

**Title**

Investment account

**Issuance Date**

14-Mar-2014

**Effective Date**

14-Mar-2014

**Applicability**

DFIA

FSA

IFSA

**Summary**

This policy document on investment account aims to outline the regulatory requirements on the conduct of investment accounts which encompass product structuring, oversight arrangement, risk management, market conduct and disclosure and transparency aspects. This policy document shall apply to products that are classified as investment accounts.

Queries may be directed to: [tpifsa@bnm.gov.my](mailto:tpifsa@bnm.gov.my)

**Issuing Department**

Islamic Banking and Takaful

**Attachment**

[Investment Account Reporting.zip](#)



**BANK NEGARA MALAYSIA**  
CENTRAL BANK OF MALAYSIA

# **Investment Account**

Issued on: 14 March 2014

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account
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## Table of Contents

<b>PART A</b>	<b>OVERVIEW</b>	<b>1</b>
1.	Introduction .....	1
2.	Applicability .....	2
3.	Legal provisions .....	3
4.	Effective date.....	3
5.	Transition arrangement .....	3
6.	Related policies .....	3
7.	Interpretation .....	4
<b>PART B</b>	<b>PRODUCT STRUCTURING</b>	<b>5</b>
8.	Shariah compliant investment account.....	5
9.	Investment objectives.....	6
10.	Minimum amount of investment.....	6
11.	Investment tenure.....	7
12.	Redemption of investment.....	7
13.	Profit distribution and agency fee .....	8
14.	Valuation of investment asset .....	10
15.	Termination of investment account.....	10
<b>PART C</b>	<b>MANAGEMENT OF INVESTMENT ACCOUNT</b>	<b>11</b>
16.	Separate management of investment account .....	11
<b>PART D</b>	<b>OVERSIGHT ARRANGEMENT</b>	<b>12</b>
17.	Role of the Board .....	12
18.	Shariah Committee.....	13
19.	Senior management.....	14
<b>PART E</b>	<b>RISK MANAGEMENT AND INTERNAL CONTROL</b>	<b>15</b>
20.	Policies and procedures .....	15
21.	Investment concentration risk.....	16
22.	Liquidity risk.....	17

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account
---------------------	---	--------------------

<b>PART F</b>	<b>BUSINESS AND MARKET CONDUCT .....</b>	<b>25</b>
23.	Suitability and fair dealing practices .....	25
<b>PART G</b>	<b>TRANSPARENCY AND DISCLOSURE .....</b>	<b>28</b>
24.	General principles .....	28
25.	Product disclosure sheet .....	29
26.	Terms and conditions of agreement .....	32
27.	Financial information disclosure .....	33
<b>PART H</b>	<b>PRUDENTIAL REQUIREMENTS .....</b>	<b>35</b>
28.	Product approval .....	35
29.	Outsourcing .....	35
30.	Liquidity framework .....	36
31.	Computation of Capital Adequacy Ratio.....	38
32.	Statutory Reserve Requirement .....	40
Appendix 1	Related policy documents .....	41
Appendix 2	Example of liquidity risk management on ‘per fund basis’ ..	42
Appendix 3	Illustration of ‘dedicated’ and ‘pooled’ liquefiable assets for URIA funds.....	43
Appendix 4	Minimum format of Suitability Assessment.....	44
Appendix 5	Minimum format of Product Disclosure Sheet .....	48
Appendix 6	Illustration of Movement in the Investment Account in the Notes to Accounts .....	52
Appendix 7	Illustration of Profit Sharing Ratio, Rate of Return and Performance Incentive Fee in the Notes to Accounts.....	53
Appendix 8	Calculating Liquidity Requirements for Investment Account	54
Appendix 9	Look-through Approach (LTA) for Capital Adequacy .....	58
Appendix 10	Computation of Capital Adequacy Ratio incorporating effect from Investment Accounts .....	60

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 1/60
---------------------	---	--------------------	--------------

## **PART A OVERVIEW**

### **1. Introduction**

1.1 The Islamic Financial Services Act 2013 (IFSA) 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. Notwithstanding this, the IFSA provides adequate legal basis to support the further strengthening of investment account operation that provides appropriate protection to investment account holders (IAH) whilst ensuring financial stability of the Islamic financial system. Under the IFSA, the priority of payment for investment account upon liquidation of the Islamic financial institution (IFI) is treated separately from Islamic deposit, in accordance with the rights and obligations accrued to the IAH.

#### **Policy objective**

- 1.2 This policy document on investment account aims to outline the regulatory requirements on the conduct of investment accounts. The objectives of this policy document are as follows:
- (a) to facilitate the orderly development and operationalisation of investment accounts that are consistent with the IFSA and to ensure compliance with standards on Shariah issued by the Bank;
  - (b) to establish strong oversight arrangement and sound risk management infrastructure in the management of investment accounts in order to safeguard the interest of the IAH and other stakeholders;
  - (c) to set out the minimum disclosure requirements that will facilitate fair assessment of investment proposals and performance, and informed decision making by the IAH; and

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 2/60
---------------------	---	--------------------	--------------

- (d) to outline the prudential requirements in order to support sound risk management of investment accounts and ensure financial stability in the Islamic financial system.

### **Scope of policy**

- 1.3 This policy document sets out:
  - (a) specific requirements on the structuring, risk management and market conduct of investment accounts;
  - (b) oversight requirement over the management of investment account funds and investment assets; and
  - (c) transparency and disclosure requirements including minimum information to be disclosed in product disclosure sheet, key terms and conditions to be included in primary documents, investment account performance report to the IAH and additional disclosures in the IFI's financial statements; and
  - (d) prudential requirements relating to investment accounts.

## **2. Applicability**

- 2.1 The policy document is applicable to:
  - (a) a licensed Islamic bank under the IFSA;
  - (b) a licensed bank and licensed investment bank under the Financial Services Act 2013 (FSA) and approved by the Bank under section 15 FSA to carry on Islamic banking business; and
  - (c) a prescribed institution under the Development Financial Institutions Act 2002 (DFIA) which is approved under section 129(1) DFIA to carry on Islamic banking business or Islamic financial business.

These institutions are hereinafter referred to as "Islamic financial institutions" (IFI).

- 2.2 Paragraph 31 of this policy document is also applicable to a licensed bank under the FSA.

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 3/60
---------------------	---	--------------------	--------------

### **3. Legal provisions**

- 3.1 The requirements in this policy document are:
- (a) specified pursuant to sections 29(1), 57(1) and 135(1) of the IFSA and sections 41(1) and 126 of the DFIA; and
  - (b) constitute a direction under section 129(3) of the DFIA.

### **4. Effective date**

- 4.1 This policy document comes into effect on 14 March 2014.

### **5. Transition arrangement**

- 5.1 This policy document shall apply to products that are classified as investment account. For the purpose of transition, such Islamic deposits on current account, deposit account, savings account or other similar accounts (e.g. general investment account and specific investment account) under any Shariah contract which is non-principal guaranteed, previously approved under the repealed Islamic Banking Act 1983 shall be exempted from this policy document.
- 5.2 Unless otherwise stated in this policy document, the prudential requirements applicable to the investment account are as specified in Part H. For avoidance of doubt, policy documents which have referred to general investment account and specific investment account, shall continue to be applicable to such products during transition.

### **6. Related policies**

- 6.1 This policy document shall be read together with but not limited to such documents as specified in Appendix 1.

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 4/60
---------------------	---	--------------------	--------------

## 7. Interpretation

7.1 The terms and expressions used in this policy document shall have the same meanings assigned to them in the FSA, IFSA and DFIA, as the case may be, unless otherwise defined in this policy document.

7.2 For the purpose of this policy document:

“**S**” denotes a standard, requirement or specification that must be complied with. Failure to comply may result in one or more enforcement actions; and

“**G**” denotes guidance which may consist of such information, advice or recommendation intended to promote common understanding and sound industry practices which are encouraged to be adopted.

“**Investment account holder**”, refers to a customer with an investment account maintained at an IFI.

“**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*).

“**Musharakah**”, means 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 partnership.



BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 5/60
---------------------	---	--------------------	--------------

“**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.

“**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.

“**Wakalah**”, means a contract in which a party (*muwakkil*) authorises another party as his agent (*wakil*) to perform a particular task, in matters that may be delegated, either voluntarily or with imposition of fee.

“**Wakalah bi al-istithmar**”, means a wakalah contract entered for the purpose of investment.

## PART B PRODUCT STRUCTURING

### 8. Shariah compliant investment account

- S** 8.1 The IFI must ensure that the overall operation of investment account is in compliance with Shariah. The IFI shall be guided by the rulings of the Shariah Advisory Council of the Bank (and the Shariah Advisory Council of the Securities Commission, if applicable), policy documents issued by the Bank and rulings of the IFI’s own respective Shariah committee in structuring the investment account.
- S** 8.2 The IFI must ensure that the investment account is structured based on the application of Shariah contract(s), including such arrangement which does not create an obligation on the IFI to repay in full, the money accepted from the IAH e.g. *mudarabah*, *musharakah* or *wakalah bi al-istithmar*.

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 6/60
---------------------	---	--------------------	--------------

- S** 8.3 The IFI must ensure that the structure and terms of the investment account provide sufficient legal enforceability to affect the loss bearing or loss transfer arrangement to the IAH in accordance with Shariah.

## **9. Investment objectives**

- S** 9.1 The IFI must clearly outline the investment objectives of the investment account including identifying the types of assets that would be invested in. In developing the investment objectives the IFI must conduct an assessment on the following:
- (a) investment and risk management strategies to achieve the investment objectives, including robust analysis of the expected return on investment of the underlying assets and stress testing or scenario analysis; and
  - (b) suitability criteria of the prospective IAH, especially the criteria that reflects the IAH's risk appetite, to accept the risks arising from the proposed investment objectives, including study of investor's preference/behaviour analysis using reliable data and appropriate research methodology.
- S** 9.2 In the case of RIA, the IFI must clearly stipulate any terms to the investment objectives (e.g. types of assets), including any restrictions, imposed by the IAH on the IFI.

