

# The Evolution of Islamic Deposits

## *From Wadiah to Tawarruq*

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# **Agenda**

**Introduction to UOB Malaysia**

**Market Outlook**

**Deposits Evolution in Malaysia**



# Introduction to UOB Malaysia

Islamic Banking windows

### **About the speaker**



Amir Alfatakh Yusof is senior vice president Islamic Banking in UOB Malaysia. He is part of the original team member that launched the Islamic Banking windows business proposition in July 2016 with 19 products. He works as part of a small team to support business, regulatory and Shariah requirements to take Islamic Banking forward.

Amir has been in the Islamic Banking industry since 2003. He occasionally conduct talks on various topics on Islamic Banking and maintains a public website Islamic Bankers Resource Centre. (<https://islamicbankers.me>)

### **About UOB Malaysia**

United Overseas Bank (Malaysia) Bhd (UOB Malaysia) was incorporated in 1993 but has had a presence in Malaysia since 1951. UOB Malaysia is rated among the top banks in Malaysia with a long-term 'AAA' rating from Ratings Agency Malaysia. Guided by our rich heritage and values, we have built lasting relationships with our customers and continue to ensure we act in their best interest by delivering solutions that meet their financial goals and suit their lifestyles and preferences. Today, UOB Malaysia has 45 branches across the country and has the largest branch network of any foreign bank operating in Malaysia.

Drawing on our expertise and understanding of what is unique to ASEAN, and the needs of our customers and businesses, UOB Malaysia offers its retail and commercial customers a broad range of products and solutions that best suit their lifestyles, preferences and business life cycles. These range from personal financial services, corporate and commercial banking, investment banking and treasury services to wealth management and Islamic banking.



**UOB is larger than any other  
Malaysian regional banking groups**

**Today, UOBM has the largest foreign  
bank branch network in Malaysia**

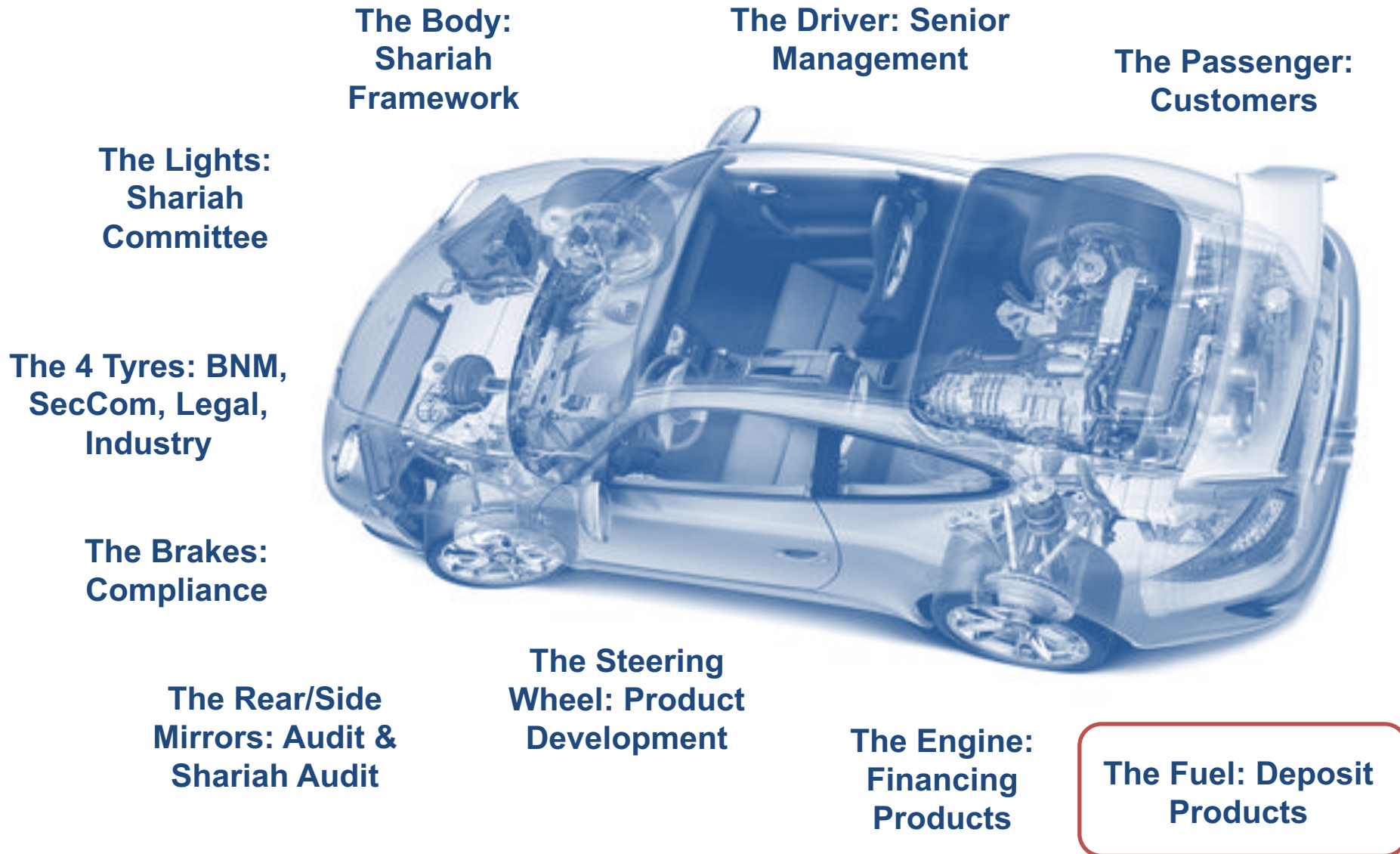
# Our strengths



# Market Outlook

Islamic Banking Deposits

# Islamic Banking Roadcar



## Enjoy Better Returns on your Deposits

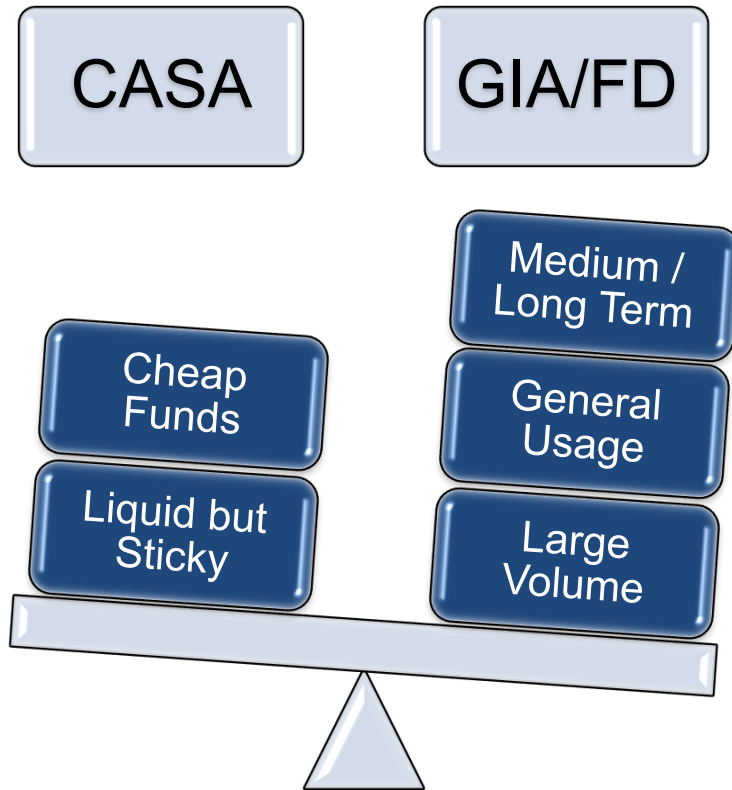
MEMBER



- ✓ Observers place emphasis on growth of Financing products
- ✓ Deposits are usually seen as supporting a financing strategy
- ✓ But there reasons why Banks are fighting for deposits
- ✓ Every year we see Banks entering “deposit price wars”

