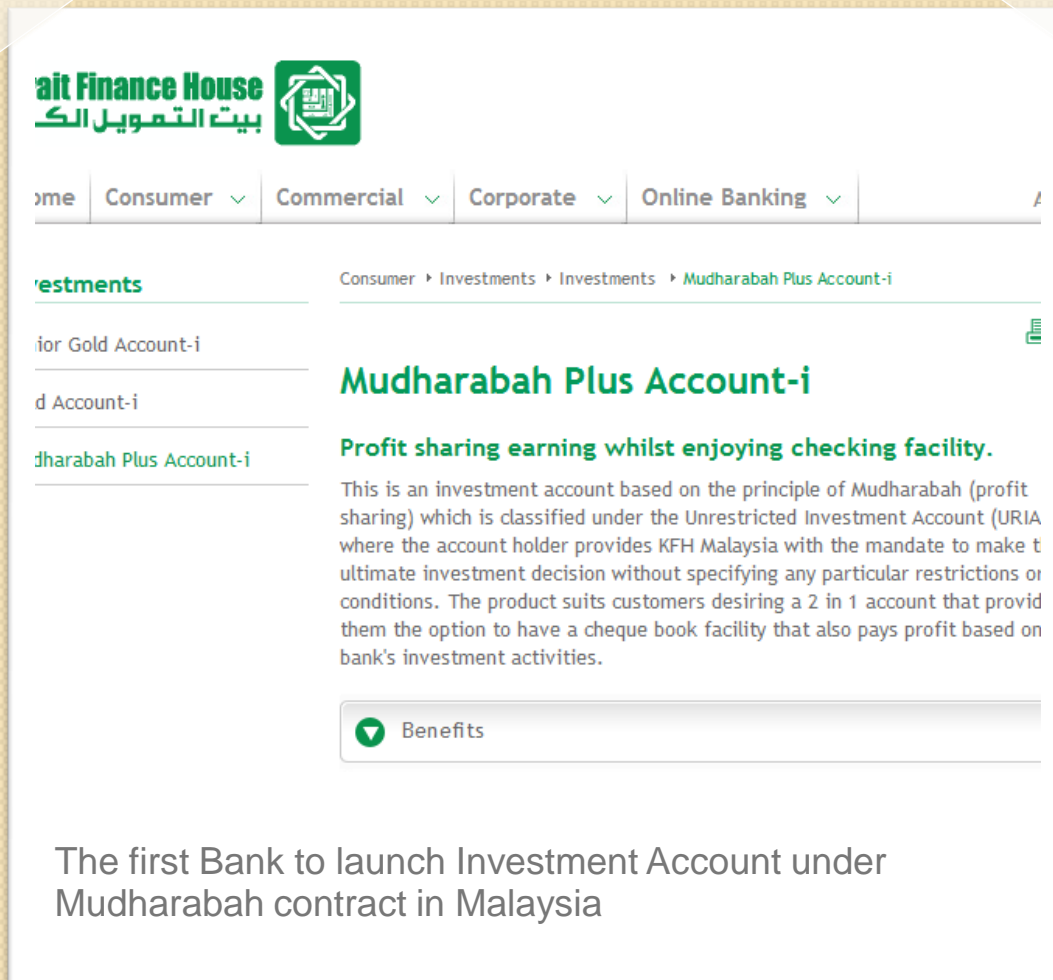
(via opt-in conversion by 30 June, else Wadiah-based Acc)

# 11. Impact of Investment Account



- ✓ Unsuitable Needs – Customer seeking CASA, but faced with additional disclosure requirements and terminologies. A lot of effort required for awareness.
- ✓ Deposit Flight – CASA has been long associated with principal protection, movements to Wadiah-based and conventional banking.
- ✓ Product Change – Some feature changed which is yet to be accepted; potentially higher returns (but hardly seen), capital at-risk, warnings, loss of PIDM coverage.

All the above have resulted in challenges for Islamic Banks to grow deposit to fund the financing activities. With impending Qard guidelines, Islamic Banks is expected to face a liquidity crunch.