## **10. Minimum amount of investment**

- S** 10.1 The IFI must indicate the minimum amount to be invested by the IAH and the minimum investment account fund size required to create the investment assets in line with the investment objectives.
- S** 10.2 Pursuant to paragraph 10.1, the IFI must identify the strategy in the event that the investment account fund size is less than the minimum

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 7/60
---------------------	---	--------------------	--------------

amount including soliciting additional investment funds from alternative sources or termination of investment and refund of initial investment to the IAH.

- G** 10.3 Pursuant to paragraph 9.1, where relevant the IFI should also indicate the types of assets to be invested in until the minimum investment account fund size is met.
- G** 10.4 The IFI may also indicate the maximum amount to be invested by the IAH and the maximum investment account fund size accepted.

## **11. Investment tenure**

- S** 11.1 The IFI must clearly set out the investment tenure of the respective investment account either with or without maturity.
- S** 11.2 The IFI must also indicate the applicable terms of reinvestment by the IAH after the maturity or redemption of the investment.

## **12. Redemption of investment**

- S** 12.1 The IFI must stipulate the terms of redemption or withdrawal of investment account. In determining the terms of redemption, the IFI must take into consideration the following factors:
  - (a) liquidity of underlying investment assets;
  - (b) profit distribution policy;
  - (c) valuation of investment assets; and
  - (d) liquidity risk management strategies available to the IFI.
- S** 12.2 The terms of redemption shall include:
  - (a) specific provision allowing the IAH to redeem prior to the

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 8/60
---------------------	---	--------------------	--------------

- maturity date of the investment account, if applicable;
- (b) specific qualifying criteria to be satisfied to facilitate early redemption of investment account. For example, subject to the disposal of assets, availability of another IAH to substitute the redemption of others;
  - (c) rights to share in the profit and/or loss following early redemption, such as waiver of share of profits and/or loss of principal investment value;
  - (d) applicable methodology for the valuation of the underlying investment assets and calculation of profit and loss at redemption; and
  - (e) operational procedures of redemption including submission of relevant document or form and number of days taken to process the redemption transaction.
  - (f) specific provisions on the ability of the IFI to suspend redemptions for URIA under circumstances allowed by this standard or to invoke any other applicable additional mechanisms that may affect the redemption capability of the IAH such as lock-in period or gating mechanisms upon trigger events as determined and disclosed by the IFI.

### **13. Profit distribution and agency fee**

- S** 13.1 The IFI must clearly set out the profit distribution policy including:
- (a) method of profit distribution;
    - (i) if under *mudarabah* and *musharakah*, the share of profit or profit and loss between the IAH and the IFI is based on the agreed profit sharing ratio (PSR); or
    - (ii) if under *wakalah*, the profit distribution is after deducting the agency fee and any agreed performance incentive fee to the IFI;
  - (b) profit distribution date(s) and manner which the distributable

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 9/60
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profit shall be paid; and

- (c) eligibility criteria for profit distribution e.g. minimum investment period for investment accounts without maturity or early redemption for investment accounts with maturity.

- S** 13.2 Pursuant to paragraph 13.1(a), the IFI shall comply with the requirements specified in *Rate of Return*.
- S** 13.3 In determining the frequency of profit distribution, in particular for investment accounts without maturity and distribution prior to maturity of investment accounts with maturity, the IFI must consider the following factors:
  - (a) income recognition criteria i.e. realised or unrealised income;
  - (b) cashflow for distribution;
  - (c) stability and sustainability of profit distribution; and
  - (d) consistency of the distribution policy with the investment objectives.
- S** 13.4 In determining the appropriate PSR and agency fee, the IFI must at minimum consider the following factors:
  - (a) expected return on the investment assets;
  - (b) benchmark rate of return of equivalent investment assets or products; and
  - (c) expected management or operational costs incurred by the IFI in managing the investment account.
- S** 13.5 The IFI must not implement profit smoothing practices or displaced commercial risk (DCR) <sup>1</sup> techniques.

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<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.

## 14. Valuation of investment asset

- S** 14.1 The IFI must clearly outline the valuation policy of the investment assets including:
- (a) valuation methodology;
    - (i) must be objective, robust, verifiable and consistent with the recognition and measurement criteria of the applicable Malaysian Financial Reporting Standards (MFRS);
    - (ii) impairment assessment on illiquid assets<sup>2</sup> shall reflect current valuation. The IFI shall put in place adequate mechanism to ensure timely and fair recognition and measurement of impairment loss during the period in which it is arises.
  - (b) valuation points or frequency;
    - (i) must commensurate with redemption terms and investment account performance reporting requirements. For investment accounts which may not be redeemed prior to maturity date, the IFI is required to perform valuation of the investment asset at **minimum** on a monthly basis.

## 15. Termination of investment account

- S** 15.1 The IFI must stipulate the applicable terms of termination or exit mechanism of the investment account fund including:
- (a) the manner of which termination shall be conducted;
  - (b) the valuation methodology of investment assets upon termination;
  - (c) profit distribution policy upon termination; and
  - (d) any other operational requirements that will affect the conduct of business with the IAH.

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<sup>2</sup> For financing assets, the IFI shall refer to requirements in *Classification and Impairment Provisions for Loans/Financing*.

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 11/60
---------------------	---	--------------------	---------------

- S** 15.2 The IFI shall inform the Bank<sup>3</sup> its intention of terminating any URIA funds which has been approved by the Board.
- S** 15.3 The IFI shall ensure that all liabilities of the investment account fund are discharged before the completion of the termination or winding up.

## **PART C MANAGEMENT OF INVESTMENT ACCOUNT**

### **16. Separate management of investment account**

- S** 16.1 The IFI must separate the management and maintenance of records of investment accounts and the investment assets from other funds and assets managed by the IFI. For this purpose the IFI shall either:
- (a) conduct separate management of funds in the manner specified in the *Rate of Return*; or
  - (b) appoint a trustee.
- S** 16.2 Pursuant to paragraph 16.1(a), the IFI must establish appropriate internal controls including the following:
- (a) policies and procedures and systems for separate management of investment accounts and investment assets funded by the investment account funds; and
  - (b) systems for maintenance of records and preparation of financial information disclosure specified in this policy document.
  - (c)
- S** 16.3 Pursuant to paragraph 16.1(b), the trustee shall be an approved trustee under the Capital Market and Services Act 2007 (CMSA). The IFI shall ensure that the appointed trustee has the appropriate capacity to perform the functions specified in paragraph 16.1.

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<sup>3</sup> Notification shall be made either to Jabatan Penyeliaan Kewangan Konglomerat or Jabatan Penyeliaan Perbankan.

## **PART D OVERSIGHT ARRANGEMENT**

### **17. Role of the Board**

- S** 17.1 The Board of Directors (the Board) is responsible to establish an effective governance arrangement to facilitate effective monitoring and control of the overall management and conduct of the investment account. The adequacy of the governance arrangement shall commensurate with the nature, scale, complexity and risk profile associated with the conduct of the investment account.
- S** 17.2 The duties and responsibilities of the Board with respect to giving due regards to the interest of the IAH shall include the following:
- (a) approve and review the objectives, strategies, policies and processes of the investment account including profit distribution policy and valuation policy;
  - (b) ensure the investment operations are performed in accordance with the fiduciary duties and agency duties in the agreed terms and conditions of the investment account, relevant legislations and Shariah rulings;
  - (c) ensure establishment of effective risk management policies, processes and infrastructure to identify, measure, monitor, control and report the various types of risk associated with the assets funded by the investment account including policies and procedures to determine the significant level of investment account business for the purpose of paragraph 17.3;
  - (d) ensure the management of investment accounts is conducted by personnel with the appropriate competency and investment expertise; and
  - (e) approve disclosure policies to ensure reliable, relevant and timely information are disseminated to the IAH to facilitate informed decision making and conduct regular review on the effectiveness of these policies to protect the interest of the IAH.



### ***Board Investment Committee***

- S** 17.3 The IFI shall establish a separate Board Investment Committee (BIC) when the investment account constitutes a **significant** proportion of the total asset of the IFI.
- G** 17.4 In determining the level of significance the Board may consider:
- (a) quantitative measures e.g. percentage of investment assets funded by investment account compared to total assets of the IFI; and
  - (b) qualitative measures e.g. impact on reputation of the IFI or value of the IFI's brand name.
- S** 17.5 The membership of the BIC shall comprise of only non-executive directors with at least three members. The committee shall be chaired by an independent director. Key responsibilities of the BIC include assisting the Board in performing the oversight function and provide recommendations in respect of the investment strategies, management and performance of the investment account. The BIC shall hold regular meetings, at least once every quarter and shall report regularly to the Board.
- S** 17.6 The Board Risk Management Committee (BRMC) is responsible to provide risk oversight on investment account.