## Deposits are “sold” products

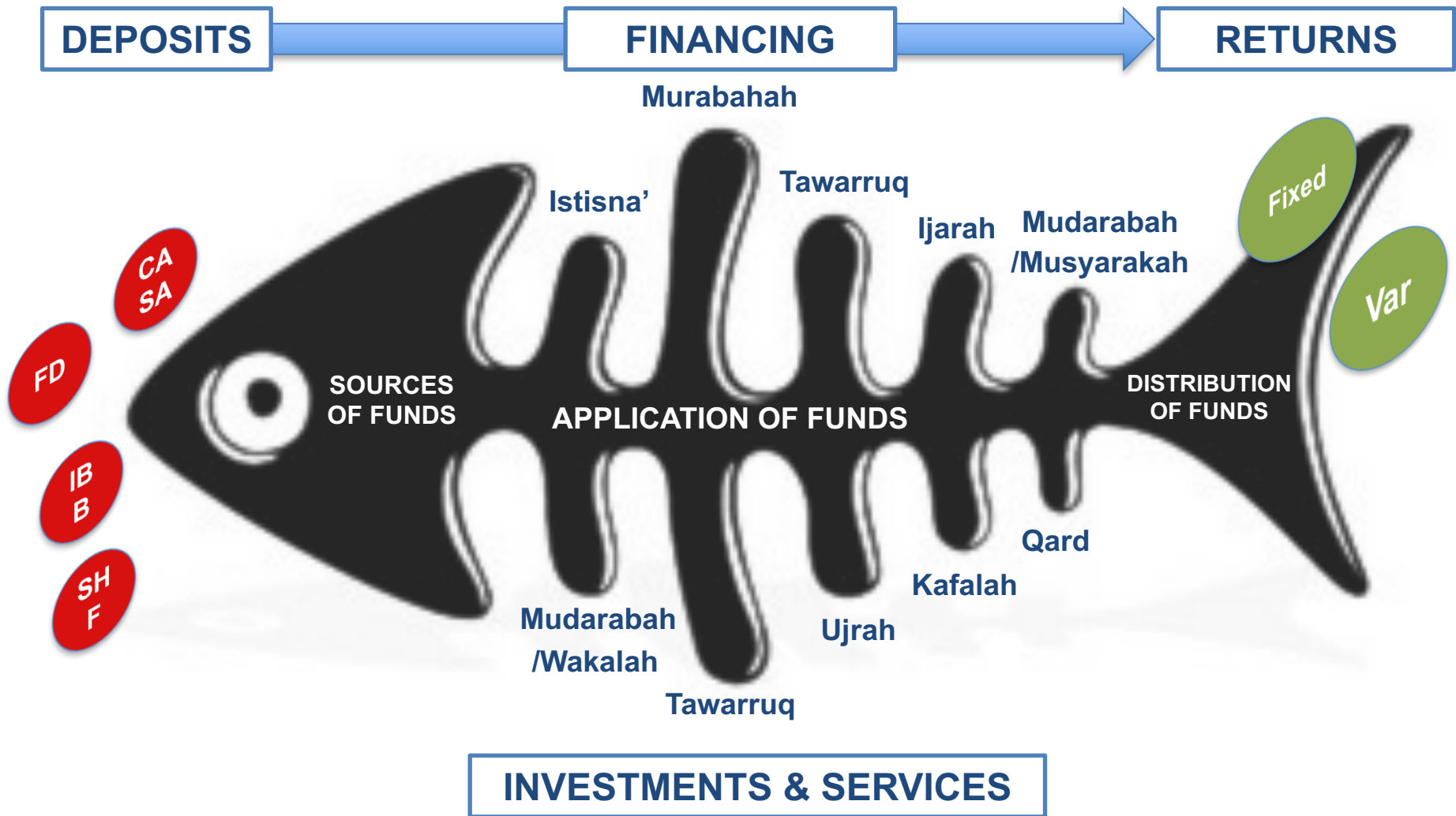
*Whereas Financing are “bought” products*



### USES OF DEPOSITS

1. Fund Bank's Asset and Financing Activities
2. Take advantage of Investment Opportunities
3. Statutory Reserves
4. Replacement Liquidity (LCR, NSFR)
5. Financial Ratios and Stability (FDR)
6. Fee Generator
7. Cheap source of funding
8. The funding of eWallet and ePayment