The screenshot shows the Kait Finance House website. The header includes the logo and navigation tabs for Home, Consumer, Commercial, Corporate, and Online Banking. The main content area is titled 'Investments' and features a sidebar with links to 'Gold Account-i', 'd Account-i', and 'Mudharabah Plus Account-i'. The main heading is 'Mudharabah Plus Account-i' with a sub-heading 'Profit sharing earning whilst enjoying checking facility.' The text describes the account as an investment account based on the principle of Mudharabah (profit sharing) classified under the Unrestricted Investment Account (URIA). It mentions that the account holder provides KFH Malaysia with the mandate to make the ultimate investment decision without specifying any particular restrictions or conditions. The product suits customers desiring a 2 in 1 account that provides them the option to have a cheque book facility that also pays profit based on bank's investment activities. A 'Benefits' section is partially visible at the bottom.

**Kait Finance House**  
بيت التمويل كيت

Home Consumer Commercial Corporate Online Banking

**Investments**

Consumer ▶ Investments ▶ Investments ▶ Mudharabah Plus Account-i

Gold Account-i

d Account-i

Mudharabah Plus Account-i

## Mudharabah Plus Account-i

**Profit sharing earning whilst enjoying checking facility.**

This is an investment account based on the principle of Mudharabah (profit sharing) which is classified under the Unrestricted Investment Account (URIA) where the account holder provides KFH Malaysia with the mandate to make the ultimate investment decision without specifying any particular restrictions or conditions. The product suits customers desiring a 2 in 1 account that provides them the option to have a cheque book facility that also pays profit based on bank's investment activities.

