

INVESTMENT ACCOUNT: ISSUES, CHALLENGES AND THE WAY FORWARD

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ABSTRACT

The current Islamic banking products are merely resembling the conventional products, replacing interest-based to profit based; resulted to different in form but merely similar in substance. In Malaysia, efforts are ongoing for a call to embrace risk sharing as their new source of funds through the Investment Accounts (IA) products offering. This new product offered by Islamic bank with the aims to better position the current Islamic banking practices and promote true equity based financing. Supported by the Bank Negara Malaysia, IA provides a promising avenue with a wider range of risk-return preference for the investor to invest and participate in the real economy activities. However, there is considerable ambiguity in the nature and characteristics of IA in the actual practice of Islamic banks. The paper aims to examine the issues and challenges arising from the use of IA by Islamic banks, and to suggest a solution to the main issues, which will also greatly reduce other challenges faced.

Keywords: Investment account, risk sharing, real economy.

INTRODUCTION

Islamic financial industry shows a promising future and no longer a peculiar to the world. In fact, this emerging industry finds itself sitting at the cusp of great opportunities to serve the real economy through its diverse spectrum of Shariah contract and fulfil the dynamic demands of stakeholders. In theory, Islamic banks differ from conventional banks as they do not allow for any engagement with interest (*Riba*) and rely on the idea of profit and loss through trading. They also promote risk sharing and posit that all transactions have to be backed by a real economic activity that involves a tangible asset. However, in practice, Islamic banking products are merely resembling the conventional products (Shamsher et al., 2017; Ariff, 2017; Suandi, 2017), replacing interest-based to profit based; resulted to difference in form but merely similar in substance.

In the context of Malaysia, efforts are ongoing for a call to embrace risk sharing as their new source of funds through the Investment Accounts (IA) products offering. This new product offered by Islamic bank with the aims to better position the current Islamic banking practices and promote true equity based financing (BNM, 2016). Supported by the Central Bank of Malaysia (BNM), IA provides a promising

avenue with a wider range of risk-return preference for the investor to invest and participate in the real economy activities (BNM, 2016). IA holders would have the option to choose and place their IA funds based on their investment preferences. However, there is a considerable ambiguity in the nature and characteristics of IA in the actual practice of Islamic banks. The current paper aims to examine the issues and challenges arising from the use of IA by Islamic banks, and to suggest a solution to the main issues, which will also greatly reduce other challenges faced.

THE NATURE OF INVESTMENT ACCOUNT (IA)

The contractual basis of IAs and their implication for profit and loss sharing

In Jun 2013, Islamic Financial Services Act IFSA (2013) has been introduced to provide the classification of a comprehensive regulatory framework on specificities of the various Islamic financial contracts; which include the reclassification of deposits to either being investment or deposit accounts. The initiatives taken into account the specificities of Islamic finance contracts while ensuring a robust governance of an end-to-end Shariah compliant regulatory framework. It also provides an empowering environment for Islamic banks to diversify their business through the offering of IA as an alternative means of raising funds from the public. With this, Islamic banks are allowed to pursue their role as investment intermediaries in which the alternative modes of risk-sharing contracts can be applied through the IA product. A two-year transition period had been accorded for such efforts to ensure the seamless and effective reclassification process. Ample time is needed for Islamic banks to engage, educate and guide their customers on the differences between the two, provide options either to retain the current Islamic deposit or switch to investment accounts (BNM, 2016).

Unlike Islamic deposits which have maximum flexibility in withdrawal and amount guaranteed by Malaysia Deposit Insurance Corporation (better known as PIDM¹), IA has a restricted withdrawal condition where the holders are advice to retain funds till the end of pre-determined period of time. Due to that, the IA holders would expect for a higher return as compared to Islamic deposits and enjoy the benefit of increase in the value of their investment. These distinctions allow the accelerated growth of investment accounts as Islamic banks are able to customise their products based on the customers' profile and risk appetite. Not only that, the structure of the IA would also be influenced by the nature and the characteristics of the underlying assets used in the investment.

¹ Perbadanan Insurans Deposit Malaysia (PIDM) is a Government agency established in 2005 under Akta Perbadanan Insurans Deposit Malaysia (PIDM Act); to administer the Deposit Insurance System (DIS) and the Takaful and Insurance Benefits Protection System (TIPS) to protect depositors and owners of takaful certificates and insurance policies in the event of a member institution failure. Further details: <http://www.pidm.gov.my/en/>

The aspiration of IA which gives its uniqueness lies within the aim of the sources of funds to be directed to diverse form of financing beyond debt-based contract, focusing more on equity financing or viable projects that underlies the real economy. It also provides channels for private equity and venture capital businesses to access financing where the funds can be in the form of asset-based products such as capital assets like machinery or equipment use by a group of small and medium enterprises. In this context, the level of returns generated depends on the performance of the underlying assets and the types of Shariah contract adopted.

The main key difference between Islamic and conventional banks products is that Islamic products encourage risk sharing through profit and loss-bearing investment as interest-based products are prohibited under Shariah rules (Archer et al., 2010). Similarly, Islamic banks are allowed to offer IA to its customer either based on *Mudarabah* partnership, where the Islamic banks act as the *Mudarib* (Entrepreneur) and the customers as the *Rabul Maal* (Capital Provider), or *Musharakah* partnership, or *Wakalah* agency contract. However, in practice², Islamic banks offered IA based on *Mudarabah* partnership contract or *Wakalah* agency contract, but not *Musharakah* as yet. The data collected shows that the Islamic banks are not yet ready to take up the challenge to offer pure *Musharakah* partnership with IA customers due to more risks and other considerable costs (i.e. theoretically, borrowed capita is much cheaper than equity capital) that need to be managed.