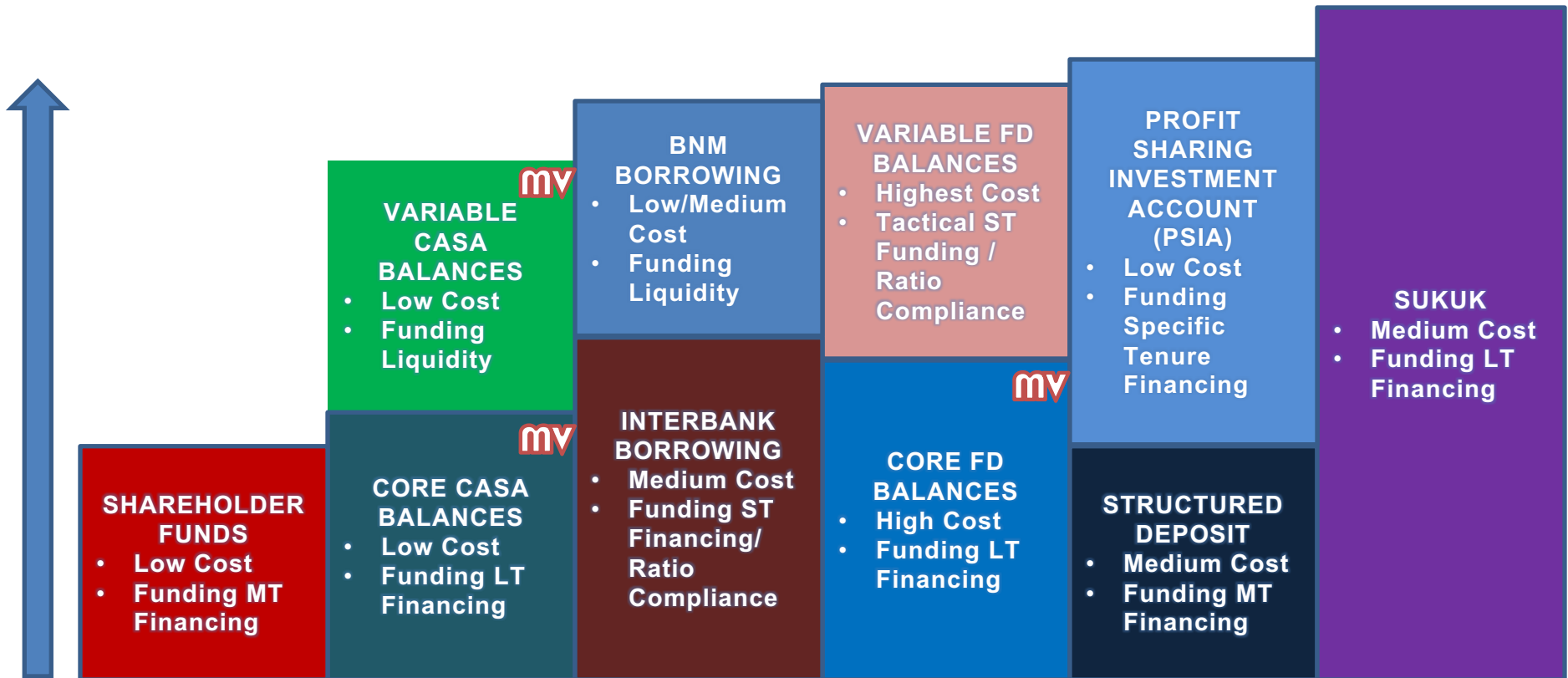
# The Sources and Application of Funds



End-to-end correlation between Fund Sources and Application



# Uses of Deposits in Balance Sheet Management



## Types of Deposits



**Reserves**

*Minimum Requirement*



**Core**

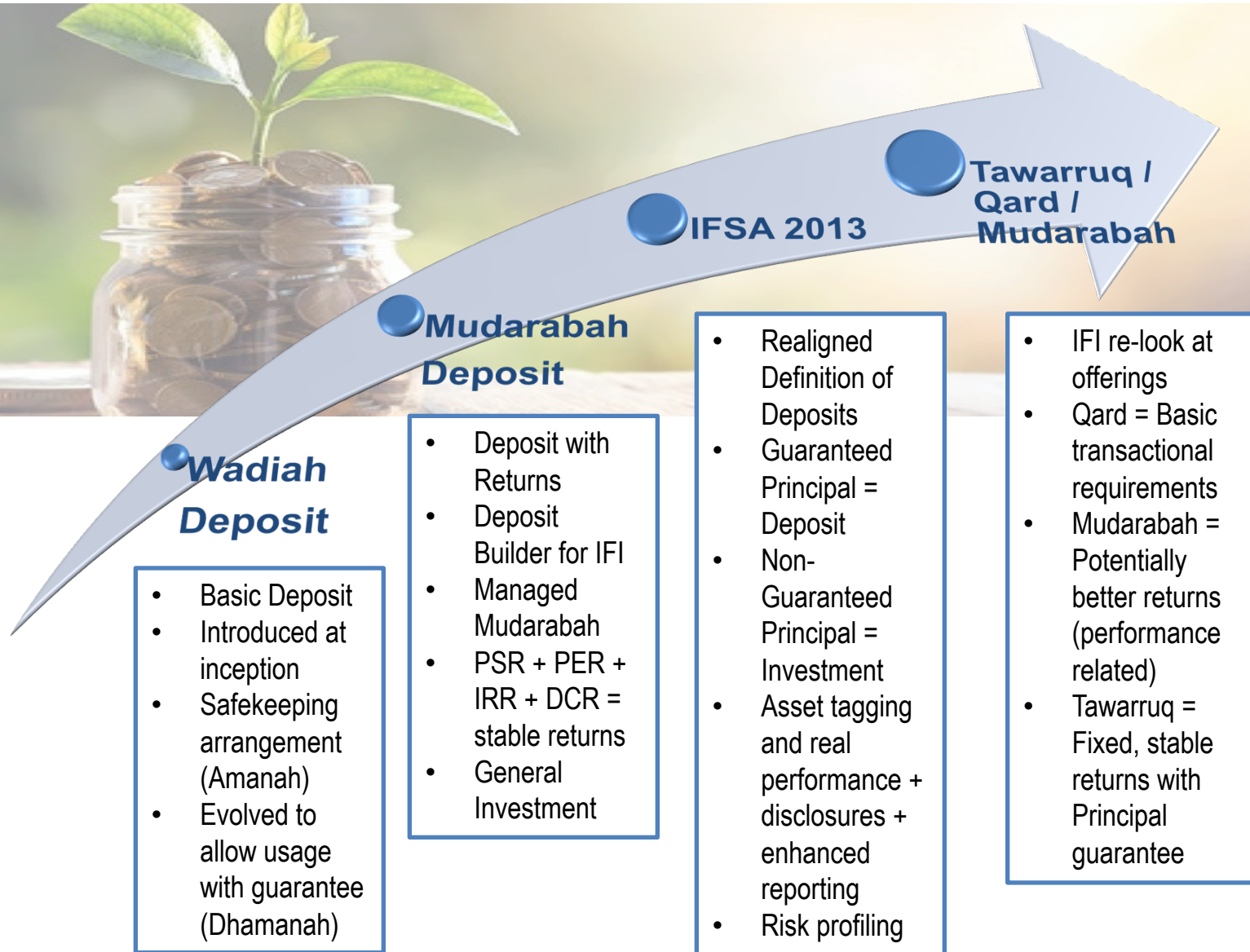
*Supports Stable LTF*



**Non-Core**

*Supports Volatile STF/ MTF*

# Brief History of Deposit in Malaysia



# Contract: Depository Products

	WADIAH (DEMISED)	QARD	TAWARRUQ	MUDARABAH	WAKALAH ISTHIMAR
Current Account	√	√	√	√	√
Savings Account	√	√	√	√	√
Fixed Deposit			√	√	√
Structured Investments			√	√	√
Interbank Placement / Deposit	√	√	√		
Money Market Deposits	√	√	√		
Excess and Overdraft		√			
Profit Sharing Investment Account				√	√

**Each Contract (features, usage)  
attracts different depositor profile**

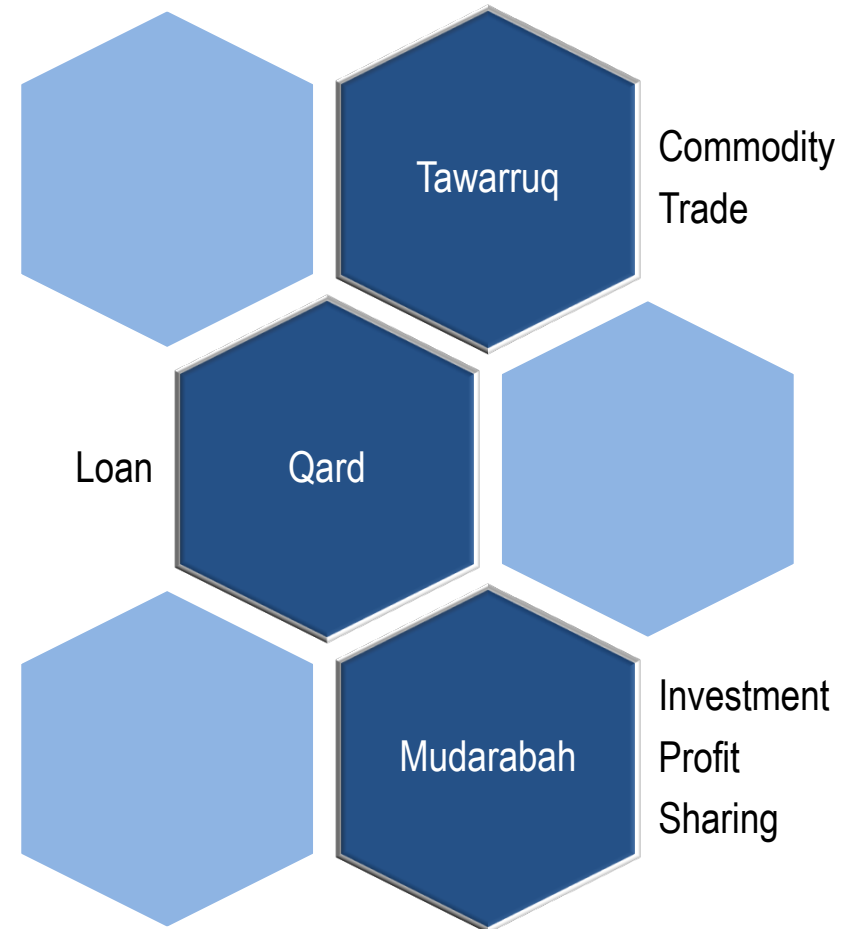
# Industry : Deposit & Investment Accounts