## **18. Shariah Committee**

- S** 18.1 The IFI is responsible to ensure the overall operation of the investment account is in compliance with Shariah.
- S** 18.2 The Shariah committee is expected to perform the following duties and responsibilities to ensure activities associated with the investment account are conducted in line with Shariah:

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 14/60
---------------------	---	--------------------	---------------

- (a) endorse the investment account structure, objectives, investment assets and policies and procedures;
- (b) advise and provide clarification to the Board on relevant Shariah rulings, decisions or policies on Shariah matters issued by the Bank and any other issues on Shariah affecting the operations and activities of the investment account;
- (c) endorse and ensure the terms and conditions stipulated in the legal documentations, information published in promotional materials, product manuals other publications used in the investment account operations;
- (d) assess the work carried out by Shariah review and Shariah audit on the investment account operations; and
- (e) provide opinion on the Shariah compliance of the investment account and the related operations. The opinion shall be prepared in accordance with the requirements of the Shariah Committee's Report specified in *Shariah Governance Framework for Islamic Financial Institutions and Financial Reporting for Islamic Banking Institutions* and *Financial Reporting for Development Financial Institutions* respectively.

## 19. Senior management

- S** 19.1 Senior management of the IFI is responsible for the development and implementation of operational policies that govern the conduct of the investment account.
- S** 19.2 The roles and responsibilities of the senior management shall include the following:
  - (a) formulate and implement investment strategies, internal control and risk management system, including profit distribution policy and valuation policy, in line with the investment objectives;
  - (b) implement relevant internal systems and infrastructure for

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 15/60
---------------------	---	--------------------	---------------

controlling, monitoring and reporting of investment account operations, performance and risk exposures;

- (c) establish policies and procedures for the appointment of key investment personnel and other key functions;
- (d) pursuant to (c), identify, assign and train the staff with the right skill set to manage, monitor and review the performance of the investment account operations; and
- (e) timely reporting to the Board and the Shariah Committee;
- (f) timely disclosure of relevant information to the IAH as set out in approved internal policies to facilitate investment decision making.

## **PART E RISK MANAGEMENT AND INTERNAL CONTROL**

### **20. Policies and procedures**

- S** 20.1 The IFI must establish risk management policies and procedures to identify, measure, monitor and control the various types of risk associated with the investment assets funded by the investment account to effectively support the investment objectives set out for the investment account.
- S** 20.2 The IFI shall ensure the internal risk management policies and procedures are in compliance with the regulatory policies specified in the policy document on risk management issued by the Bank.
- S** 20.3 The IFI must establish an effective risk management system that is supported by adequate policies and procedures and competent human resource to ensure that the investment account continue to adhere with Shariah requirements.

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 16/60
---------------------	---	--------------------	---------------

- S** 20.4 The risk management policies and procedures on the investment account shall at **minimum**, outline the following requirements:
- (a) process to identify and monitor risks exposures associated with the investment assets funded by the investment account;
  - (b) development and implementation of relevant risk mitigation techniques to safeguard the IAH's interest;
  - (c) establishment of risk exposure limits to mitigate excessive risk taking;
  - (d) establish the mechanism for risk analysis and methodology for investment asset allocation or rebalancing;
  - (e) assessment of the appropriateness of profit distribution policy and valuation policy;
  - (f) set out the scope and frequency of risks reporting to the Board and the Shariah committee and disclosure to the IAH; and
  - (g) establishment of a mechanism to monitor and report any observation of non-compliance to the requirements set out in this policy document to the Board.

## **21. Investment concentration risk**

- S** 21.1 For URIA, the IFI must ensure that the investment account funds are not exposed to investment concentration risk which may produce losses that are substantial enough to threaten the financial condition of the investment account. Investment concentration risk can materialise from excessive exposure to a particular type of asset, a single counterparty, a single geographical location or others. Therefore, the IFI is required to establish internal policies governing the investment concentration risk including:
- (a) compliance with the prudential limit;
  - (b) pursuant to paragraph 20.4(c), setting out internal limits (e.g. investment limit on specific type of asset, a single geographical location or etc.) that are reflective of its risk appetite and risk

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 17/60
---------------------	---	--------------------	---------------

bearing capacity, which also takes into account the potential movement in the market value of the underlying exposures; and  
(c) pursuant to paragraph 20.4(g), monitoring and reporting mechanisms to ensure adherence to the above limits.

- S** 21.2 Pursuant to paragraph 21.1(a), the investment concentration limit to a single counterparty<sup>4</sup> with regards to URIA, shall be 25% of the carrying value of the total net asset value of the respective URIA fund.
- (a) The IFI must notify the Bank<sup>5</sup> immediately of any breaches together with an explanation on the causes of the breach and remedial actions taken or to be taken (with a proposed time frame) to bring the exposures within the specified limit. During the rationalisation period, the IFI shall not increase the exposures to the affected counterparty (including its connected counterparties).
- G** 21.3 With regards to RIA, the IFI may set out limits based on the agreement with the IAH. The requirement in paragraph 21.2 is not applicable to RIA since the investment mandate and underlying investment assets are determined by the IAH and not the IFI.

## **22. Liquidity risk**

- G** 22.1 The liquidity risk profile of each investment account fund<sup>6</sup> is different due to the differences in the investment objectives and strategies. The liquidity risk profile would, among others, depend on the types of underlying assets and the level of sophistication of the IAH within each investment account fund.

<sup>4</sup> The computation of an exposure to a single counterparty is as specified in paragraph 9 of the policy document on Single Counterparty Exposure Limit (SCEL) for Islamic banking institutions, which was issued by the Bank on 17 December 2013.

<sup>5</sup> Notification shall be made either to Jabatan Penyeliaan Kewangan Konglomerat or Jabatan Penyeliaan Perbankan.

<sup>6</sup> An investment account fund also refers to investment account on 'per fund basis' as described in paragraph 22.3.

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 18/60
---------------------	---	--------------------	---------------

### ***Internal policies and procedures***

- S** 22.2 The IFI must outline assets and liabilities management policies and procedures, including an effective liquidity risk management framework, that commensurate with the risk profile of the investment account fund.
- S** 22.3 The management of liquidity risk must be conducted according to the respective investment account fund (i.e. per fund basis), which includes:
- (a) identification of sources of liquidity risk and factors impacting the level of risk;
  - (b) identifying the appropriate composition<sup>7</sup> of underlying assets according to, among others, their maturity and cash-flow profile that would commensurate with the potential redemption profile of the IAH;
  - (c) measurement of liquidity risk, particularly cash flow analysis. In analysing cash flows, the IFI shall include assessment on:
    - (i) the IAH's redemption pattern and behaviour;
    - (ii) maturity and cash-flow profile of underlying assets; and
    - (iii) liquidity and marketability of the underlying assets as well as contingency needs, if any;
  - (d) monitoring of liquidity position;
  - (e) outlining risk mitigation strategies which includes identifying:
    - (i) conditions on redemption;
    - (ii) appropriate level of liquefiable assets<sup>8</sup>;
    - (iii) appropriate composition of underlying assets, taking into consideration their level of tradability and maturity;
    - (iv) mechanisms and strategies to honour redemption which includes avenues for asset disposal, finding replacement for an IAH or usage of liquefiable assets; and

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<sup>7</sup> Assets with cashflow which are uncertain or requires long-to-medium term cash realisation such as project financing are more appropriate as underlying assets in RIA.

<sup>8</sup> Subject to mandate or consent from the IAH, where applicable.

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 19/60
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(v) contingency plans to manage liquidity risk.

Illustration of 'per fund basis' is given in Appendix 2.

### ***Surplus or shortfall of liquidity for URIA***

- G** 22.4 The IFI may hold liquefiable assets within each of the URIA funds using the amounts provided by the IAH of each fund, in line with the investment objectives of the funds (here onwards known as 'dedicated liquefiable assets').
- S** 22.5 With reference to paragraph 22.4, such dedicated liquefiable assets and any other surplus<sup>9</sup> in a particular URIA fund belong to that fund and shall be used to manage liquidity needs of that fund only. Notwithstanding this, any surplus liquidity after taking into consideration liquidity requirements as per paragraph 30.2, is allowed be used by another investment account fund or the IFI, subject to such transaction being conducted on an arm's length basis<sup>10</sup>.
- S** 22.6 In order to reduce the correlation between funds arising from the use of surplus across funds, the IFI shall:
- (a) ensure that the usage is to address liquidity shortages<sup>11</sup> only; and
  - (b) identify the limit for usage of surplus of an URIA fund by another fund.
- G** 22.7 As an alternative to 'dedicated liquefiable assets', the IFI may utilise its own funds<sup>12</sup> to hold liquefiable assets (here onwards known as 'pooled<sup>13</sup> liquefiable assets') which can be used to cover against liquidity shortfall of any URIA funds. The IFI may also apply a

<sup>9</sup> For instance, arising from cash inflows exceeding its cash outflows in a given time period.

<sup>10</sup> Allowing use of surplus in consideration of investor's best interest, which includes ensuring liquidity needs of investors are effectively managed and pricing for the use of funds is appropriate.

<sup>11</sup> Not for purposes of asset expansion.

<sup>12</sup> Funds sourced from deposits, shareholder's or other funds.

<sup>13</sup> Where the total liquefiable assets maintained using IFI's funds at pooled-level shall be adequate to cover potential liquidity needs of both the investment account funds and the IFI.

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 20/60
---------------------	---	--------------------	---------------

combination of the ‘dedicated liquefiable assets’ and the “pooled liquefiable assets” to manage liquidity for a particular URIA fund. Please refer to Appendix 3 on illustration of ‘dedicated’ and ‘pooled’ liquefiable assets.