Under *Mudarabah* partnership contract, the IA holders are *Rabul Maal* who provide the capital and the Islamic banks act as the *Mudarib*, to manage the IA funds. These contractual partners share profits according to a pre-determined profit-sharing ratio specified during the initial stage. The profit earned by the banks is considered as part of partner's remuneration for successful managing the funds invested by the *Rabul Maal* (Suandi, 2017). In the case of losses, it will be borne solely by the IA holders provided that such losses are not due to the *mudarib's* misconduct or negligence. Similarly, if the Islamic banks and customers enter into IA contract on the basis of a *Wakalah* contract, Islamic banks will not bear any loss as the Islamic banks act as a *wakeel* or agent managing the IA funds. In return, Islamic banks receive management fees due to its efforts of managing those IA holders' funds.

² Data gathered is based on Bank Islam Malaysia Berhad (BIMB) and Maybank Islamic Berhad Annual Report for period of 2013-2016.

The IA is a unique product of Islamic Banks?

Investment Account is unique in the sense of it is an innovative product introduced with the aspiration to serve the real economy and fulfil the dynamic needs of customers. It offers new investment opportunities that can be offered to a wider range of investors depending on their risk appetite. The investors can be in the form of individual, corporate and institutional investor channels will have the option of placing their funds to selected ventures of their choice. It will also depends on the type of IA products that they have chosen (i.e. restricted and unrestricted IA). For Islamic banks, IA not only enhances the intermediary role of the banks but also offer a new source of funds through equity financing that can be channelled to more viable economic ventures. Consequently, it is able to promote the economic growth and development. The target ventures are expected from government agencies, small and medium-sized enterprises (SMEs) and other ventures in innovative and real growth areas (BNM, 2016). **Figure 1** summarizes the relationship between the provider or source of fund (IA holders), Islamic Banks and the potential ventures users (i.e. beneficiary of the fund).

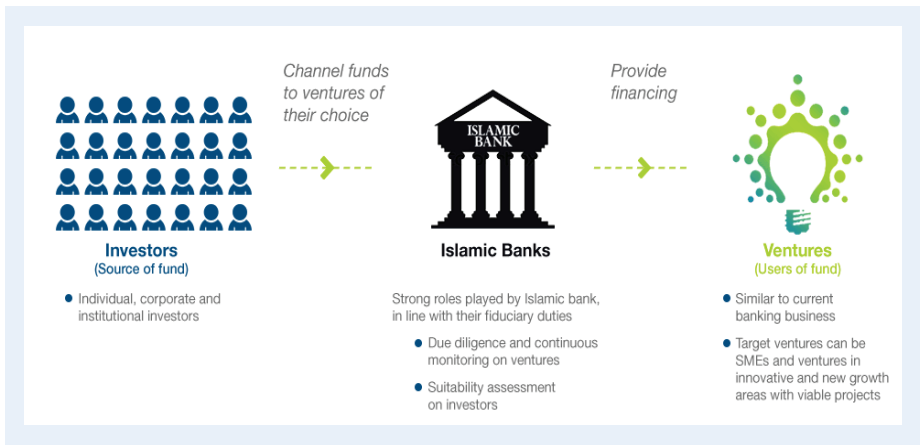


Figure 1: illustration of investment account framework (BNM, 2016)

To facilitate the IA operation, Investment Account Platform (IAP)³ was launched in February 2016 as a new innovative medium for Shariah-compliant investments and fund-raising initiatives. It is the first bank-intermediated financial technology (Fintech) platform initiated by Bank Negara Malaysia and supported by a group of Malaysian Islamic banks. IAP was a strategic initiative of the Islamic finance industry that combines the expertise of Islamic banking institutions and efficiency of technology to channel funds from investors to viable economic ventures. IAP is backed by Islamic banking institutions via the offering of IA to potential investors. Through this platform, Islamic banks will facilitate matching of investments with the identified ventures or projects that are in need of funding (Refer to **Figure 2**).

Given its greater visibility, the target ventures include those from government agencies, small and medium-sized enterprises (SMEs) and other ventures in innovative and real growth areas (BNM, 2016). IAP also offers investors to directly choose a broad range of economic activity based on their own selection and diversify their investment portfolio with exposures to various types of projects and industries that yield potential higher returns. Initially, the start-up fund for IAP is RM150 million with several tax initiatives to promote the investment in IAP (BNM, 2016). For Islamic banks, IAP provides advance value-based intermediation by creating a new exclusive source of income and funding in which it opens up an opportunity for the business owners to get fund for their activities, with more competitive financing terms.