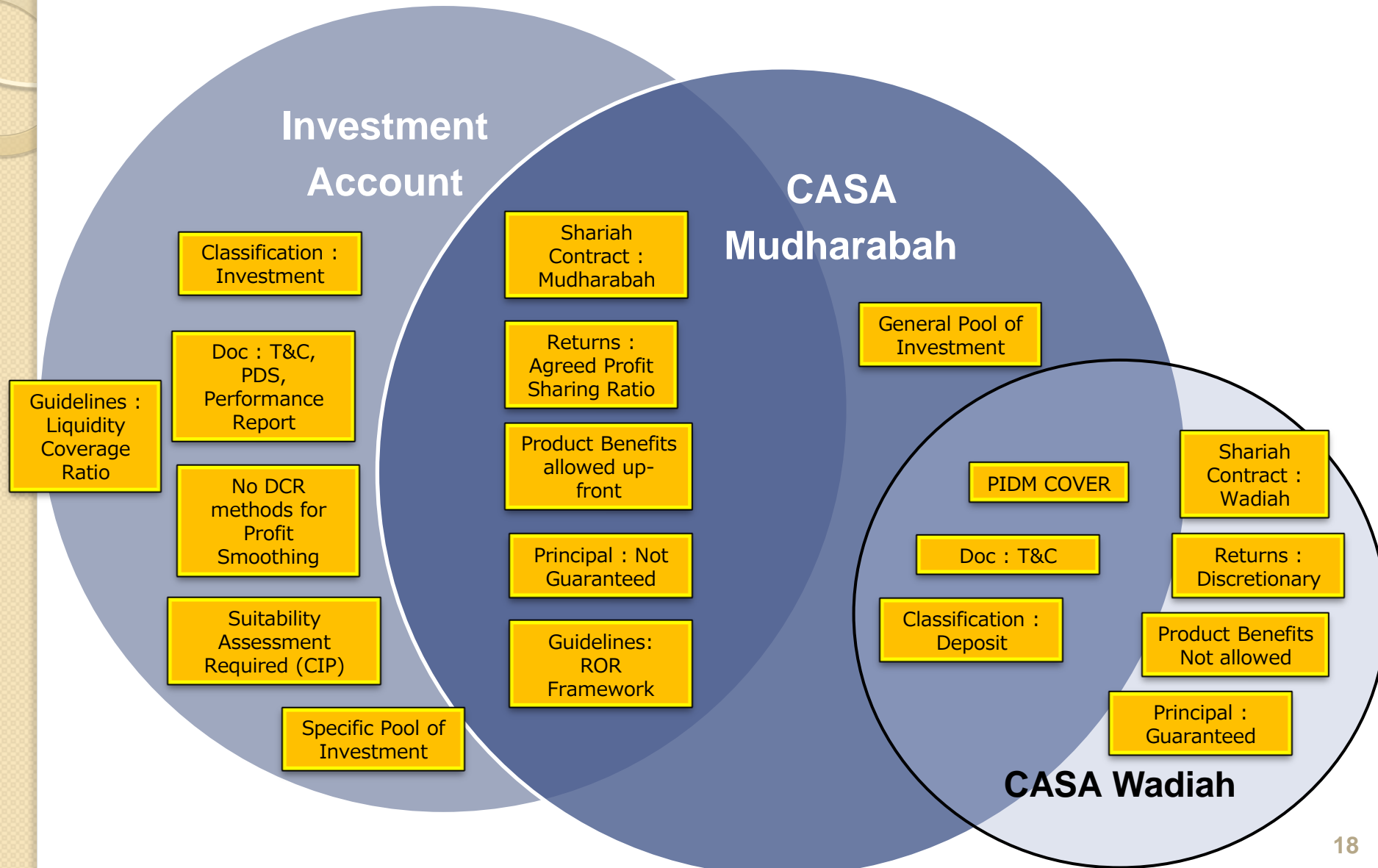
Benefits

The first Bank to launch Investment Account under Mudharabah contract in Malaysia

## Challenges in Investment Accounts.

Investment Accounts are supposed to behave like Unit Trust or other similar investments. But will customers have confidence that Banks are as equipped as Unit Trust companies with fund managers?