- S** 22.8 If the IFI uses its own funds for purposes of meeting redemption by the IAH, the IFI shall ensure that:
- (a) policies and procedures on the IFI’s involvement are in place, which includes the following:
    - (i) application of an appropriate limit <sup>14</sup> on the IFI’s involvement;
    - (ii) instances where the IFI’s involvement is required; and
    - (iii) methods used for the involvement, where the method and any terms involved must be in line with the IFI’s fiduciary duty to ensure protection of the IAH’s interest. The IFI is required to consult the Bank (Jabatan Penyeliaan Kewangan Konglomerat or Jabatan Penyeliaan Perbankan) if methods other than those in paragraph 22.9 are used; and
  - (b) regular assessment on the impact arising from the IFI’s involvement under stressed conditions are conducted, which includes:
    - (i) impact to capital requirements where the IFI shall ensure the adequacy of capital against additional risks that may be borne by the IFI from the provision of liquidity to the URIA funds; and
    - (ii) impact to compliance limits e.g. single counterparty exposure limit (SCEL) and investment limits.
- G** 22.9 The IFI may provide liquidity to the IAH either via purchase of the underlying assets in the fund or investing in the underlying assets of

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<sup>14</sup> This should be in line with IFI’s strategy in determining the appropriate amount under ‘pooled liquefiable asset’.



BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 21/60
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the fund.

***Additional requirements in managing liquidity risk for URIA***

- S** 22.10 The IFI shall identify and apply the appropriate additional measures such as notice/settlement period, lock-in period or gating<sup>15</sup> mechanism for each investment account fund in order to further manage liquidity risk in stressed conditions. The identification of an appropriate type of additional measures shall commensurate with the liquidity risk profile of investment account fund.
- S** 22.11 In applying the additional measures, the IFI shall ensure that:
- (a) appropriate policies and procedures are in place, which shall include the following:
    - (i) identification of trigger events for commencement and ending of the additional measures;
    - (ii) effective communication strategies to relevant stakeholders especially the IAH. The communication should:
      - be done in a timely manner;
      - be done in sufficient clarity in order to minimise potential negative implications<sup>16</sup>;
      - be conducted regularly during the application period;
    - (ii) contingency plans and strategies to resolve issues which triggered the use of the additional measures;
  - (b) applicability of the additional measures are disclosed with sufficient clarity up-front in the agreement with the IAH and product disclosure sheet;
  - (c) application of the additional measures must ensure fair treatment for the IAHs within a particular investment account fund e.g. imposition of measures must be done simultaneously

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<sup>15</sup> Such as limiting redemption amounts within a certain period.

<sup>16</sup> Such as misunderstandings or miscommunication between the IFI and the IAH which may further escalate redemptions.

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 22/60
---------------------	---	--------------------	---------------

for all the IAHs in the same investment account fund;

- (d) there is prior notification and engagement<sup>17</sup> with the Bank on the possibility of invoking additional measures. The IFI shall ensure early warning mechanisms are in place to detect potential triggering of events; and
- (e) the additional measures taken are temporary and should be uplifted or ceased to be applied when stressed conditions no longer exists or such mechanism is no longer necessary.

**S** 22.12 The IFI shall have the ability to suspend redemption, subject to compliance with paragraph 22.11. However, suspension of redemption can be invoked only<sup>18</sup> under the following circumstances:

- (a) exceptional circumstances, considering the interest of the IAH, which includes:
  - (i) market-wide failures or financial/economic crisis such as stock-market crash or asset price crash;
  - (ii) operational issues such as wide-scaled blackout or system failure; or
  - (iii) force majeure; or
- (b) exercised in the best interest of the IAH, where:
  - (i) underlying assets cannot be liquidated at appropriate<sup>19</sup> price and terms to honour redemption. For this purpose, the price for illiquid assets shall be obtained from or validated by independent third party, which may take place either before or after<sup>20</sup> such suspension; and
  - (ii) interests of the IAH would be materially affected if dealings were not suspended.

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<sup>17</sup> Early engagement, where possible, should be conducted by the IFI with the Bank.

<sup>18</sup> These requirements do not apply in circumstances e.g. winding-up where the fund is liquidated under paragraph 15.

<sup>19</sup> An example of inappropriate price is a price which results in significant loss to the IAH if assets were disposed-off immediately i.e. fire sale, where the asset price is expected to stabilize after a period of time or after restructuring of underlying assets.

<sup>20</sup> Immediately or within a reasonable period of time.

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 23/60
---------------------	---	--------------------	---------------

- G** 22.13 In ensuring the best interest of the IAH for purposes of paragraph 22.12(b), the IFI may wish to ensure that the circumstances which lead to suspension shall only be those which are expected to prolong and cannot be rectified in the near term. In this regard, temporary difficulties in realising assets or temporary liquidity shortfalls may not, on their own, be sufficient justification for suspension.
- S** 22.14 Upon invoking of suspension mechanism, the IFI must call for a meeting with the IAH within a reasonable time period to discuss on the next course of action and possible strategies.
- S** 22.15 Redemption conditions that would significantly mitigate the liquidity risk exposure to the IFI as required under paragraph 22.16 shall also apply to URIA funds that are invested into assets which consists of *mudarabah* or *musharakah* ventures<sup>21</sup>.

***Additional requirements in managing liquidity risk for RIA***

- S** 22.16 Given that the investment objectives for RIA are mandated<sup>22</sup> by the IAH, the IFI shall ensure that redemption conditions imposed on the IAH would significantly mitigate the liquidity risk exposure to the IFI, which includes:
- (a) redemption only upon maturity<sup>23</sup> of underlying assets;
  - (b) redemption only upon realisation of underlying assets to a third party (other than the IFI); or
  - (c) redemption only upon finding replacement of funds from other IAH (other than the IFI).

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<sup>21</sup> Excludes *musharakah mutanaqisah*.

<sup>22</sup> Underlying assets in RIA are usually those specifically identified by the IAH, which may impose further challenges for efficient disposal or fund replacement compared to the more generic underlying assets under URIA.

<sup>23</sup> For avoidance of doubt, any extension to the tenure or maturity of the underlying asset must also be supported by an extension of period where redemption by the IAH is also not allowed.

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 24/60
---------------------	---	--------------------	---------------

- S** 22.17 The IFI shall also identify potential operational issues pertaining to underlying assets that may affect the redemption capacity of the IAH such as cost overrun and delays in project completion. In this regard, the IFI shall:
- (a) ensure that such circumstances will not create an obligation or expose the IFI to liquidity risk; and
  - (b) set clear expectations on the role, rights and responsibilities of the IAH in such circumstances such as additional capital injection by the IAH.
- S** 22.18 Notwithstanding paragraph 22.16, where the IFI choose to provide liquidity, such as via capital contribution, or any other form of support which may expose the IFI to liquidity risk or potential losses on its capital contribution, the following shall be ensured:
- (a) such involvement is done only if supported with strong business justification. In this regard, the IFI shall conduct a thorough assessment and valuation of project viability before making such decisions; and
  - (b) a new contract based on appropriate terms and conditions, including the IFI's new role as capital contributor, shall be agreed upon by the contracting parties.
- S** 22.19 The IFI shall ensure that any conditions, including the redemption conditions, means for honouring redemption and any other additional expectations are clearly disclosed upfront to the IAH in the agreement.

## PART F BUSINESS AND MARKET CONDUCT

### 23. Suitability and fair dealing practices

- S** 23.1 The IFI shall act fairly, responsibly and professionally in its dealing with the prospective IAH on investment account. The IFI shall undertake a customer suitability assessment<sup>24</sup> before accepting placement of the investment account especially by individuals and small and medium enterprises (SMEs)<sup>25</sup> (collectively referred as retail customer).
- S** 23.2 The prospective IAH must be adequately informed of the risk and return profile of the investment account. At **minimum**, the IFI shall ensure that the prospective IAH has read and understood the product disclosure sheet.
- S** 23.3 The following are key considerations that the IFI must observe with regard to the suitability assessment:
- (a) **KNOW YOUR IAH:** The IFI must gather sufficient information which would enable the IFI to have sufficient background information on the prospective IAH. This information should include, among other things, the investor's age, annual income and number of dependants;
  - (b) **IAH RISK PROFILE AND NEEDS:** The IFI must gather sufficient information on the prospective IAH's investment objectives, financial situation, risk profile and current portfolio. By gathering this information, the IFI should be able to determine the prospective IAH's risk profile and needs; and
  - (c) **IAH INVESTMENT KNOWLEDGE:** The IFI must gather sufficient information on the prospective IAH's level of financial

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<sup>24</sup> A suitability assessment refers to an exercise carried out by the IFI. This exercise would entail the IFI gathering necessary information from the prospective IAH in order to form a reasonable basis for the IFI's recommendation.

<sup>25</sup> As defined in Circular on New Definition of Small and Medium Enterprises.

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 26/60
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knowledge, having regard to relevant factors such as the IAH's educational qualification, training, work experience and investment experience. The prospective IAH's knowledge and experience should demonstrate that he has sufficient understanding of the features and risk associated with the product recommended. The IFI should be comfortable with the prospective IAH's level of knowledge. The required level of knowledge or experience possessed by the prospective IAH's should correspond to the complexity of the product.

- S** 23.4 The IFI shall record its recommendation made to the prospective IAH and a copy of the recommendation shall be provided to the prospective IAH. The IFI must set out the reasons for the recommendation clearly.
- S** 23.5 In the event the IFI is unable to identify a suitable product for the prospective IAH, the IFI must inform the prospective IAH immediately and provide the reasons.
- S** 23.6 The IFI must obtain a written acknowledgement from the prospective IAH that:
- (a) all information disclosed by the prospective IAH is true, complete and accurate;
  - (b) the prospective IAH has read and understood the features and risks of the product upon the explanation from the IFI;
  - (c) the prospective IAH for URIA has read, understood and agreed to the redemption terms of the product, in particular of the suspension of redemption or any other applicable additional mechanisms that may affect the redemption capability of the IAH, which can be invoked by the IFI without requiring approval, consultation or prior notification to the IAH. The IAH has agreed and understood that the invocation of the suspension of redemption shall depend on the circumstances allowed under this standard and the invocation of the other additional

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 27/60
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mechanisms shall depend on trigger events as identified and disclosed by the IFI; and

- (d) the prospective IAH has received a copy of the product disclosure sheet.