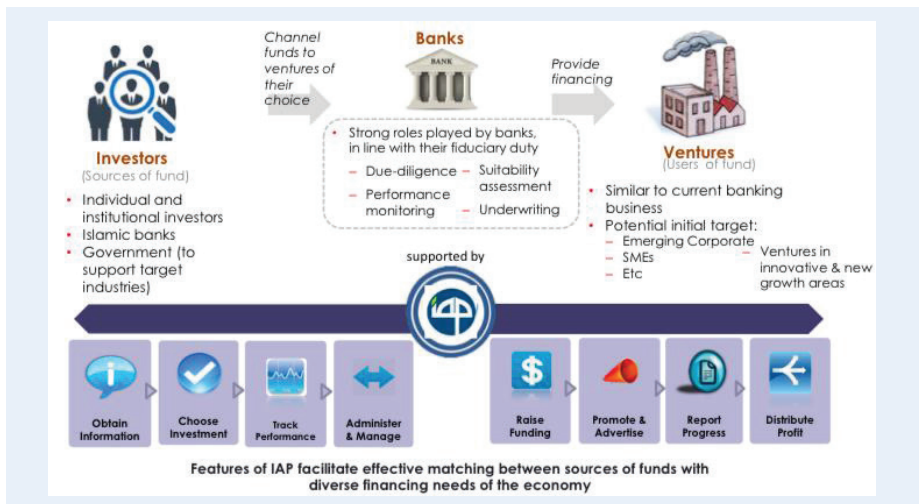


Figure 2: Mechanics of IAP (BNM, 2016)

³ IAP was developed by wholly-owned unit of Raeeed, IAP Integrated Sdn Bhd, which comprised a consortium of six Islamic banking institutions – Affin Islamic Bank Bhd, Bank Islam Malaysia Bhd, Bank Muamalat Malaysia Bhd, Maybank Islamic Bhd, Bank Kerjasama Rakyat Malaysia Bhd and Bank Simpanan Nasional

RESTRICTED AND UNRESTRICTED INVESTMENT ACCOUNTS

According to the Bank Negara Malaysia (2017)⁴ report, the proportion of IA to total funding for Islamic banks has increased dramatically within this short interval period to 11.7 per cent as at September 2017. This indicates the overwhelming response of the investors towards this new product offering. From that, the total of IA amounted to RM75.3 billion with Restricted IA and Unrestricted IA were RM43.2 billion and RM32.1 billion respectively. There are two types of IA which are restricted and unrestricted IA. Restricted IA refers to a type of investment where the IA holders provide a specific investment mandate to the Islamic banks which includes but not limited to purpose, asset class, economic sector and period of investment.

The tenure of the IA contracts for Restricted IA depends on their preference to be matched against the period of the underlying assets. In practice, the funds of restricted IA are usually being managed through the opening of restricted IA accounts with other participating Islamic banks using IAP mechanism. However, it is considered as Unrestricted IA if the IA holders provide the Islamic banks with the mandate to make the ultimate decision without specifying any restriction or conditions. Unrestricted IA gives diversification effort to investors who look for flexible and shorter investment period (unlike the Restricted IA which is for those who prefer long term investment period) but the redemption or withdrawal of unrestricted IA are to be stipulated by the Islamic banks based on certain criteria and consideration. **Figure 3** shows the main different features of unrestricted and restricted IA offered by Islamic Banks in Malaysia.

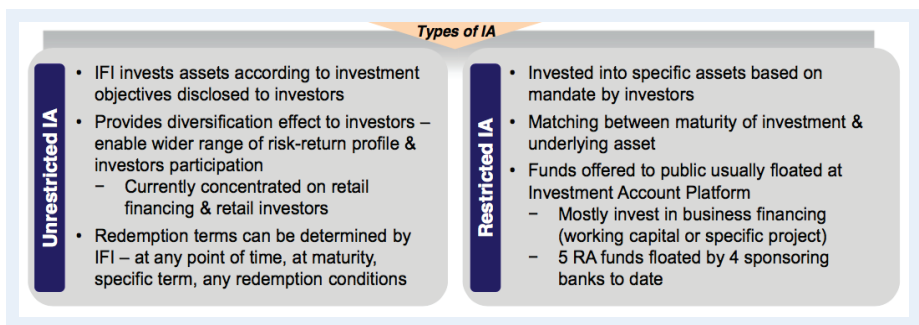


Figure 3: The unrestricted and restricted IA (BNM, 2014)

⁴ Data gathered is based on Sept 2017, BNM Monthly Highlights and Statistics extracted from http://www.bnm.gov.my/files/publication/msb/2017/9/ebook_9.pdf

THE ISSUES AND CHALLENGES OF INVESTMENT ACCOUNTS

Justice and fairness on profit and loss sharing for IA holders.

The main issue arising from the use of IA is on the distribution of bank's earning towards the IA holders (Archer et al., 2010; Suandi, 2017). As discussed in the above section, Islamic banks act as either a Mudarib or a Wakeel who managed the IA funds on behalf of the customers. The IA funds are expected to be well-managed by the Islamic banks as it subjects to many risks that may increase or erode the value of the funds depending on the performance of Islamic Banks (Suandi, 2017) as well as the economics or market conditions during the period. Further, it is a challenge for Islamic banks to balance up and offer competitive rates of return at acceptable risk levels with the liberalisation of the financial sector and dual banking system in Malaysia. Hence, some would argue, whether the allocation of profits is fair to IA holders based on the level of risk faced by them? In the case of losses arising from IA funds under the *Mudarabah* contract, it will be borne solely by the IA holders, unless such losses are due to the gross mismanagement of funds. But, how to prove a mismanagement of funds? We know that under *Mudarabah* contract neither the investors' capital nor any return on IA is guaranteed by the Islamic banks as the IA contract are purely for investment purposes.