## 12. Key Structural Differences

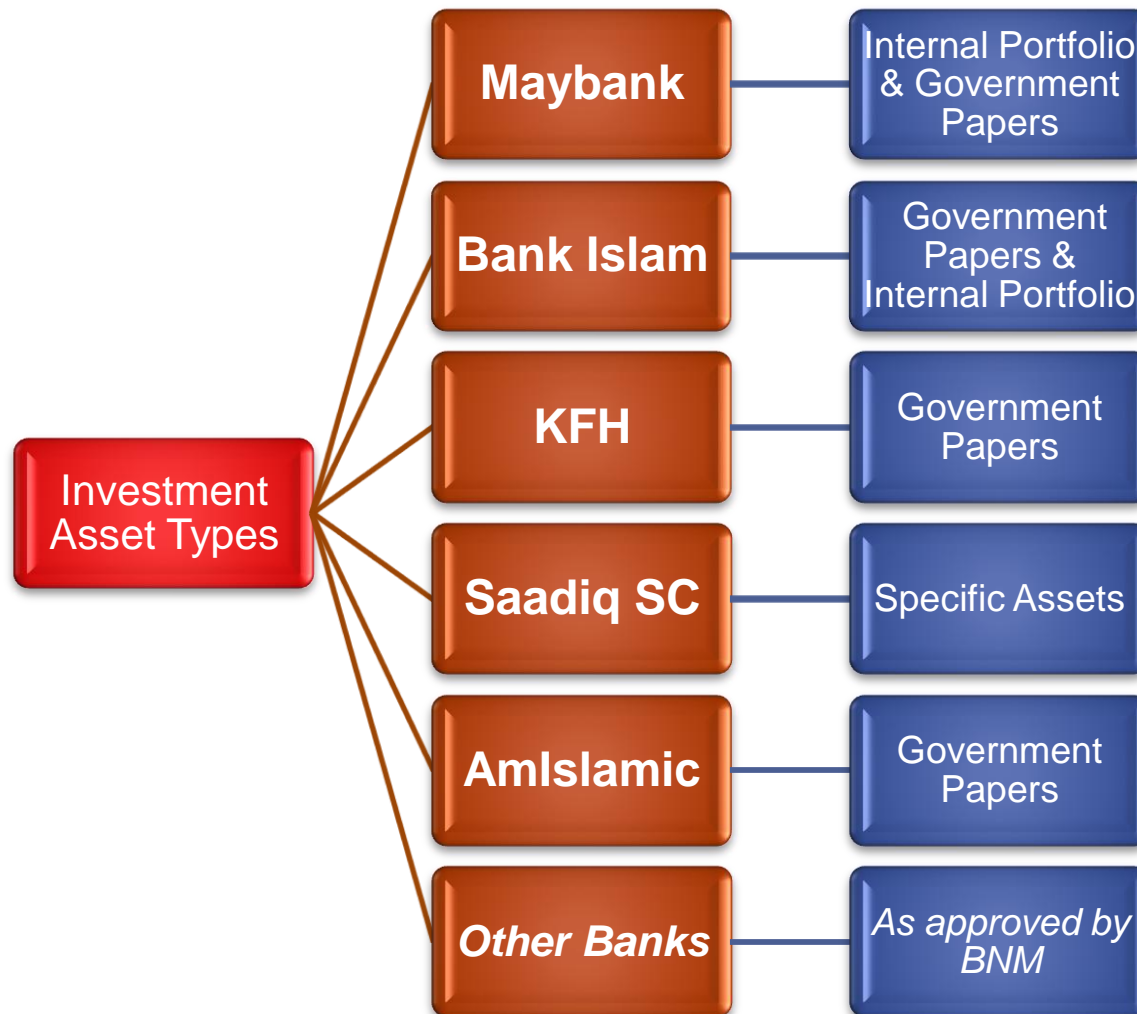


# 13. “I see Unit Trust”

	<i>Deposit Acc (CASA)</i>	<i>Investment Account</i>
<b>Type of Shariah Contracts</b>	<i>Wadiah / Qard</i>	<i>Mudharabah Wakalah</i>
<b>Principal</b>	<i>Protected</i>	<i>Not Protected</i>
<b>Profit</b>	<i>Discretionary</i>	<i>Profit Sharing</i>
<b>Loss</b>	<i>Not Applicable</i>	<i>Lower Returns</i>
<b>Treatment on Balance Sheet</b>	<i>On-balance Sheet</i>	<i>Off-Balance Sheet or On-Balance Sheet</i>
<b>Risk Profile</b>	<i>No Risk</i>	<i>Low/Medium Risk</i>
<b>Tenure</b>	<i>On Demand</i>	<i>Minimum tenure</i>
<b>PIDM Coverage</b>	<i>Yes</i>	<i>No</i>
<b>Disclosure Format</b>	<i>Savings Account</i>	<i>Unit Trust</i>
<b>Investment Instruments</b>	<i>General Investment Account</i>	<i>Defined Investment Account i.e. Unrestricted Investment Account (URIA) or Restricted Investment Account (RIA)</i>
<b>Customer Documents</b>	<i>Terms and Conditions</i>	<i>PDS, Terms and Conditions, Performance Report and Risk Warning Statements</i>

**IS THE CUSTOMER READY FOR THIS NEW “INVESTMENT ACCOUNT” EXPERIENCE?**

## 14. “CASA” is different now

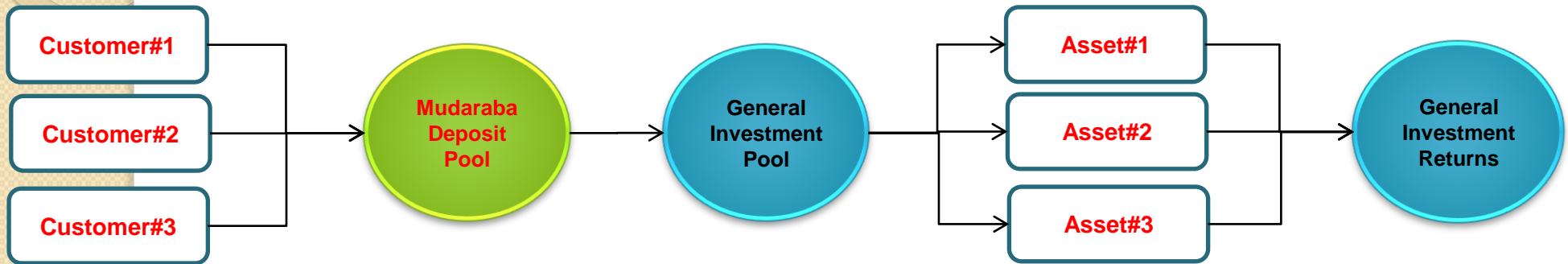


- ✓ Many Banks, many structures
- ✓ Customers are now “Investors” and have to be aware of “Risks” in a CASA-type accounts
- ✓ Understanding the Investment Assets and its behaviour
- ✓ Different Assets  
Different Risk profile
- ✓ CASA is no longer a CASA where its use is predominantly SAVINGS AND TRANSACTIONAL