Prior to 2013, Deposits are being defined as any types of funds collected by the bank from the public.

**With IFSA 2013, the definition of deposits and investment is clarified, resulting in the demise of Wadiah as a deposit-taking structure and the introduction of Qard and Tawarruq structures, and Mudarabah reclassified as investment.**

To maintain the objectives of the deposit products, the industry, the banks re-looked at their offering.

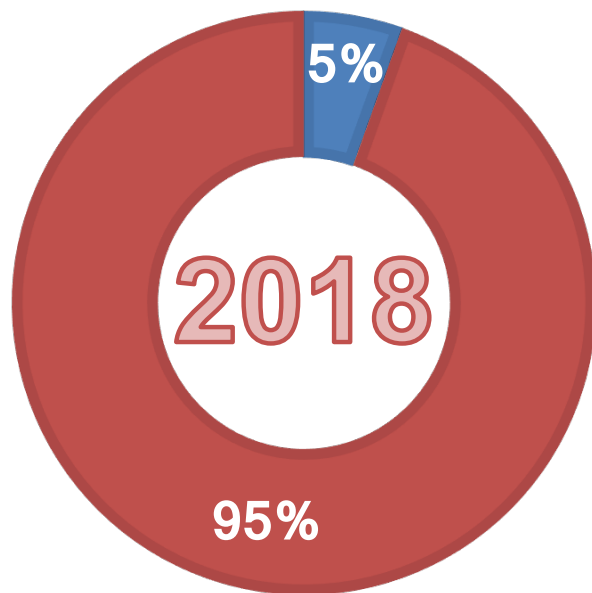
**Deposit products are guaranteed by PIDM. Investment products are not.**



# Composition of Depository Products (Industry)

## INVESTMENT ACCOUNTS VS DEPOSITS

■ Investment Acc ■ Other Deposits



## Investment Account

- ✓ Mudarabah Current Account
- ✓ Mudarabah Savings Account
- ✓ Mudarabah Fixed Deposit
- ✓ Wakalah Fixed Deposit

## Deposit Account

- ✓ Qard Current Account
- ✓ Qard Savings Account
- ✓ Tawarruq Current Account
- ✓ Tawarruq Savings Account
- ✓ Tawarruq Fixed Deposit

The market overwhelmingly prefers Deposit structures with Principal Guarantee and Fixed Returns

# The Strategy of Deposits

Building deposits are not just about “rates”. These must also be considered:

## Reserves



Usefulness to financial ratios such as Statutory Reserves, Liquidity Coverage Ratio (HQLA), NSF Ratio, F/D Ratio, Regulatory Placements. Valuable Deposits to be built (Retail CASA).

***Considerations:*** A portion of deposits collection will not be available for deployment, and considered part of expenses

## Cost of Funds



Deposit Mix that is the least costly. Financial obligations to be managed (fixed or variable obligation). Target CASA to be 40% or more. Best product : Operational Account, Cash Management Accounts.

***Considerations:*** Aggressive deposit campaigns may result in expensive obligations with limited deployment and negative carry

## Spread



Ability to manage cost of funds = potential to earn higher spread from financing and investment activities. With strong operational capability (including collections), better profit margins.

***Considerations:*** Requires good mix of high/low yield products + retail/corporate customers to provide stable long term returns

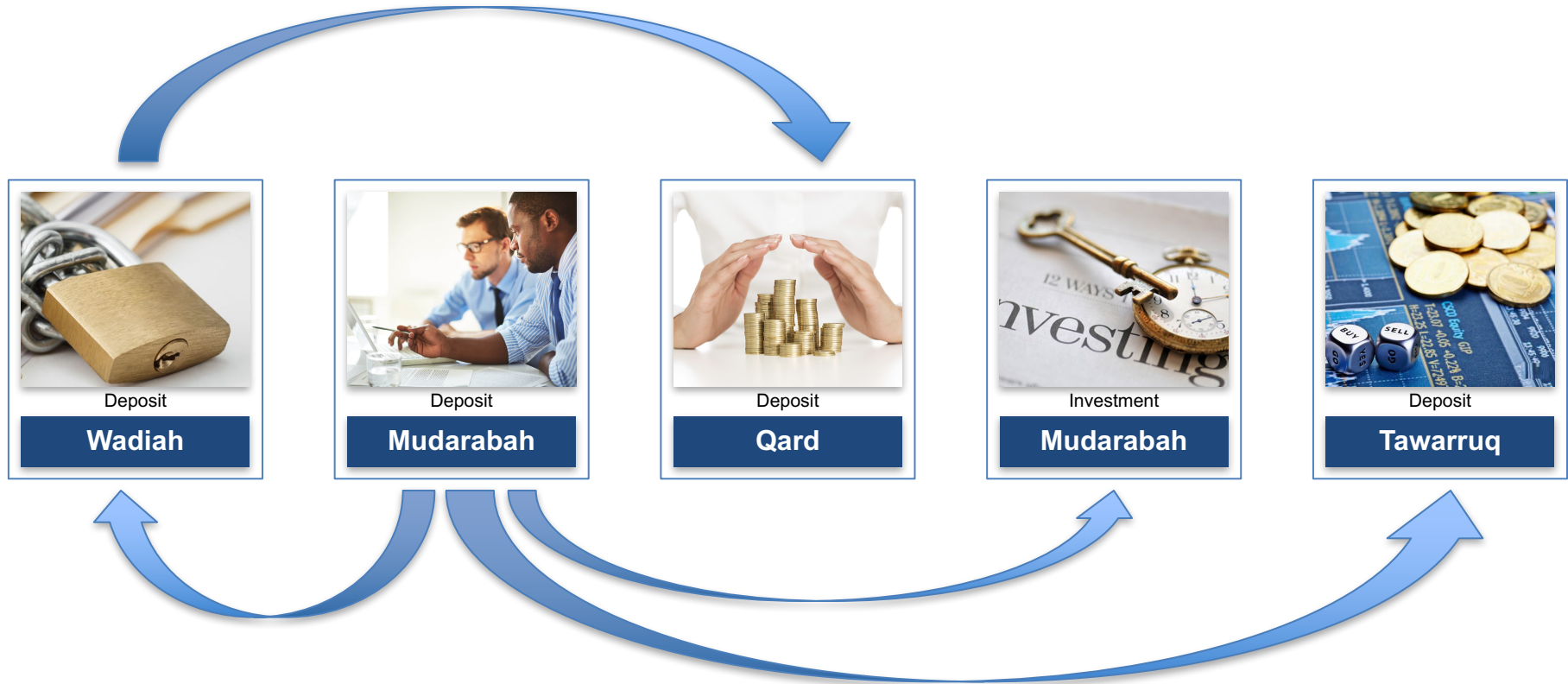


# Deposits Evolution in Malaysia

Qard, Mudarabah and Tawarruq



# The Big Deposit Migration of 2015



Following IFSA 2013, the re-classification of Deposit and Investment has resulted in massive migration exercise in the Islamic Banking industry. IFIs are required to obtain customer's consent for moving into investment accounts, or obtain customer appointment for agency to trade commodities for tawarruq-based products, failure of which means auto-convert into Wadiah deposit account. In 2016, IFIs are requested to further migrate Wadiah accounts into Qard-based deposit products.