In Malaysia, the operationalisation of IA is regulated by the policy document on Investment Accounts which was issued by the Bank Negara Malaysia in 2014. The document outlines all the necessary requirements that need to be abided by the Islamic Banks including but not limited to capital adequacy, liquidity requirements and governance structures. Pursuant to Investment Account (2014) policy standard, the Islamic banks should clearly set the profit determination and distribution mechanism depending on the type of contract offered to customers. This is the same process for both; Unrestricted or Restricted IA. For *Mudarabah*, the share of profit and loss between the IA holders and Islamic Banks is based on the pre-agreed profit sharing ratio while under *Wakalah*, the profit distribution is after deducting the agency fee and any agreed performance incentive fee to the Islamic Banks. Eligibility criteria for profit distribution i.e. minimum investment period for investment accounts without maturity or early redemption for IA with maturity will also need to be well defined by the Islamic banks and pre-agreed at the initial stage of the contract as it will affect the returns of the IA holders.

Previously, Islamic banks are allowed to use two kind of reserve accounts which are called Profit Equalization Reserve (PER) and Investment Risk Reserve (IRR) to smooth the profit-payouts and mitigate the risk. PER is allocated based on the profits prior to segregating the profits' shared between IA holders and Islamic banks and IRR is set aside from profits available for distribution to the IA holders. In fact, the accumulated IRR, which belongs entirely to IA holders, can be used to

cover any losses attributable to IAHs that might arise (Archer et al., 2010). However, Islamic banks are not allowed to implement any profit smoothing practices or displaced commercial risk techniques under this new Investment Accounts (2014) standard regime. This indicates that the profit to be distributed to the IA holders based on actual earnings. Although this practice reflects the real Shariah practice but this would create commotion in the market as we know our current market fluctuates in nature, so how “actual” is the actual amount?

The source of financing for IA funds

The aspiration of IA to finance the real economic activities are questionable. This is based on the data collected from two annual reports, which are Bank Islam Malaysia Berhad (BIMB) and Maybank Islamic Berhad for the period of 2013-2016. The selection of these two banks is based on the largest market share of the IA products offering. The aspiration of IA is mainly to promote real economy with true risk sharing principle. Hence, the returns of IA are not guaranteed and even not insured by the Malaysian Deposit Insurance Corporation (better known as PIDM) unlike normal deposit accounts. The returns are based on to the performance of the selected investment avenues where the bank plays a key role, acts on behalf of the customer, needs to make wise choices in selecting Shariah high yielding and compliant investment avenues to invest the IA funds. It is not an easy task for the bank, as banks prefer stable returns and often reluctant to engage to riskier activities considering its role as financial intermediary. For example, *Wafiyah* Investment Account offers by BIMB is based on the *Wakalah* concept where it is clearly mentioned that the funds will be invested in house financing and packaged personal financing to ensure stable returns over the IA period⁵. Consistently, our analysis based on the annual reports of BIMB and Maybank Islamic Berhad also revealed the same. The source of financing for IA portfolio is contributed mostly from Home *Ijarah* financing and *Tawaruq* financing which ideally does not really reflect the real economy activities. The pertinent questions are: Are Islamic banks taking the ‘short cut’ of real economy activity? unwilling or refuse to participate in *Musharakah* contract? Further, both of the banks’ preference to use the *Wakalah* contract instead of *Mudarabah* contract shows that the Islamic banks are not yet ready to take the challenge of risk sharing and the transition from debt financing to equity-based finance.

Another unsolved issue is on the ‘contamination’ of the source of funds from an Islamic subsidiary who are wholly-owned by its parent company which is conventional in nature such as the case of Maybank Islamic Berhad. Maybank Islamic Berhad is a subsidiary of Maybank Group which is the largest bank in Malaysia by market capitalisation. By nature, each subsidiary will have some mix

⁵ BIMB Wafiah Investment Account product is based on *Wakalah* contract offer for 1, 3 and 6 months tenure with a minimum investment of RM1000. For more details <http://www.bankislam.com.my/home/personal-banking/deposit-products/wafiyah/>

with its parent, where in most cases when the subsidiary makes any investment or trades, it will have a cash flow that either funded or, at some stage, extracted from its parent. Further, when the subsidiary facing difficulties or any losses incurred by the investment where they do not have enough capital to cover it up and this is normal for any businesses to seek aid from the parent. In the context of Islamic bank, this exercise is not allowed in any circumstances. The funds intended for Shariah-compatible investments should not be mixed with those non-Islamic investments at any level. This requirement is not based on the assumption that the activities of the conventional counterparty (i.e. the conventional parent) are intrinsically impure, but rather the rationale behind this noble principle is on prudence, to ensure the Islamic funds do not mixed with other funds that may contain *riba*, *gharar* or any non-permissible activities. Therefore, Islamic subsidiary that offers IA product must guarantee and publicize that the funds devoted to conventional activities will not be mixed with those destined for Islamic activities in any situation. The operation, end to end process should be established in the sense that it is a separate entity from the rest of the bank group. But in practise is the separation really reflected, given their differentiation of needs? Even past studies (Archer et al., 2010, 2014; Al-Shattarat & Atmeh, 2016; Shamser et al. 2017; Suandi, 2017) reveal that there is a significant link between the profit rate of Islamic banks and interest rate of conventional bank and not vice versa, so what's more for a subsidiary that is owned by a conventional counterparty. This may not be insignificant to some but without proper parameter and control in place, the IA overall processes and returns obtained may lead to an uncertainty which contradicts the original aspiration of IA.