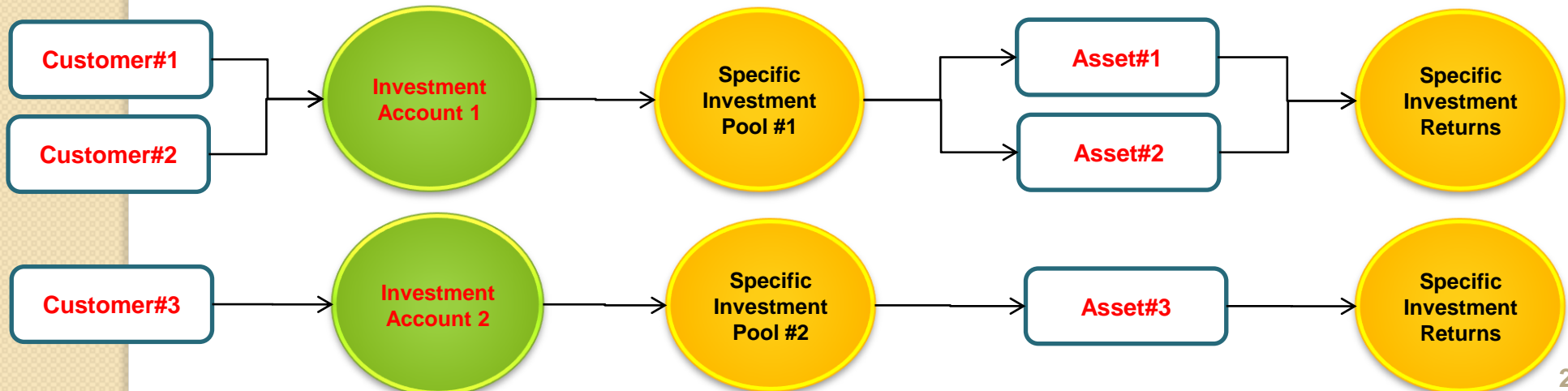


# 15. Managing the pools

Under the existing Mudharabah ROR Calculation, Customer deposits goes into GENERAL pool



Under the new ROR Framework, Customer INVESTMENT goes into specific INVESTMENTS assets, which must be clearly disclosed to Customer (historical performance, expected returns, terms of investment)



# 16. Other Issues

## No simple CASA solution

- Mudharabah / Wakalah CASA heavily governed
- Explore Tawarruq CASA or remain in generic CASA deposit-types (Qard, Wadiah)

## PIDM Impact

- Removal of PIDM became key loss proposition for IA, underestimated by Islamic Banks
- To explore the creation of “3<sup>rd</sup> party guarantee”

## Conventional Banking push

- Opportunity for Conventional Banking to promote products
- Simple, easy, safe taglines being used

## Future Regulations

- With impending Qard and Hibah guidelines in 2016, Islamic Banks are strained for solutions
- Difficulty in raising funds for financing / Investment activities

## Awareness Building

- Contract of Mudharabah is investment-based, but with new disclosure requirements, investors sense risk on principal (although low risk)

## Customer Profile

- Alternative products available for the customer profile i.e. Risk taking customers
- Unit Trust, Shares Market, Retail Bonds, Structured Notes / Investments