- S** 23.7 As the case may be, the IFI must also obtain from the prospective IAH a written acknowledgement where the prospective IAH:
  - (a) declines to provide information requested by the IFI; or
  - (b) decides to purchase another investment account product that is not recommended by the IFI.
  
- S** 23.8 The recommendation provided by the IFI shall be signed by the IFI and the prospective IAH.
  
- S** 23.9 The confirmation of receiving appropriate recommendation shall not waive the right of the IAH in the case of misselling or negligence by the IFI.
  
- S** 23.10 The IFI must record all the information gathered during the suitability assessment exercise and updates thereto, including any recommendation made. Such information must be retained by the IFI in an easily accessible form and place.
  
- G** 23.11 Appendix 4 provides guidance in respect of the form that may be used for the purposes of carrying out a suitability assessment. The IFI may request additional information, if necessary.

## **PART G TRANSPARENCY AND DISCLOSURE**

### **24. General principles**

- S** 24.1 The IFI is required to establish internal policies and procedures on disclosure of information to the IAH. The IFI shall disclose to the IAH fair, accurate, clear and timely information to enable the IAH to make an informed decision.
- S** 24.2 The policies and procedures on disclosure of information shall include the following:
- (a) clear principles of disclosure that are consistent with fair dealing practices which must be observed when dealing in, marketing and offering an investment account;
  - (b) types and nature of information to be made available to the IAH in relation to the operation, performance and termination of investment account;
  - (c) applicability of information to various categories of the IAH, such as individuals, SMEs and others; and
  - (d) financial information disclosure to the IAH and other stakeholders.
- S** 24.3 The IFI is required to promptly inform the IAH on material changes in the investment environment and appropriate measures to be implemented following this development. For instance changes in asset allocation strategy and risk exposures. The IAH must also be notified on potential implication arising from the implementation of any remedial action. This requirement shall take into consideration the IFI's policies on liquidity risk.
- S** 24.4 Any statement of opinion provided by the IFI on investment account product shall be reasonable, relevant, factually-based, credible and where appropriate, capable of verification.



BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 29/60
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- S** 24.5 The IFI shall not represent or use any terms that indicate the investment account product as principal and/or profit guaranteed or equivalent or similar to an Islamic deposit product. For example the use of the terms such as “fixed return” or “fixed income” and “investment deposit”.

## **25. Product disclosure sheet**

- S** 25.1 The IFI shall provide product disclosure sheet for each type of investment account offered to retail customers.
- S** 25.2 The following information must be made available to the prospective IAH with regard to the offering or marketing of investment account:
- (a) name of investment account product;
  - (b) Shariah contract adopted and description of the salient features of the contract including;
    - (i) nature of the Shariah contract and the roles and responsibilities of the contracting parties;
    - (ii) type of investment account either RIA or URIA and the rights and obligations of the contracting parties;
    - (iii) profit distribution policy including clear illustrations on the application of the PSR and agency fee/performance incentive fee; and
    - (iv) nature of losses associated with the investment account to be borne by the IAH;
  - (c) description of the product structure including investment objectives, strategies and proposed investment assets and other information relevant to the structure;
  - (d) principal terms and conditions of the investment account product;
  - (e) explanation on any matter of significance to the prospective IAH to make an informed decision;

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 30/60
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- (f) fees and charges if applicable;
- (g) risks disclosure statement highlighting risk factors of the investment account product;
- (h) analysis of past and future performance;
  - (i) when using past performance of the investment assets to project future returns of the investment account, the IFI are expected to use actual returns of the immediately preceding 5 years (or the available period, if shorter). The past performance figures shall be based on actual historical performance and not simulations, and should not be unduly biased (e.g. based only on a period of exceptionally favourable market conditions). The IFI must clearly state that past performance is not indicative of future performance. Likewise, when using any forecast of the economic trends of the markets, the IFI must include a prominent warning that the projection of future performance does not guarantee actual performance;
  - (ii) projection of future performance of the investment account shall include the best case (where feasible), flat case and worst case scenarios, showing a range of potential gains or losses resulting from changes in the value of the investment assets. The purpose is to enhance the customer's understanding of the impact of different scenarios. The projection shall not exceed 5 years period. The assumptions used must be reasonable and should be clearly stated;
  - (iii) disclosure on prospective outcome of the investment shall highlight both the potential upside return and downside risk of losses;
  - (iv) information on future performance shall not appear as the most prominent feature in the communication materials; and
  - (v) comparative analysis between investment accounts and

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 31/60
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similar product must be relevant, fair, accurate and not misleading;

- (i) disclaimer statement
  - (i) in Arial 12-point font, bold capital letters and on the top of the first page of any document issued pertaining to the offering of the investment account;
  - (ii) in Arial 24-point font, bold capital letters and on the first page of hard copy and soft copy of the promotional slide presentation; and
  - (iii) in Arial font, bold capital letters, on the first and last pages of any advertising material, in a font size no smaller than the font size of the content and readable with reasonable ease.

Illustration of disclaimer statement

**IMPORTANT/DISCLAIMER**

**THIS IS AN INVESTMENT ACCOUNT PRODUCT THAT IS TIED TO THE PERFORMANCE OF THE UNDERLYING ASSETS, AND IS NOT A DEPOSIT PRODUCT.**

- (j) Risk warning statement
  - (i) in Arial 12-point font, bold capital letters and at the bottom of the last page of any document issued pertaining to the offering of the investment account;
  - (ii) in Arial 24-point font, bold capital letters and on the last page of hard copy and soft copy of the promotional slide presentation; and
  - (iii) in Arial font, bold capital letters, on the first and last pages of any advertising material, in a font size no smaller than the font size of the content and readable with reasonable ease.

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 PIDM TO ADD: “THIS INVESTMENT ACCOUNT IS NOT PROTECTED BY PERBADANAN INSURANS DEPOSIT MALAYSIA”.]**

- G** 25.3 Please refer to illustration in **Appendix 5**.

## **26. Terms and conditions of agreement**

- S** 26.1 The terms and conditions must be provided in clear and concise manner that can be easily understood by the IAH. The following conditions must be explicitly disclosed in the legal documents:
- (a) rights and obligations of contracting parties under the applicable Shariah contract, in particular with respect to the IAH’s responsibility to assume financial losses associated with the investment account and the IFI’s responsibility to perform its duties in accordance with the agreed terms and conditions;
  - (b) investment objectives and strategies including the investment asset allocation;
  - (c) PSR and agency fee where applicable;
  - (d) the IFI’s accountability and responsibility to disclose fair, accurate, relevant and timely information to IAH and frequency of disclosure;
  - (e) methodologies used in valuation and frequency of valuation of the investment account;

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 33/60
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- (f) investment tenure, redemption and reinvestment terms and applicable liquidity risk management policies and tools; and
- (g) financial implication following any breaches of contractual terms such as the premature redemption.

## 27. Financial information disclosure

- S** 27.1 The IFI must maintain accounting records and other records to facilitate the preparation and reporting of true and fair financial information to IAH.

### A. Investment account performance report

- S** 27.2 The IFI shall at **minimum** prepare and publish periodical performance and manager's report at the following intervals:
- (a) quarterly either based on the particular investment account product launch date or the IFI's own quarterly reporting period<sup>26</sup>; and
  - (b) at the end of the investment either due to termination/closure of investment account fund or maturity of investment asset e.g. investment account product with matched asset and funding structure.
- S** 27.3 The performance report shall at **minimum** contain the following information:
- (a) summary of the investment account information including description of the investment objectives, strategies and investment asset allocation;
  - (b) analysis of fund performance and valuation up to date;
  - (c) analysis of historical performance and rate of returns of not less than five years (or available period if shorter);

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<sup>26</sup> If the IFI choose to report based on its own quarterly reporting period, the IFI shall clearly disclose the performance period of reporting if it is less or more than three (3) months.

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 34/60
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- (d) statement on any changes in the investment objectives, strategies, restrictions and limitations during the period with sufficient explanation;
- (e) details of any profit distributions made and proposed during the period, and the effects in terms of the valuation of the investment account before and after the distribution;
- (f) description of any charges imposed against the investment account fund during the period; and
- (g) commentary by the IFI on the fund performance up to date and a review of future prospects of the investment asset and proposed strategies.

**S** 27.4 The IFI shall publish the fund performance report and it shall be made available to the IAH either in print or on the IFI's website in accordance with the IFI's disclosure policy.

**S** 27.5 In respect of investment account which has been terminated, the IFI shall prepare a final investment account performance report to the IAH. The final report must state the date on which the investment account affairs were wound up.

## **B. Financial reporting**

**S** 27.6 The IFI shall disclose in the notes to accounts of the annual financial statements the following:

- (a) accounting policy in respect of investment account including nature of the relationship between the IFI and the IAH and rights and obligations associated with particular type of investment account;
- (b) movement of funds in the investment account, which is segregated by types of investment account including:
  - (i) balance at the beginning of the period;
    - (a) additional investments received during the period;
    - (b) redemption of investments during the period;

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 35/60
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- (c) the IFI's share in profits, agency fee and performance incentive fee if applicable;
- (d) allocated expenses, if any, to the investment account;
- (e) balance at the end of the period; and
- (f) asset portfolio allocation.

Please refer to illustration in Appendix 6.

- (c) average PSR and declared rate of return to IAH, agency fee and performance incentive fee to the IFI, if applicable by respective tenures and types of investment account. Please refer to illustration in Appendix 7.