Corporate Governance

Islamic Banks should ensure that at every level, a due diligence process is in place at the same time follow and maintain objectivity, including identifying the conflicts of interest, appropriately assess the risk associated with the investment assets funded by the IA, and comply with the necessary regulatory requirements. In this context, not only the Islamic banks need to ensure the profit earned from IA funds is in accordance to the Shariah parameters, the good governance and due diligence are also required to be in place to ensure the interest of IA holders are protected. This includes having a robust internal surveillance and reporting mechanism that allow the detection and reporting of any potential misconduct or conflict of interest that can affect the IAH' interest. Most of the issues discussed previously are essentially related to corporate governance where IA is exposed to similar risks like any shareholders or equity investors, but their rights are denied, such as monitoring or voting rights. Plus, unlike Islamic deposit, the capital and returns of IA are not guaranteed, as they are tied to the performance of the IA funds.

Prior studies conducted by Magalhaes & Al Saad (2013) and Suandi (2017) reveal that the governance practices of Islamic banks do not sufficiently address the rights of IA holders. Suandi (2017) claimed such rights include the IA needs to bear more risks as compared to shareholders for their investments. Theoretically, the IA holders require greater guarantees than shareholders do. This is due to the fact that IA holders lack voting rights, and not able to influence the bank's strategies. Most of the time, the shareholders are in the upper hands with all the information and authorisation, while the IA holder might bear the negative consequences of the decision made. IA holders also have no representative from the board to influence the management decision and less information about the banks overall operation (Magalhaes & Al Saad; 2013). It is more severe for URIA holders who have no choice in deciding the types and risk-return characteristics of the assets in which their funds are invested (Suandi; 2017). Normally, the practice for URIA funds are co-mingled and pooled together within the same portfolio with shareholders' funds and other sources of funds such as current accounts. The concern here is on the investment decision made in regards to URIA funds as any decisions or judgements made by the bank should be for the benefit of all its stakeholders not to fulfil the interest of a specific group of people only.

Further, it is argued that by nature, rational shareholders may opt for decisions that give benefit to them first (Magalhaes & Al Saad; 2013; Al-Shattarat & Atmeh, 2016; Suandi; 2017), resulting to sometimes ignoring the interest of others, hence, necessary control and proper balance of power are required within the board to ensure the interest of the minorities stakeholders are in place. In the case of the aggregate investment portfolio yields a profit, then the allocation is based on the proportionate respective shares. While it may seem straightforward, the crucial and controversial issues may arise particularly if the pooled funds incur a loss, plus if the loss is due to the absence of effective governance through immoral assessment by certain group of shareholders who want to protect their own interest. Then who should be held responsible? Given the shareholders would always in the upper hand and be able to influence the board decision, the pertinent question that we should ask would it be fair for IA holders to bear all the consequences; including the risk of having to lose the capital due to other parties' ignorance? There seems to be a deficiency in the protection of IA holders and it is part of the accountability and transparency element where they should naturally flow in the vein of Islamic bank practices; not only sculpted on the mission and vision statements but instead need to be internalised and demonstrated in its business operations. It is a challenge and not an easy task for Islamic banks given the complexity of financial transactions and economic condition. The initial step that Islamic banks can take is to ensure at least proper governance structure is in place with certain modifications on case to case basis for balance of power. This includes the responsibility to review all the decisions to verify that any decisions or transactions made are fair, reasonable and not detrimental to the minority stakeholders.

Furthermore, the classification of IA is still debatable. This is due to the fact that IA is being treated as part of the liability but the nature of IA does not fall under such definition. Better known as the accounting dilemma, it is argued that IA funds should not be considered as a liability because the bank is not obliged to return the funds in case of loss though IA has some characteristics of liability (Suandi, 2017). IA also does not fall under the definition of equity as the IA holders do not enjoy the necessary rights such as the voting rights held by the shareholders. Several past studies (Magalhaes & Al Saad, 2013; Al-Shattarat & Atmeh, 2016; Suandi, 2017) agreed that IA should be treated similar to equity while AAOIFI proposed for new category in between liability and equity section. However, without proper reclassification of the assets in the financial statement to reflect the assets attributable to IA holders may still create undue bias, at the same time contradict with the concept of transparency and full disclosure. It is long-standing challenges for Islamic banks when one-size-fits-all accounting standards are applied which makes IA holders receive less attention due to limited information on IA holders disclosed in the financial statements.

Figure 4 shows a new proposed IA structure which is extended from the existing IA framework. It is designed to enhance the intermediary role of Islamic banks as well as to protect the interest of IA holders. The 1st tier has been comprehensively outlined in the Investment Account (2014) act where all Islamic banks should adhere to. However, Islamic banks should avoid having a fixation on, or preoccupation with debt-based products like *Mudarabah* and should focus more on equity-based financing and promoting the risk sharing by shifting to IA *Musharakah* partnership. In this context, Islamic banks and IA holders will be accountable to each other; share their risk of economic activities, put appropriate risk management mechanism, select the most efficient and profitable projects and allocate the returns accordingly based on pre-determined agreements. In this IA *Musharakah* partnership structure, to balance the management (i.e. between the IA holders and Islamic banks) and to make sure everyone plays their roles effectively including the ventures (users or beneficiary of IA funds) is really a challenge but it is not impossible and let us hope we can achieve it in the near future.