## Qard

- Principal: Guaranteed
- Category : Deposit
- BNM Policy Document : Qard

Not useful to build deposit due to limiting nature of Qard in a marketing campaign



## Mudarabah

- Principal: Non-Guaranteed
- Category : Investment
- BNM Policy Document : Investment Account

High level of compliance, monitoring and management expected from a Bank



## Tawarruq

- Principal: Guaranteed
- Category : Deposit
- BNM Policy Document : Tawarruq

Continued criticisms from academia and scholars on the nature of commodity usage

# DEPOSIT : Qard

Qard refers to a contract of lending money by a lender to a borrower where the latter is bound to repay an equivalent replacement amount to the lender.

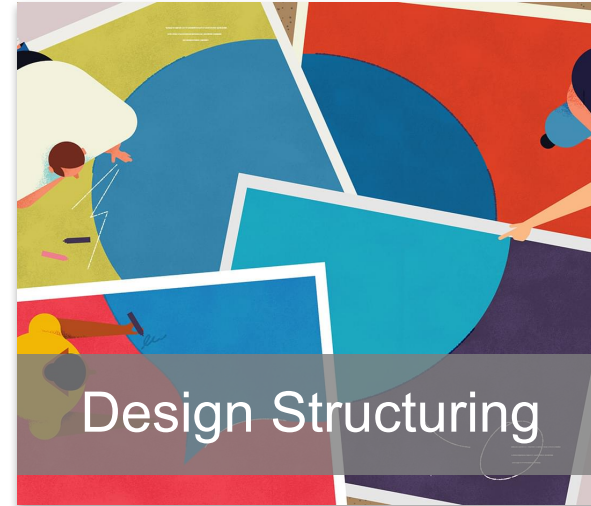
Money may include cash in any currency, gold or silver.



1. Qard Deposit is to cater for depositors basic needs
2. Cheap source of funds with no obligation to provide returns
3. Relationship : Loan arrangement (Lender / Borrower)
4. Hibah (gift) may be granted based on IFIs discretion
5. Guarantees the Principal Amount
6. No correlation of Hibah granted and actual performance

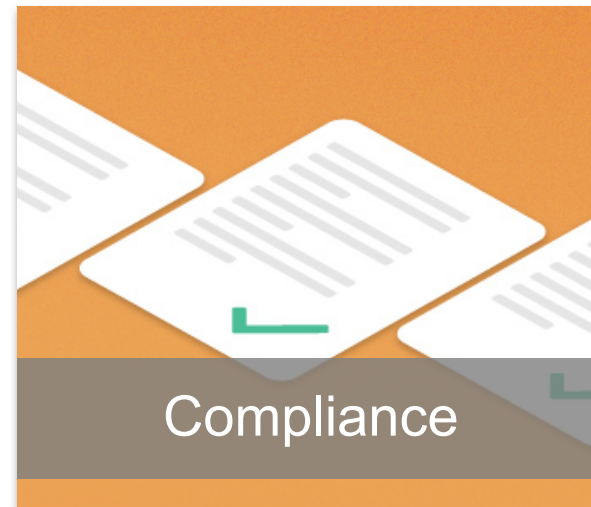
# Why Qard is NOT Popular

Inability to shout and promote and attract customers



Inability to structure with other contracts effectively e.g. Cash Mgmt

Inability to highlight benefits of products to customers



Limited features and high potential of breaching Shariah rules

# INVESTMENT : Mudarabah

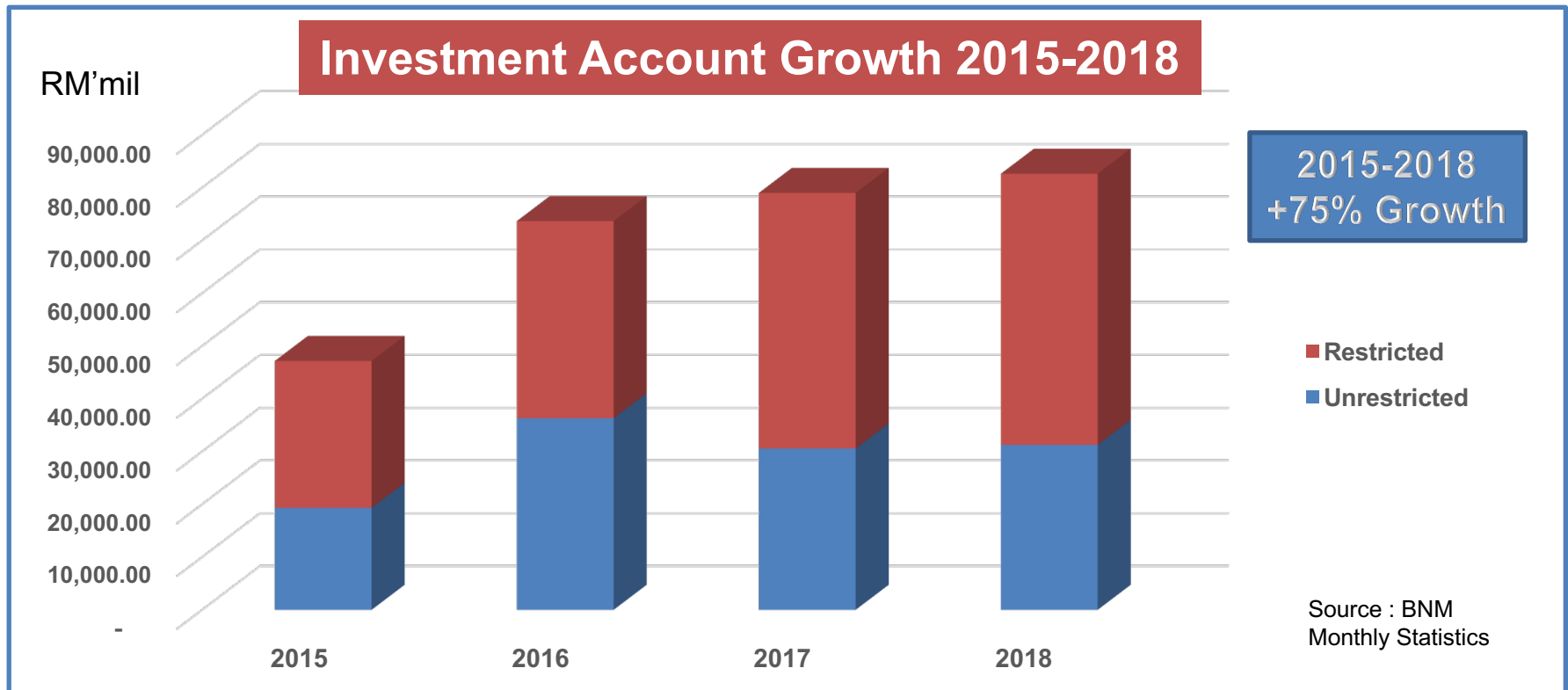
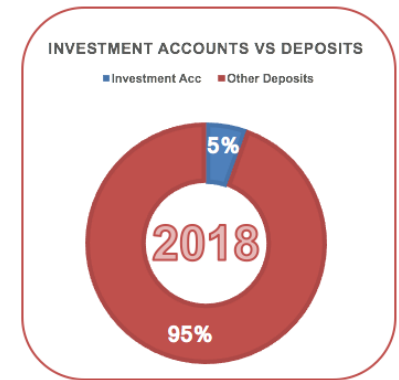
Mudarabah means a contract between capital provider (rabbul mal) and an entrepreneur (mudarib) under which the rabbul mal provides capital to be managed by the mudarib based on any profit generated from the capital is shared between the rabbul mal and the mudarib according to mutually agreed profit sharing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