## PART H PRUDENTIAL REQUIREMENTS

### 28. Product approval

- S** 28.1 The file-and-launch system is applicable for investment account as specified under the *Guidelines on Introduction of New Product*. For clarity purposes, the IFI must submit a new product application for any existing investment deposit product, which the IFI has opted to classify as an investment account.

### 29. Outsourcing

- S** 29.1 The IFI shall only outsource its non-core operation functions of the investment account to resident outsourcing service provider.

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 36/60
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## 30. Liquidity framework

### ***Regulatory compliance and reporting requirements***

- S** 30.1 Investment account under this policy document is subject<sup>27</sup> to the requirements in the Liquidity Framework<sup>28</sup>, and further requirement as per paragraphs 30.2 to 30.7.

### ***URIA***

- S** 30.2 The IFI is required to calculate the net surplus or shortfall as required under the Liquidity Framework on per fund basis. For this purpose:
- (a) the cash inflow and outflow shall be calculated within each investment account fund and shall not be aggregated across funds or aggregated with the IFI's own<sup>29</sup> funds;
  - (b) due to inadequate historical data to form behavioural assessment for investment accounts under this policy document, cash flow projection based on historical data of general investment deposits may be used. However, the IFI shall closely monitor for any additional cash outflows and immediately reflect this in the computation, unless specified otherwise by the Bank;
  - (c) any dedicated liquefiable assets as described in paragraph 22.4 shall be included in deriving the net surplus or shortfall for that particular investment account fund; and
  - (d) minimum liquidity requirements applied on per fund basis shall be 3% and 5%<sup>30</sup> of that particular investment account fund's prevailing Net Asset Value for 1 week and 1 month buckets

<sup>27</sup> For the avoidance of doubt, the reporting and compliance requirements for investment deposits shall remain as per the requirements in the Liquidity Framework.

<sup>28</sup> Refers to *Liquidity Framework, Liquidity Framework-i and Guidelines on Liquidity Management Framework for DFIs*.

<sup>29</sup> Refers to fund from other than the IAH including Islamic depositors and shareholders.

<sup>30</sup> For Development Financial Institutions, this shall be 5% and 7% of that particular investment account fund's Net Asset Value for 1 week and 1 month buckets respectively, as required under the "Guidelines on Liquidity Management Framework for Development Financial Institutions".



BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 37/60
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respectively.

- S** 30.3 Since any net surplus from each investment account fund is not considered as a surplus belonging to the IFI as mentioned in paragraph 22.5, such surplus shall not be aggregated with the net compliance surplus or shortfall calculated at the IFI's own fund level.
- S** 30.4 However, any net shortfall from a particular investment account fund shall be aggregated with the IFI's own funds for purposes of calculating the IFI's net compliance surplus or shortfall. This is in view that the IFI may need to use its own funds to honour redemption by the IAH particularly in stressed conditions.
- S** 30.5 For purposes of paragraph 30.4, the total amount of net shortfall for all investment account funds shall be reported in the reporting for Liquidity Framework as an additional amount to the line item "Compliance requirement as agreed with BNM" in the Summary of Maturity Mismatch Reporting at the IFI's own fund level. Illustration of the calculation for reporting purposes is given in Appendix 8.
- RIA**
- S** 30.6 Arising from the requirements in paragraphs 22.16 to 22.19, the IFI is not required to provide liquidity buffer for RIA, unless otherwise specified by the Bank.
- S** 30.7 Surplus, if any, from RIA funds shall not be aggregated with the net compliance surplus or shortfall calculated at the IFI's own fund level.

## 31. Computation of Capital Adequacy Ratio

### ***IFI as Mudarib/Wakeel (ie. Entrepreneur/Agent) for the Investment Account***

- S** 31.1 Credit and market risk weighted assets funded by investment accounts<sup>31</sup> that fulfil the requirements in this policy document shall be excluded from the calculation of capital adequacy ratio of the IFI<sup>32</sup>. As such, the IFI shall apply the alpha ( $\alpha$ )<sup>33</sup> value of “0 (zero)” for exposures to assets funded by investment accounts in calculating the capital adequacy ratio as prescribed in Appendix 10. In addition, any committed but unfunded investment accounts (where actual cash has not been received from the IAH) shall not qualify as risk absorbent.
- S** 31.2 Notwithstanding paragraph 31.1, IFI is required to ensure adequacy of capital<sup>34</sup> where the IFI is exposed to the risk of the underlying assets in the investment account funds in circumstances arising from the IFI’s involvement to provide liquidity as described in paragraph 22.8.

### ***Financial Institution (FI<sup>35</sup>) as the IAH (ie. Fund Provider)***

- S** 31.3 In the case where an FI places funds into an investment account offered by an IFI, the FI as the IAH shall apply the following approaches in calculating credit and market risk capital requirements:
- (a) look-through approach based on the underlying assets in the investment account as if the underlying assets are directly held by the FI. The look-through approach must be used when the

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<sup>31</sup> Using capital provided by the IAH either from RIA or URIA.

<sup>32</sup> For the avoidance of doubt, both the RIA which fulfill the requirements in this policy document and the specific and loss bearing fund placement (such as the specific investment deposit) that fulfill the requirements in *Guidelines on Recognition and Measurement of Profit Sharing Investment Account (PSIA) as Risk Absorbent* are eligible for risk absorbent. In addition, the URIA which fulfill the requirements in this policy document is also eligible for risk absorbent.

<sup>33</sup> Alpha ( $\alpha$ ) represents the proportion of commercial risk to be absorbed by the IFIs, if profit smoothing practices or DCR is applied. However, since profit smoothing practices or DCR is not allowed as mentioned in paragraph 13.5, the Alpha ( $\alpha$ ) shall be ‘zero’.

<sup>34</sup> Under the Risk-Weighted Capital Adequacy Framework (Basel II) – Internal Capital Adequacy Assessment Process (Pillar 2).

<sup>35</sup> Also applies to a licensed bank under section 10 of the FSA.

following conditions can be fulfilled:

- (i) the financial information regarding the underlying assets is sufficient and appropriately granular to enable calculation of the corresponding risk weights; and
- (ii) frequency of financial reporting of the investment account must be the same as, or more frequent than, that of the FI as the IAH.

Illustration of the look-through approach and specific requirements on look-through are given in Appendix 9.

- (b) Where conditions in (a) are not met, the FI as the IAH shall treat the investment account as exposure to equities<sup>36</sup>:

(i) Credit risk

- For standardised approach, apply risk-weight of 150%;
- For Internal Ratings Based (IRB) approach, apply simple risk weight of 400%; and

(ii) Market risk

- For standardised approach, apply 14% specific risk charge, in addition to general risk charge;
- For Internal Models Approach (IMA) approach, calculate according to the FI's internal models for equities.

- G** 31.4 For purposes of facilitating the determination of capital adequacy requirements of the FI as the IAH with regard to the investment account, the IFI as the *mudarib/wakeel* and the FI as the IAH may specify in the investment account agreement, the type of information to be disclosed, frequency as well as time period for submission of such information.

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<sup>36</sup> Development Financial Institutions as IAH shall treat the investment account as exposure to "other assets" where 100% risk weight is applicable as required under the "*Capital Adequacy Framework for Development Financial Institutions*".

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 40/60
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## **32. Statutory Reserve Requirement**

- S** 32.1 All investment accounts are excluded from Eligible Liabilities (EL) base for the purposes of statutory reserve requirement (SRR) computation.

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 41/60
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## APPENDICES

### Appendix 1 Related policy documents

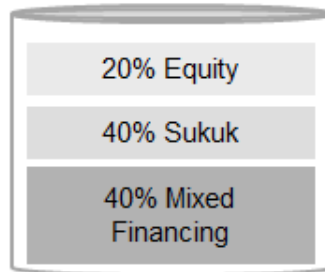
- (i) Shariah resolutions of the Shariah Advisory Council, Bank Negara Malaysia
- (ii) Guidelines on Investor Protection (BNM/RH/GL 018-2)
- (iii) Guidelines on Corporate Governance for Licensed Islamic Bank (GP1-i) (BNM/RH/GL/002-1)
- (iv) Guidelines on Corporate Governance for Development Financial Institutions (BNM/RH/GL/005-14)
- (v) Shariah Governance Framework for Islamic Financial Institutions (BNM/RH/GL 012-3)
- (vi) Rate of Return (BNM/RH/STD 033-2)
- (vii) Financial Reporting for Islamic Banking Institutions (BNM/RH/GL/002-23)
- (viii) Guidelines on Financial Reporting for Development Financial Institutions (BNM/RH/GL/005-16)
- (ix) Guidelines on the Recognition and Measurement of Profit Sharing Investment Account (PSIA) as Risk Absorbent (BNM/RH/GL 007-11)
- (x) Guidelines on Product Transparency and Disclosure (BNM/RH/GL 000-3)
- (xi) Guidelines on Imposition of Fees and Charges on Financial Product and Services (BNM/RH/GL 016-2)
- (xii) Single Counterparty Exposure Limit (BNM/RH/GL 001-38)
- (xiii) Single Counterparty Exposure Limit for Islamic banking institutions (BNM/RH/GL 07-22)
- (xiv) Guidelines on Introduction of New Product (BNM/RH/GL 008-3)
- (xv) Classification and Impairment Provisions for Loans/Financing (BNM/RH/GL 007-17)
- (xvi) Anti-Money Laundering and Counter Financing of Terrorism (AML/CFT) – Banking and Deposit-Taking Institutions (Sector 1) (BNM/RH/STD 028-1)
- (xvii) Guidelines of Outsourcing of Islamic Banking Operations (BNM/RH/GL/002-4)
- (xviii) Guidelines on Outsourcing for Development Financial Institutions (BNM/RH/GL 005-10)
- (xix) Capital Adequacy Framework for Islamic Banks (Risk-Weighted Assets)(BNM/RH/GL 007-21)
- (xx) Capital Adequacy Framework for Islamic Banks (Capital Components)(BNM/RH/GL 007-20)
- (xxi) Capital Adequacy Framework (Basel II Risk-Weighted Assets)(BNM/RH/GL 001-22)
- (xxii) Capital Adequacy Framework (Capital Components)(BNM/RH/GL 001-35)
- (xxiii) Liquidity Framework-i (BNM/RH/GL/ 002-12)
- (xxiv) Guidelines on Liquidity Management Framework for DFIs (BNM/DFI/GP5) Capital Adequacy Framework for Development Financial Institutions (BNM/RH/GL 005-7).