A POSSIBLE SOLUTION

Structure

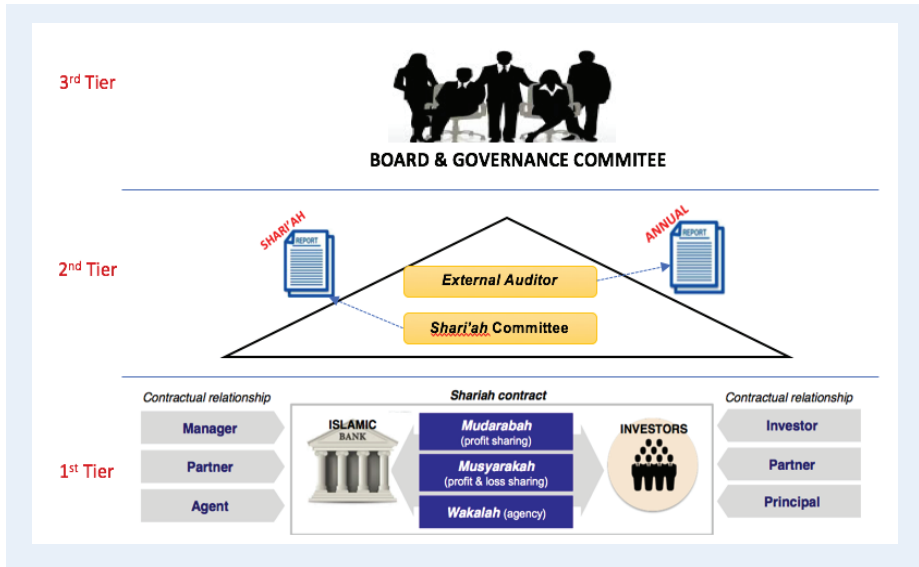


Figure 4: The new proposed IA structure

The additional 2nd tier is suggested to be in the IA framework to establish an independent review and audit assessment on the IA operation and funds' performance covering both the financial and non-financial elements including the Shariah related issues. Since IA holders do not sit in the board of Islamic banks, these frequent reviews and audit works will be carried out by independent persons, (i.e. the Shariah Audit and External Auditor) depending on their area of expertise. The results obtained must be able to be quantified and measurable in nature; to compare against the performance of IA products offered by other Islamic banks (i.e. The performance of IA product offered by Islamic bank A can be compared against IA product offered by Islamic bank B). This exercise is important to give IA holders an independent view of overall IA operations besides it is able to increase the credibility of Islamic banks. Credibility is important to Islamic banks, not only because it carries the name of Islam but more on trying to build trust and positive reputations. Then, the IA report will be prepared based on the relevant information and analysis gathered, attestation by two independent experts (i.e. Shariah Auditors and External Auditors), at the same time will be publically available as part of the Islamic banks' Annual Reports or can be part of the Value-

based Intermediation Report⁶ of the Bank. The comprehensiveness of the IA report not only caters to the benefit of existing IA holders for the decision making process but also able to attract new investors to participate in the IA platforms.

The final tier or 3rd tier is important in the sense of the board is responsible to establish an effective governance arrangement to facilitate effective monitoring and control of the overall management and conduct of the IA. The adequacy of the governance arrangement shall be in place to commensurate with the nature, scale, complexity and risk profile associated with the conduct of the IA. The overall IA activities should operate beyond mere Shariah compliance as Islamic banks have garnered much expertise and experience over several decades of its existence (Ariff, 2017). The board also needs to make sure the IA products offered with competitive package that match or even better than other financial instruments that are available in the market. At the same time, the board should ensure the IA contributes to the socio-economic well-being of its communities given the inclusiveness of its structure. To strengthen the board role, the board should be composed of qualified and competent members including representative from the investment and risk committee without neglecting the rights of IA holders. The IA holders should have some involvement in the board decision making process particularly on issues related to IA (Magalhaes & Al Saad, 2013; Al-Shattarat & Atmeh, 2016; Ariff, 2017). The appointment of a representative from IA holders can be done on periodical basis through the approval of the Central Bank (BNM) to ensure the objectives are met. Such avenues would also encourage more participation from the public to save money in the IA channel rather than *Wadiah* (safe-keeping) without any or small return in nature) where they are able to generate more returns.

Five principles for a fair and effective management of investment accounts⁷

The rapid changes and dynamism of the industry require Islamic banks to strive even harder now. True to its name, Islamic finance needs to continuously carve its own branding and distinctiveness to be viable and sustainable in the current competitive market. There is a need to balance between clients' demand and their risk appetite, profitability of the banks and at the same time to ensure the operations of the Islamic banks are within the Shariah parameters. It is not easy for Islamic banks as Islamic banks are generally smaller as compared to its counterparts (Shamser et al., 2017). But if the Islamic banks really focus on its niche area, stop competing with their conventional counterpart and make full use of its uniqueness, they are able to capture the market and among the way is

⁶ Value-based Intermediation (VBI) initiated by BNM in collaboration with the Islamic Finance Industry with the purpose to strengthen the roles and impact of Islamic banking institutions (IBIs) towards a sustainable financial ecosystem

⁷ The principles are adopted from 2017, BNM Principles for a Fair and Effective Financial Market for the Malaysian Financial Market

through proper implementation of IA by Islamic banks. To achieve that, the author proposes five principles that need to be embedded in the culture of the Islamic banks to ensure a fair and effective management of IA.