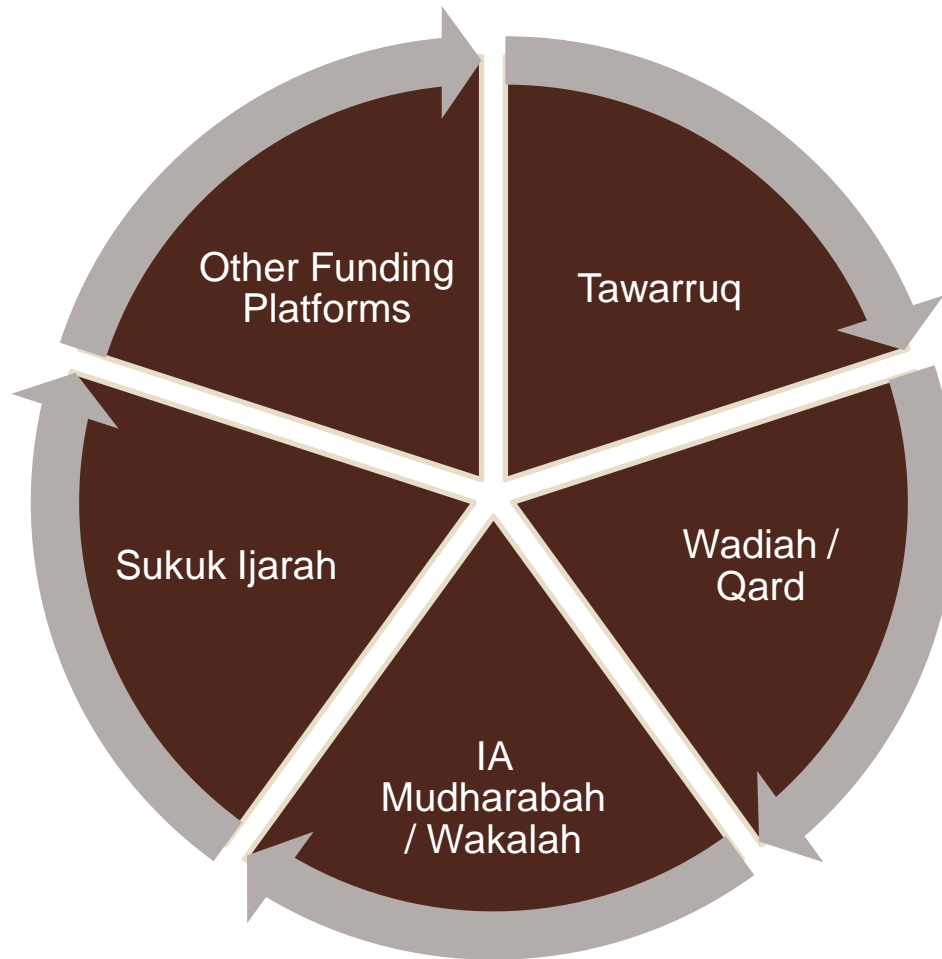


Musyarakah and Mudharabah models are also viable funding mechanisms for customers.

## How then do Islamic Banks build Deposit or Fund customers?

Bearing in mind that the options of building funds can also via Interbank Placement, Sukuk issuance, Pricing campaigns and capital injection.