## Appendix 2 Example of liquidity risk management on ‘per fund basis’

The IFI may structure investment accounts to consist of only one large investment account fund as per the example in Scenario 1. Alternatively, the IFI may also structure investment accounts to consist of various types of investment account funds as per the example in Scenario 2.

Scenario 1: One large investment account fund considered as ‘per fund’

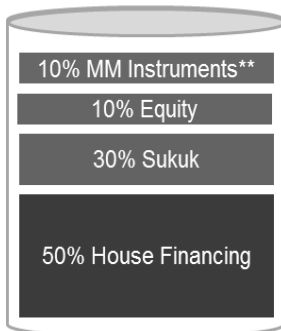
**URIA Fund**  
*Example: Objective-Mixed Fund*  
*Risk Profile- Moderate*



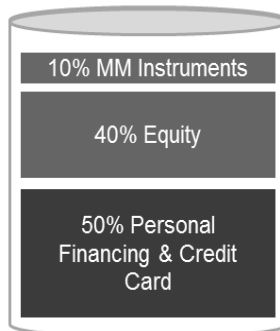
Where only one large IA fund is created

Scenario 2: Differentiated investment account funds as individual funds. Therefore, in this example there are 3 separate funds where each one is considered as “per fund”

**URIA Fund 1**  
 E.g.  
*Obj: Income & Modest Growth*  
*Risk Profile: Low*



**URIA Fund 2**  
 E.g.  
*Obj: Aggressive Growth*  
*Risk Profile: High*



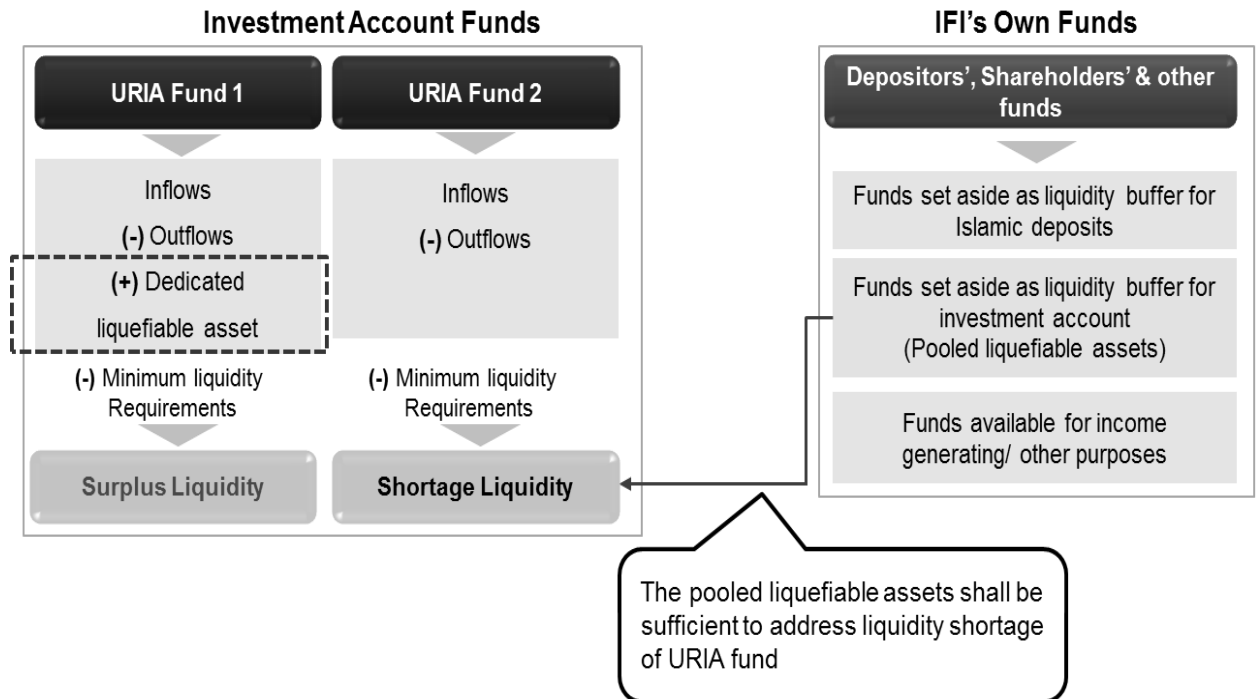
**RIA Fund**  
 E.g.  
*Obj: Long-Term Capital Appreciation*  
*Risk Profile: High*



Where several and separate investment account funds are created based on the different objectives and mandate

\*\*MM Instruments: Islamic Money Market Instruments

**Appendix 3 Illustration of ‘dedicated’ and ‘pooled’ liquefiable assets for URIA funds.**



## Appendix 4 Minimum format of Suitability Assessment

This IAH Suitability Assessment Form will guide you in choosing the investment account products that suit your investment objectives, risk tolerance, financial profile and investment experience. The information you provide will form the basis of our recommendation. It is important to provide accurate and complete information to ensure that suitable investment account products are recommended according to your investment needs and objectives.

### WARNING

**THE RECOMMENDATION IS MADE BASED ON INFORMATION OBTAINED FROM THE SUITABILITY ASSESSMENT. IAH ARE ADVISED TO EXERCISE JUDGEMENT IN MAKING AN INFORMED DECISION IN RELATION TO THE INVESTMENT ACCOUNT PRODUCT.**

### IAH SUITABILITY ASSESSMENT FORM

Date undertaken	
-----------------	--

Adviser's name	
----------------	--

Branch	
--------	--

Name of product	
-----------------	--

Category of product	
---------------------	--

Review date	
-------------	--

#### A. KNOW-OUR-IAH PROCESS

Name	
------	--

Age at time of recommendation	
-------------------------------	--

Nationality	
-------------	--

NRIC/ID No/Passport No	
------------------------	--

Residential address	
---------------------	--

Marital status	
----------------	--

No of dependents	
------------------	--

Contact no	
------------	--

Email address	
---------------	--

Remarks	
---------	--



Current employment status/Profession					
If conducting business, nature of IAH's business					
Annual income					
Expected/actual retirement age					
Is capital or principal security or protection important to the IAH?					
Whether capital/principal investment is protected					
Category of IAH					
Remarks					
<b>B. IAH'S NEED ANALYSIS</b>					
Duration period the IAH wishes to invest in the product					
Rationale for choosing the product					
General expectation of outcome of the product					
Purpose of investment		Please circle		Remarks	
Saving for specific purpose		Priority	Yes	No	
Supplementing income in retirement		Priority	Yes	No	
Investment for growth		Priority	Yes	No	
Investment for income		Priority	Yes	No	
Others: State in remarks box		Priority	Yes	No	
IAH refuses to provide sufficient information			Yes	No	
Remarks					
IAH's assets, liabilities, cash flow and income					
Proportion of investment out of IAH's net assets (not including IAH's residential property)					
IAH's regular financial commitment					

The risk of loss of capital that the IAH is willing to bear:	
Existing investment asset the IAH currently holds	
Performance of current investment asset	
<b>C. IAH'S INVESTMENT KNOWLEDGE ASSESSMENT</b>	
Whether prospective IAH has dealt in securities and/or derivatives	
Relevant knowledge or experience to understand risks associated with the product	
Ability to understand risks involved	
Investment experience	
Appreciate any special feature of the product	
Whether IAH understands the nature of the product	
Whether IAH understand the terms of the product specification	
<p>* To include all the important information relating to the investment account products</p> <p>* To include all the relevant questions which are crucial in relation to the investment account products to the IAH</p>	

**D. RECOMMENDATIONS** (to be completed by the IFI)

Whether the product is recommended by the IFI

YES	
NO	

If product is recommended by the IFI, the basis of recommendation shall be documented.

Basis of recommendation:

If the product is not recommended by the IFI, the reasons for non-recommendation shall be documented.