Principle 1: Professionalism and Integrity.

The ethical and professional behaviour should be in the vein of Islamic banks not only in its mission and vision statements but they need to be internalised and demonstrated through their end to end operations. In IA context, Islamic banks are expected to act professionally and honestly, including informing sufficient information on the actual performances, profit earned from the IA funds, total distributed and reserve (if needed) kept for future used. Islamic banks must clearly outline the investment objectives including identifying the types of assets that would be invested. This is important especially for unrestricted IA holders who have no choice in deciding the types and risk-return characteristics of the assets invested using their funds. Most importantly, Islamic banks should face the consequences with high professionalism and integrity when the banks are faced with losses and be responsible to the mistake if it is due to their own negligence. The right information is crucial for IA holders but most of Islamic banks have yet to have the courage to do so. Any mis-statements or any non-shariah compliance issues that can affect the IA holders also needs to be well managed and discussed with IA holders with professionalism and full integrity. It is important to note that the way IA holders behave in their engagements with the Islamic banks will ultimately reflect the integrity and credibility of the Islamic bank.

Principle 2: Transparency and Accountability

Comprehensive transparency shows the level of accountability of Islamic banks. Current information and data mainly focus on financial performance (i.e. total profit earned) (BNM, 2017), neglecting the non-financial aspects such as impact to the community well-being, environment and sustainability development. Enhanced transparency would allow the participants to make clear assessments of Islamic banks conditions as well as sound judgements and decisions. This, in turn, permits the Islamic banks to play its intermediation role more effectively. For instance, Islamic banks should transparently and timely disclose the IA activities and IA fund performance to enable the IA holders to make an informed decision. In the BNM guidelines⁸, the Islamic banks are required to promptly inform the IA holders on material changes in the investment environment or potential implication to the IA investment which could affect the profit earned by IA holders. Such information is crucial particularly if there is any revision of percentage of profit distributions or the IA fund face with losses which most of the time would affect the IA holders.

⁸ 2014 BNM Investment Account Guidelines

Further to that, the author proposes for a fair information with frequent updates for IA holders through monthly reports as a means of Islamic banks' accountability. The information should include but not limited to the role of Islamic banks, the details of the IA funds' performance and where the funds are channelled to and how they impact the IA holders, covering both the financial and non-financial aspects. This kind of initiatives are crucial and should be made available to the public as not only they are able to attract future IA customers, but also to show that Islamic banks are held accountable for all their actions and decisions made. It also can be part of Islamic banks' value proposition that is different from its counterparts and it would capture the trust of the public. Let the public choose Islamic banks products for its value proposition and its unique features not because it carries the Islamic name.

Principle 3: Competitive Environment

For Islamic banks to grow in the current competitive market, there is an urgent need to balance up between banks' profitability and fairness to its stakeholders. Fairness can be in the form of profit distribution where banks need to scale up how much profit generated need to rolled up for operation and how much to be distributed. Thus, it is about time for Islamic bank to drive and focus on its value propositions whilst by assuming they are unique and ethical certainly not enough to convince the stakeholders. Islamic banks have to offer competitive rates of return at acceptable risk levels, simultaneously fair and effective profit distribution for all. Similar to other Islamic banks' products, the core of IA products relies a great deal on instalment-based financing where *Mudarabah* or *Tawarruq* contract are among the most common contracts⁹. Based on the finding, without actual risk sharing and merely backed by debt-based financing, Islamic banks are basically replicating and adding additional products in the market which carries similar features, maybe the difference is the 'fancy' Islamic name attached to it. Islamic banks should have the courage to involve in real economic activities and promote risk sharing through trading (i.e. *al-bay'*) as it enjoins by Islam, matching its origin aspiration of IA which is to finance the real economic activities.

Islamic banks should introduce *Musharakah* (partnership) contract between the bank and the IA holders for risk sharing and governance purpose. The exposure to risks or potential loses are there in any trading but Islamic banks can manage it through screening process conducted to the potential investors (i.e. to verify the financial condition and credit behaviour of the potential investors). Then Islamic banks should also conduct proper feasibility analysis with professional estimation and projection on the investment. Continuous monitoring can be done by both parties (The Islamic bank and IA holders), and it is easier for Islamic banks as they directly participate in the management of the contract. Although Islamic

⁹ Data gathered is based on BIMB and Maybank Islamic Annual Report for period of 2013-2016.

banks are not able to guarantee profits but it needs to work in the best possible manners since in Islam, we believe it is the work of Allah SWT who determines the end results of events. It is also in parallel to the juristic principle of '*al-ghunm bil-ghurm*' which indicates that one is entitled to a gain if one agrees to bear the responsibility for the loss; or in simple words, if there is no risk, there will be no gain in Islam¹⁰.

Likewise, the Islamic banks must embrace the financial technological (FinTech) revolution given the significant estimation impact of 10 per cent to 40 per cent of banking revenue is at risk by 2025 (BNM, 2016). Obviously, FinTech would impact the operation, profit generated and distributed by Islamic banks where the depositors, IA holders or even shareholders would also be affected. The challenges are obvious (BNM, 2016) for Islamic banks as to remain competitive, to capture the market at the same time uphold the Shariah nobility. But disruptive FinTech offer Islamic banks vast opportunities to move into new markets easily and efficiently (BNM, 2016). In this context, Islamic banks particularly the subsidiary banks should fully utilise the use of IAP as a medium to enhance the IA productiveness. IAP was a strategic initiative of the Islamic finance industry that combines the expertise of Islamic banking institutions and efficiency of technology to channel funds from investors to viable economic ventures. Islamic banks should be able to take the lead of this as it can tap into the underprivileged economy given the target ventures include those from small and medium-sized enterprises (SMEs) and other ventures in innovative and new growth areas. The idea is great and noble but appropriate measures during the pre, during and post-period should in place to ensure fairness among the contractual parties given the uncertainty and high degree of risk exposure (i.e. the credit and default risk are higher among SMEs).