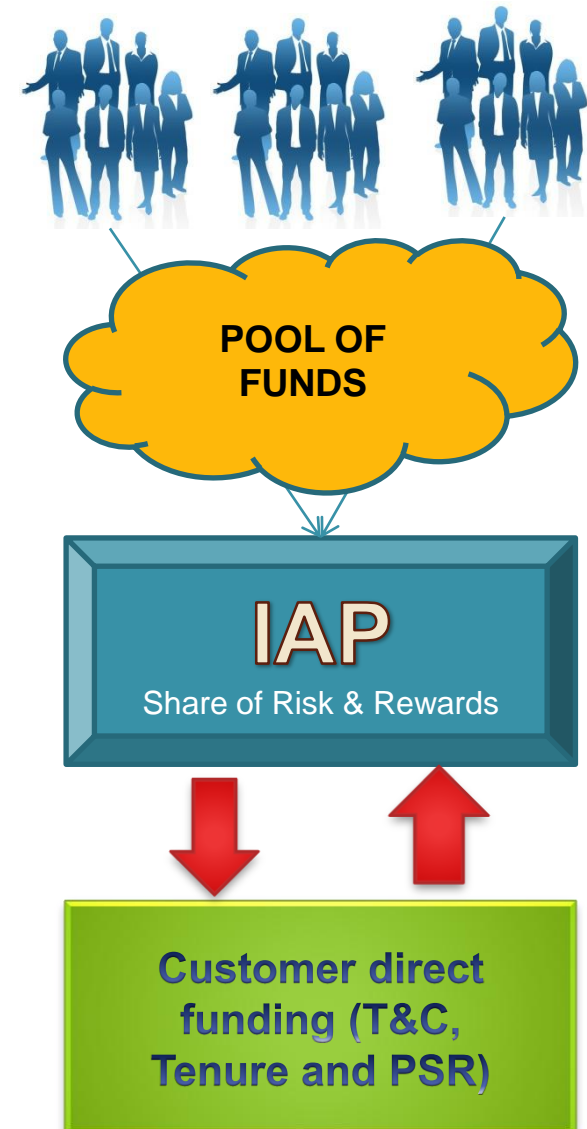
## 17. Avenues to Fund Financing Assets



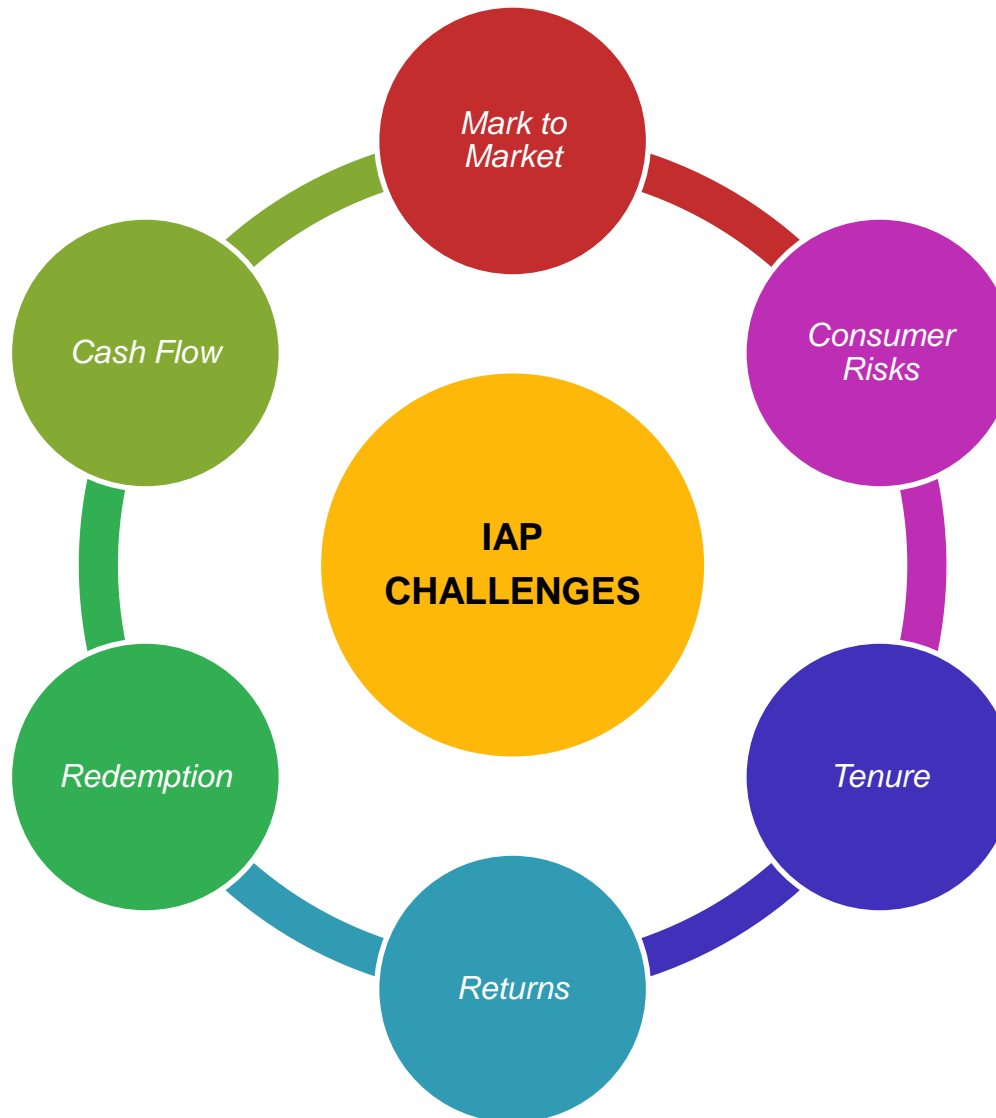
**ISLAMIC BANKS  
ARE ALWAYS  
ASKED TO FIND  
NEW SOURCES  
OF FUNDS TO  
SUPPORT THE  
BUSINESS  
ACTIVITIES AND  
FUND THE  
ASSETS**

## 18. Other Funding Platforms

- In the Budget 2015, the PM mentioned the intention to launch Investment Account Platform (IAP) to support the small business enterprises
- The intention is to link between the retail / corporate “investors” directly with companies seeking funding for projects / business
- The model is to be similar to crowd-funding or venture capitalist . Projects can be floated on IAP for investors to provide capital
- 4 Local Banks have taken the mantel to develop the IAP (target launch in H2 2016)



# 19. IAP Challenges



- 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

Future of deposit building under IFSA 2013

- Options under Qard and Wadiah expected to be restrictive
- Investment Account offers a way to build deposits by offering potential benefits from investments
- Market is slowly moving to IA
- Acceptance towards IA is still limited and greater awareness needs to happen
- Failure to build deposits via IA will result in further stress by Islamic Banks
- Investment Account Platform (IAP), although different from IA, will provide a financing / funding avenue for clients in obtaining capital



Ariffhidayat, myself and the rest of the Islamic Banking project team during our visit to Dubai.

## Thank You for Listening

Question and Answer  
Session on Investment  
Account

Visit me at  
<http://islamicbankers.me>  
*comments / feedback appreciated*

**Islamic Bankers : Resource Centre**

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