1. **Mudarabah Investment intended to be next step in deposit taking structure**
2. **Meant to reduce “pressure” from IFIs by shifting commercial risks (rate of returns) direct to depositors**
3. **Relationship : Similar to Unit Trust product (Investor / Manager)**
4. **Potentially higher returns for Investors**
5. **Caters for various Investor Risk Profile**
6. **Tagged to Performance of Real Assets**

# How Attractive is Investment Account?

- Investment Account remains supported by a few large local banks and limited foreign banks
- Growth is hampered by alternative offerings of Tawarruq-based CASA and Fixed Deposits
- Additional processes and disclosure requirements seen as a stumbling step for the growth of Investment Accounts





# Investment Accounts

## 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



Specific features of Investment Account depends on the contract used in the offering:

- Mudharabah** (profit sharing and loss bearing)
- Musyarakah** (profit and loss sharing)
- Wakalah** (agency agreement)

## 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 offering Investment Account

Affin Islamic Bank Berhad  
Al Rajhi Banking & Investment Corporation (Malaysia) Berhad  
Alliance Islamic Bank Berhad  
**AmBank Islamic Berhad\***  
Asian Finance Bank Berhad  
**Bank Islam Malaysia Berhad\***  
**Bank Muamalat Malaysia Berhad\***  
CIMB Islamic Bank Berhad\*

HSBC Amanah Malaysia Berhad  
Hong Leong Islamic Bank Berhad  
**Kuwait Finance House (Malaysia) Berhad\***  
**Maybank Islamic Berhad\***  
OCBC Al-Amin Bank Berhad  
Public Islamic Bank Berhad  
**RHB Islamic Bank Berhad\***  
Standard Chartered Saadiq Berhad\*

\* Islamic banks currently offering Investment Account



As at 2016

### LIST OF ISLAMIC BANKS CURRENTLY OFFERING INVESTMENT ACCOUNT

Affin Islamic Bank Berhad  
Al Rajhi Banking & Investment Corporation (Malaysia) Berhad  
Alliance Islamic Bank Berhad  
**AmBank Islamic Berhad\***  
Asian Finance Bank Berhad  
**Bank Islam Malaysia Berhad\***  
**Bank Muamalat Malaysia Berhad\***  
**CIMB Islamic Bank Berhad\***  
HSBC Amanah Malaysia Berhad  
Hong Leong Islamic Bank Berhad  
**Kuwait Finance House (Malaysia) Berhad\***  
**Maybank Islamic Berhad\***  
OCBC Al-Amin Bank Berhad  
Public Islamic Bank Berhad  
**RHB Islamic Bank Berhad\***  
**Standard Chartered Saadiq Berhad\***

\*Islamic banks currently offering Investment Account

Source : BNM Website

**Continuous effort by BNM to promote the use of Investment Account as viable alternative for deposits with potential better returns on funds**

# Real Performance

## PROFIT SHARING

Based on Agreed Ratio

Under Investment Accounts:

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

## LOSS BEARING

Borne by Capital Provider

### WHAT DOES THIS MEAN?

It means Banks no longer can employ Displaced Commercial Risk (DCR) profit-smoothing techniques to boost returns on the profit.



- S** 13.5 The IFI must not implement profit smoothing practices or displaced commercial risk (DCR) <sup>1</sup> techniques.

<sup>1</sup> 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.

# Displaced Commercial Risks (DCR)

“Refers to the risk arising from the assets managed on behalf of Investment Account Holders (IAH) which maybe borne by the IBI’s own capital, when the IBI foregoes part or all of its share of profits on the IAH funds, and/or make transfer to IAH out of the shareholders’ fund investment profits as a result of commercial and/or supervisory concerns in order to INCREASE the return to IAH”.

This risk arises when the IBIs displace credit and market risk losses to themselves by paying a return that **EXCEEDS** the **ACTUAL** returns that was supposedly earned by the IAH based on the contractual profit sharing arrangement.

**The mechanisms to address DCR is known as Profit Smoothing Techniques to avoid potential withdrawals.**



## Utilising PER and/or IRR

- In periods of low returns, the reserves under PER / IRR is transferred
- As per PER mandate and usage to minimise downside risks



## Transfer of Non-Mudarabah Profit or Retained Earnings

- Retained earnings / overall profit is transferred to pool of income
- The basis of Transfer = Hibah (gift)



## Foregoing “Managers” Profit

- While Banks are entitled to its share of profit or fees from the work done, they can choose to forego it.
- Performance is manipulated to look better