Principle 4: Good Internal Governance and Structure

Islamic banks should ensure that at every level, a due diligence process is in place and followed to maintain objectivity, identify conflicts of interest, appropriately assess a potential client's background and intentions, and comply with the necessary regulatory requirements. In this context, not only the Islamic banks need to ensure the profit earned is in accordance to the Shariah parameters, the good governance and due diligence are also required to be in place to ensure the interest of IA holders are protected. This includes having a robust internal surveillance and reporting mechanism that allow the detection and reporting of any potential misconduct or conflict of interest that can affect the IA holders' interest. Unlike shareholders, IA holders have no votes, no representative from the board to influence the management decision and less information about the banks overall operation. Consequently, most of the time the shareholders are in the upper hands with all the information and authorisation, while the IA holders

¹⁰ The Mejlle (2001) No: 87, pg 14: The detriment is as a return for the benefit

might bear the negative consequences of decision made (Magalhaes & Al Saad, 2013; Suandi, 2017).

It is about time for the Islamic banks to include the representative from IA holders in the board in order to manage the 'lemon problem'¹¹ as well as to influence IA governance and insure their profitability. Islamic banks should also have a proper escalation procedures and whistle-blowing provisions that serve to highlight misconduct by the managers or staff who misinformed his customers on the Islamic banks products (i.e. IAH pre-agreed rate) for his own benefits (i.e. to achieve his own KPI at the expense of the customers). Currently IA standard (2014) outlines the needs for separation of management for IA with other investment funds and assets managed by the Islamic banks is a good move especially for subsidiary that offer IA products as to ensure the investment funds is 'clear from any contamination'.

Principle 5: Compliance to Rules and Regulations

The Islamic Financial Services Act (IFSA) 2013 was introduced to modernise Islamic banks regulatory and legal framework in adapting to changing needs of the industry. The issuances include almost 12 Shariah Standards to facilitate innovation beyond credit-based products (BNM, 2017). IFSA (2013) also distinguishes investment account from Islamic deposit, where investment account is defined by the application of Shariah contracts with non-principal guarantee feature for the purpose of investment. On top of that, a supplementary policy on Investment Account (IAF) was issued by BNM in 2014 to address common and potential implementation issues and challenges faced by the Islamic banks in its respective investment account implementation initiative. Most of the elements which are not limited to the product structuring, roles and responsibilities of participants, governance and internal control, policies and procedures are clearly described to ensure fairness and the interest of all participants are safeguarded.

Since its inception two years ago, investment accounts have grown to account for 12 per cent of total Islamic deposits and investment accounts in 2016 (BNM, 2017). Its offering has been further intensified through the operationalisation of the Investment Account Platform which has the potential to mobilise capital to various productive ventures effectively (BNM, 2017). As the demand and acceptability level of the market to Islamic banks products increases, be in IA or general deposit accounts, Islamic bank must ensure they adhere to applicable rules, regulations and directives issued by authorities (i.e. BNM). They also should provide the necessary assistance and information that allow the regulators to further enhance their duties. Three-way communication and regular engagements between regulators, academician and Islamic banking practitioners are important to strike

¹¹ The lemon problem is issues that arise due to asymmetric information possessed by the buyer and the seller of an investment or product, regarding its value.

a balance between theory and practice, at the same time allowing the Islamic banks to operate efficiently. This cooperation should intensify during current high competitive periods to swiftly address problems and issues that could affect the well-functioning of the Islamic bank industry.

CONCLUSION

It is indeed remarkable for Islamic banks to introduce IA with the aspiration that it will become a means by which both investors and entrepreneurs can experience and benefit from the new risk-rewards concepts. At the same time, it gives real challenge for Islamic banks to promote IA in the current competitive market, to balance up and offer competitive rates of return at acceptable risk levels. The current Islamic banking system needs to be redefined to ensure the objectives and aspirations of IA are in place. The proposed structure with the suggested principles for a fair and effective management of IA should be considered by the Islamic banks, regulators or policy makers to further enhance the IA implementation.

Further, fairness is another important element that needs to be in the vein of Islamic banks' operation as it is a 'niche attribute' of Islamic banks. Fairness can be in many forms; not limited to fair treatment to IA, proper governance for IA holders, fair profit distribution where banks need to scale up how much profit generated need to be rolled up for operation and how much to be distributed to IA. Practically, there is no 'one-size-fits' for all but on-going monitoring and control mechanisms needs to be revisited by all parties (i.e. regulators, policymakers, Islamic banks) to strengthen the current IA practise and distribution channel. It can be designed to be part of the value propositions offered by the Islamic banks. This is important as to let the public choose Islamic banks products for its value proposition and its unique features not because it carries the Islamic name. This study subject to several limitations such as the amount of sample used and limited access to information which should be undertaken by future researchers.

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Received Date: 27 December 2017
Acceptance Date: 26 April 2018