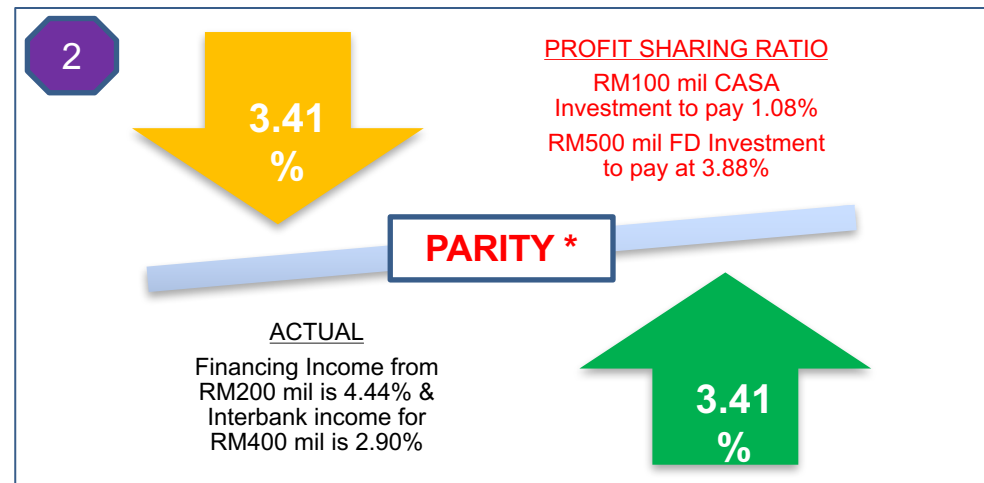
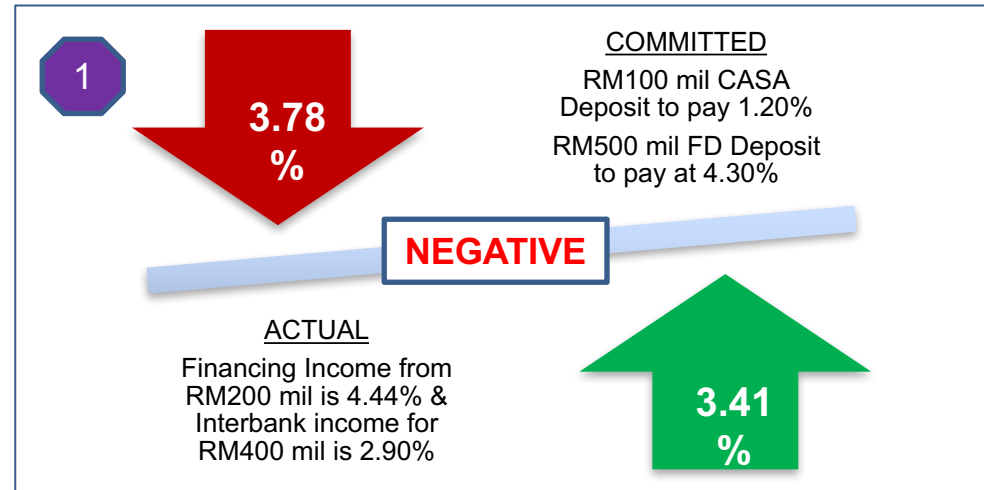
# Solving the Negative Carry Issue

## WHAT IS NEGATIVE CARRY?

It is the situation where your Deposits pay-out has been “promised and committed” but the deposits are not generating ENOUGH income from Financing and Investment Activities to meet the pay-out obligations, resulting in top up from other sources.

The Average Deposit Payout committed = 3.78% but Financing & Investment Income = only 3.41%. A top-up of cash for 0.37% is required to meet obligation (conventional bank method)

**But under Investment Account, the issue of Negative Carry is mitigated as the amount paid-out is not promised up-front (not contracted) but instead is based on the ACTUAL performance of the assets i.e. 3.41%.**



*\* Without the “assistance” of DCR techniques, Investment Account must actually pay returns based on performance*

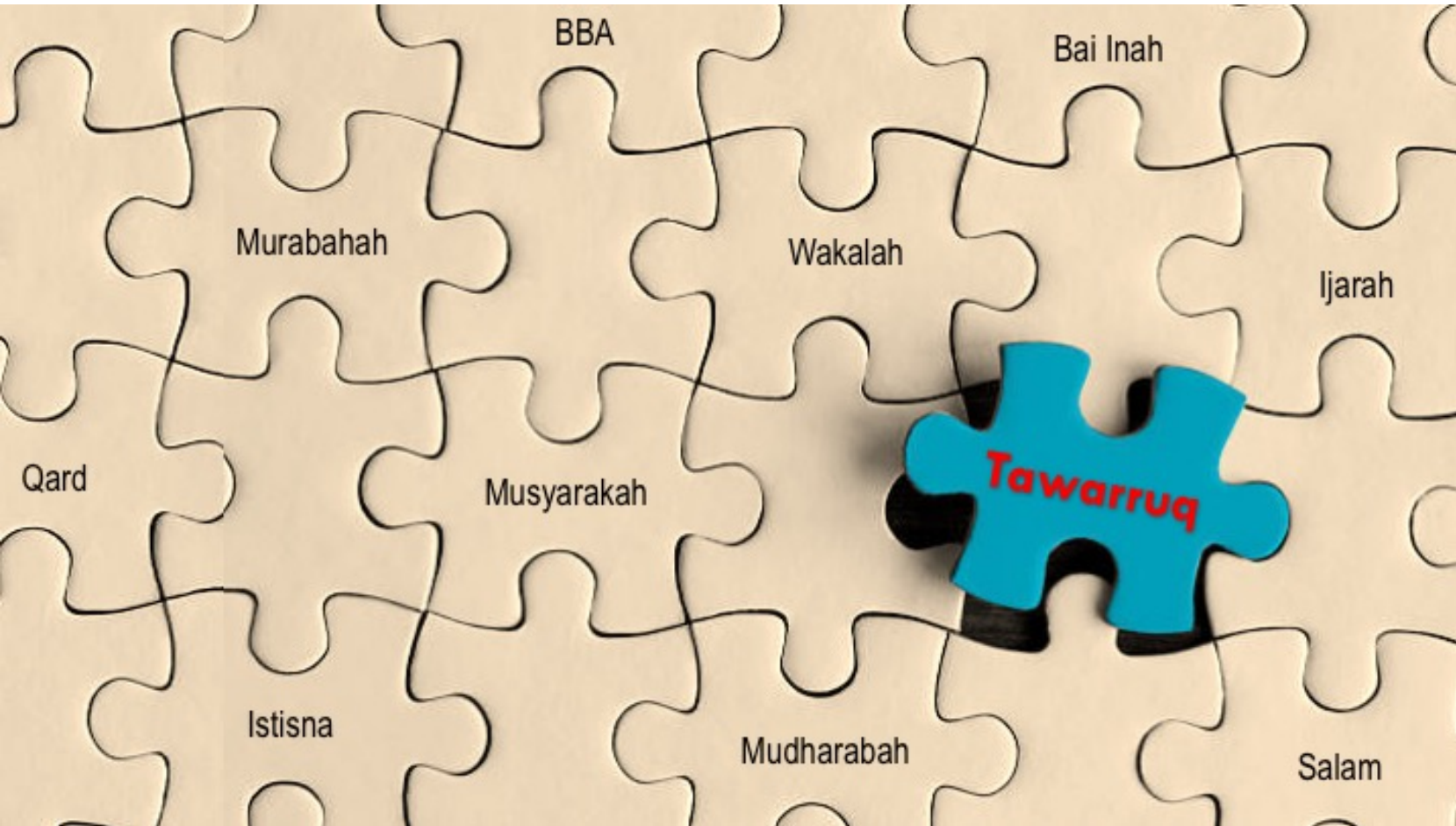
# DEPOSIT : Tawarruq

A tawarruq consists of two sale and purchase contracts. The first involves the sale of an asset by a seller to a purchaser on a deferred basis. Subsequently, the purchaser of the first sale will sell the same asset to a third party on a cash and spot basis.



1. Tawarruq Deposits fast becoming contract of choice in industry
2. Able to offer competitive benefits to attract new depositors
3. Relationship : Debt arrangement (Buyer / Seller)
4. Fixed, contracted returns for depositors
5. Operational risks exists, efficiency of process critical compliance factor
6. Campaign driven and not Performance related

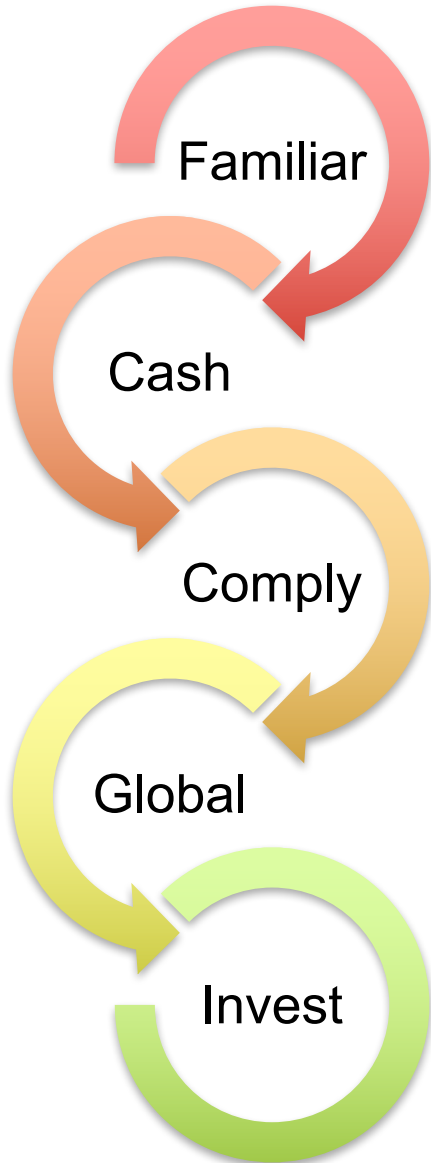
# Tawarruq as the Final Piece



The flexibility of usage of Tawarruq and the relatively ease to comply makes the structure IFI's the main choice when developing new product solutions

# Will Tawarruq Deposits Go Away?

*\* Doesn't seem like it. Tawarruq provides many solutions*



**The market is now familiar with Tawarruq**

**No alternative solution for working capital**

**Easier to comply with BNM requirements**

**Generally accepted across global geographies**

**Continued investment in infrastructure efficiency**

# The Rise of Commodities Platform

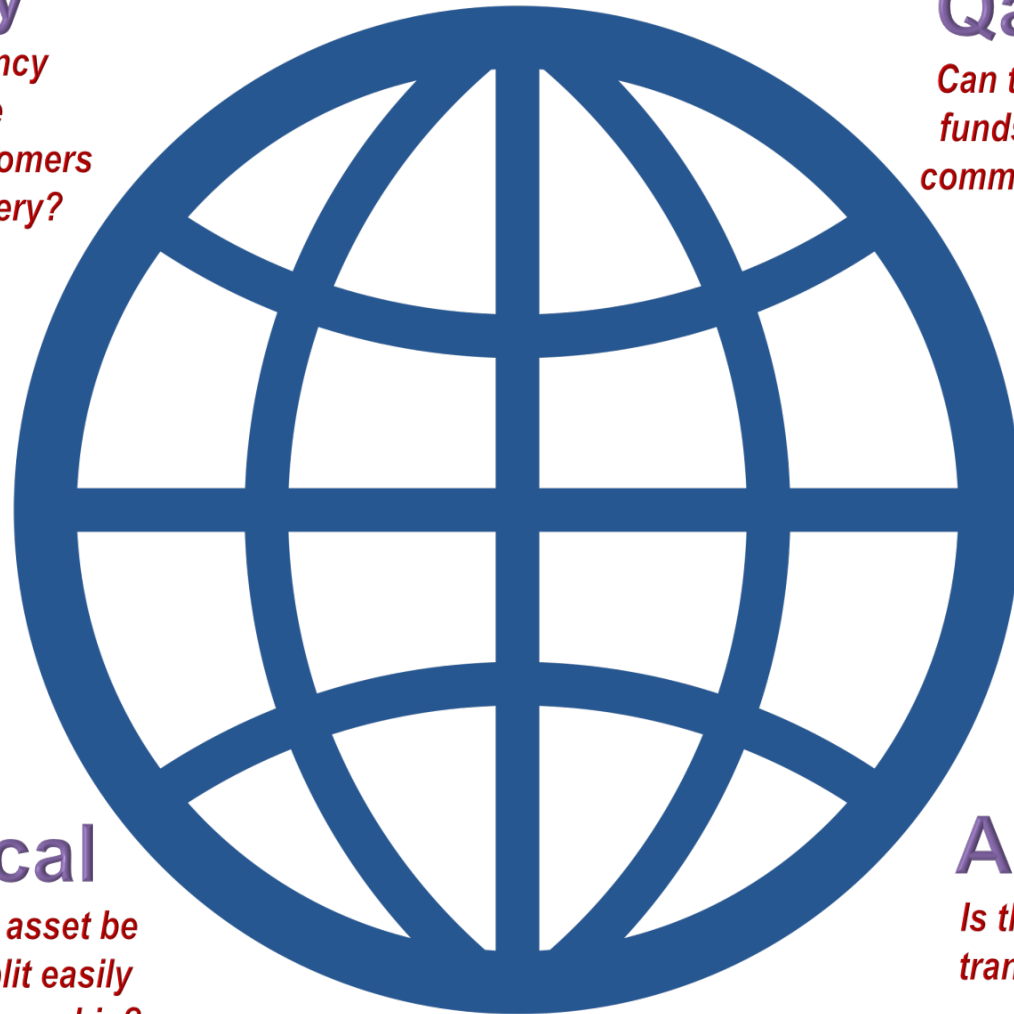
As Tawarruq arrangement becomes more acceptable, more and more investments are made into platform infrastructure for Commodity trade, as well as the supporting elements for the platform such as controlled sequencing and 24/7 trading.

The earlier criticisms such as the evidence of commodity, valuation and deliverability of the commodity has been largely resolved as the infrastructure is continuously enhanced. Tawarruq structures have become efficient across the geographies.

Name	Type	Commodities
London Metal Exchange	Bourse	Precious Metals, Non-Precious Metals
Bursa Suq Al Sila	Bourse	Crude Palm Oil, Plastic Resin, Timber, Olien
Jakarta Future Exchange Shariah Indonesia	Bourse	Crude Palm Oil, Cocoa, Coffee, Tea, Coal
Able Ace Rankin (Malaysia)	Broker	Cocoa, Coffee, Consumables
Sedania (Malaysia)	Broker	Telecommunications Airtime
Eiger Trading (UK)	Broker	Precious Metals, Cocoa, Coffee, Consumables
DD& Co (UK)	Broker	Precious Metals, Non-Precious Metals



# Criticisms and Challenges Remain



## Agency

*Will the Dual Agency  
circumvent the  
involvement of Customers  
to take asset delivery?*

## Qard Status

*Can the returns be accrued if  
funds remain as Qard before  
commodity trading is initiated?*

## Delivery

*Is the option to  
take delivery of asset  
feasible in banking  
set-ups?*

## Delay

*How long can commodity  
transactions be allowed  
to delay?*

## Physical

*Can the physical asset be  
identified and split easily  
for transfer of ownership?*

## Arranged

*Is there real economic  
transactions or is it an  
arrangement of  
convenience?*

# Have We Reached The End?

The journey is not over. Still lots to be done.



1

Must we still rely on Commodities for transactions?

2

Can the Tawarruq process be seamless?

3

Can the Mudarabah product gain better acceptance as the real alternative?

4

Is there any other structure that can resolve Tawarruq issues, or even replace it?

**New structures for Deposit Products must be  
Competitive, Efficient & Practical**

Researchers

Banking Practitioners

Academicians

Regulators

Shariah Scholars

Legal Practitioners

Higher Learning

Industry Players

**Collaboration  
Solutions-based**





# Thank You



RIGHT BY YOU