Reasons product is not recommended:

Date of recommendation:

**ACKNOWLEDGEMENT**

Remarks	IAH's signature
The IFI has explained and I have understood the feature and risks of the product.	
All information disclosed is true, complete and accurate.	
I decline to provide certain information required for product suitability assessment and understand that this may adversely affect my suitability assessment.	(* if applicable)
I acknowledge receipt of a copy of product disclosure sheet and the relevant disclosure document which have been given to me.	
I have decided to purchase another investment account product that is not recommended by the IFI.	(* if applicable)

IAH's signature

IFI's representative's signature

Name:

Name:

Date:

Date:

**WARNING**

**THE RECOMMENDATION IS MADE BASED ON INFORMATION OBTAINED FROM THE SUITABILITY ASSESSMENT. IAH ARE ADVISED TO EXERCISE JUDGEMENT IN MAKING AN INFORMED DECISION IN RELATION TO THE INVESTMENT ACCOUNT PRODUCT.**

## Appendix 5 Minimum format of Product Disclosure Sheet

### IMPORTANT/DISCLAIMER

**THIS IS AN INVESTMENT ACCOUNT PRODUCT THAT IS TIED TO THE PERFORMANCE OF THE UNDERLYING ASSETS, AND IS NOT A DEPOSIT PRODUCT.**

### PRODUCT DISCLOSURE SHEET

(Please read and understand this Product Disclosure Sheet together with the general terms and conditions before you apply and decide to accept the <Name of Product>)

#### PRODUCT NAME

<Date>

#### BRIEF INFORMATION ON THE PRODUCT

##### 1. What is this product about?

*[Brief description of the product should include the following information:*

- *Applicable Shariah contract*
- *Type of product (Restricted/Unrestricted)*
- *Parties involved in the investment activities and their roles and responsibilities]*

#### PRODUCT SUITABILITY

##### 2. Who is this product suitable for?

*[Briefly state the types of investors this product is suitable for. Information provided could include:*

- *Return objectives e.g. income/capital growth/capital preservation*
- *Whether their principal investment will be at risk*
- *How long the investor prepared to hold their investment for*
- *Any other key information peculiar to the product which would help investors to determine if the product is suitable for them e.g. investment limit and restrictions]*

#### KEY PRODUCT FEATURES

##### 3. What am I investing in?

- *Investment objective, strategy and policy to achieve the investment objective, e.g. investment focus (types of asset, allocation, country, market/sector/industry), techniques/approaches used in managing the portfolio*
- *Risk assessment on the performance of the investment assets*
- *Minimum investment*
- *Investment tenure e.g. 1, 3, 6, 9, 12, 18 months*
- *Profit sharing ratio (Customer: Bank) and calculation*
- *Profit payment method*
- *Key terms and conditions i.e. reinvestment procedures and redemption policies*

***\*To describe these features with relevant tables, diagrams or illustrations where applicable***

**Examples**

a) Profit calculation under Mudarabah/ Musharakah investment account

Date of placement	=	1/01/2012	Investment tenure	=	12 months
Date of maturity	=	31/12/2012	Profit Sharing Ratio (PSR)	=	60:40
Investment amount (Principal)	=	RM50,000	Gross rate of return	=	5.36%

**Profit Calculation (first 6-months tenure)**  
Principal x PSR X Gross Rates X 180 /365 Days = Amount payable to IAH  
RM50,000 X 60% X 5.36% X 180/365 Days = RM792.99

b) Agency fee/ Performance fee under Wakalah investment account

Investment amount (Principal)	=	RM50,000	Gross rate of return	=	5.36%
Agency fee	=	0.1%	Expected profit rate (EPR)	=	4.00%

*\*It has been agreed that the Mudarib (IFI) shall earn performance incentive fee on the basis of any return above the agreed expected profit rate (EPR) of 4%.*

Type	Calculation	Total Amount (RM)
Wakalah fee	Agency fee x Investment Amount = 0.1% x RM50,000	50
Performance incentive fee	[Gross rate of return – Agency fee – EPR] x Investment amount = [5.36% - 0.1% - 4%] x RM50,000	630

c) Profit payment method

<p>Payment of profit in respect of 12 months investment account shall be one (1) day after the profit declaration day, tentatively the 10<sup>th</sup> of every month.</p> <p>Thereafter, actual profit will be provided and accrued on monthly basis until the last month of the investment tenor or up to the interim profit payment period.</p>
--

d) Key terms & conditions

<p>(i) Redemption at maturity – the principal amount is payable in full if you redeem your investment only at maturity;</p> <p>(ii) Early redemption – you may receive a sum of less than your initial investment if you redeem all or part of the investment before it matures. The actual amount that you will be paid depends on the market value of the underlying assets of which your investment is linked to at the point of redemption less any charge payable, arising from the premature redemption.</p> <p>(iii) Redemption process – All redemption should be made on a redemption form to ensure that a record of the redemption exists. Redemption requests received before 2.00pm will be treated as received on that Business Day and redeemed at the Redemption Price applicable for that Business Day. Any redemption request after 2.00pm will be treated as received on the following Business Day and redeemed at the Redemption Price applicable for the following Business Day.</p>
--

**4. What are the possible outcomes of my investment?**

[To describe possible future gains/losses in best and worst market scenario and any other possible scenarios showing a range of potential gains or losses resulting from changes in the value of the underlying assets. Information on past performance must also be included:

- Actual rate of return of the immediately preceding 5 years on a net basis or the

available period, if shorter

- The basis of calculation of past performance
- The following statement must appear under this section:  
**“Past performance of the investment is not an indication of its future performance”**  
**\*To describe these features with relevant tables, diagrams or illustrations where applicable**

**Examples**

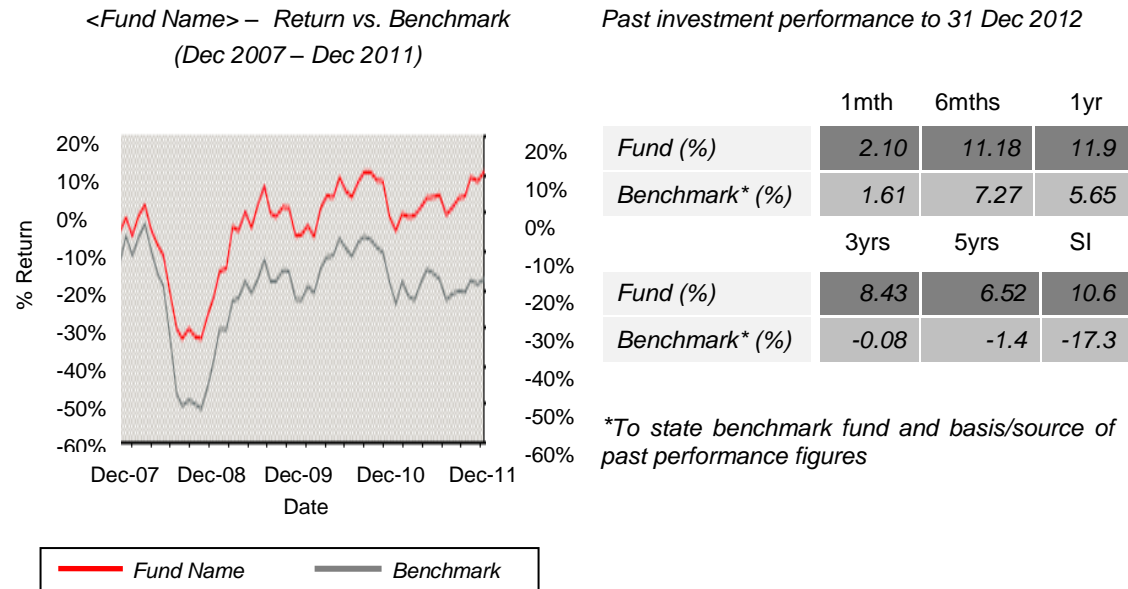
a) Possible future gains and loss (Investment of RM50,000)

<b>Table 1 Best Market</b>			<b>Table 2 Worst Market</b>		
Months	Rate of Return (%)	Avg. Rate of Return (%)	Months	Rate of Return (%)	Avg. Rate of Return (%)
Jan	5.36	5.70	Jan	5.36	5.29
Feb	5.55		Feb	5.33	
March	5.79		March	5.25	
April	6.09		April	5.21	

b) Fund performance

Launch date : 1 December 2006

Past investment performance chart of 5 years period as follows:



**KEY RISKS**

**5. What are the key risks associated with this product?**

State key risks that would commonly occur, or which may cause significant losses if they occur or both e.g. market risk, equity risk and income risk. Risks peculiar to the product should also be stated e.g. individual investment risk involved in specific investment of securities, liquidity risk and counterparty credit risk. Give appropriate formatting emphasis where investors might lose all of their initial investment. The information should include the

following statement:

**“You are advised to carefully consider all risk factors before making an investment decision”]**

#### FEES & CHARGES

**6. What are the fees and charges involved?**

- All relevant fees and charges payable. Indicate if fees payable once off or per annum basis
- If fees may be increased later, please state so
- To state if charges are negotiable

#### VALUATIONS

**7. Valuation strategy adopted, frequency & where valuations are published (i.e. web address/ newspapers where valuations are published)**

#### CONTACT INFORMATION

**8. Who should I contact for further information or to lodge a complaint?**

- Contact details of the IFI that the IAH may contact for queries or complaints on the product
- Website address and email address

Example:

- a) For internal dispute resolution, you may contact:  
(Contact details for the IFI's internal dispute resolution)
- b) If you are dissatisfied with the outcome of the internal dispute resolution process, please refer your dispute to the BNM TELELINK
- (a) via phone to : 1-300-88-5465 (1-300-88-LINK)
- (b) via fax to : +603-2174-1515
- (c) via email to : [bnmtelelink@bnm.gov.my](mailto:bnmtelelink@bnm.gov.my)
- (d) via letter to : Laman Informasi Nasihat dan Khidmat (LINK)
- Bank Negara Malaysia  
P.O. Box 10922  
50929 Kuala Lumpur

#### 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.**

The information provided in this disclosure sheet is valid as at <date>

**Appendix 6 Illustration of Movement in the Investment Account in the Notes to Accounts**

(RM'000)	Mudarabah		Wakalah	Total
	Unrestricted investment account	Restricted investment account	Unrestricted investment account	
As at 1 January 20XX	123,400	30,500	65,720	219,620
<i>Funding inflows/outflows</i>				
New placement during the year	33,560	9,765	28,395	71,720
Redemption during the year	(23,555)	(4,567)	(20,766)	(48,888)
Income from investment	18,021	4,863	8,884	31,768
<i>Company's share of profit</i>				
Profit distributed to mudarib	(7,779)	(999)	-	(8,778)
Wakalah fee	-	-	(1,454)	(1,454)
Wakalah performance incentive fee	-	-	(351)	(351)
As at 31 December 20XX	143,647	39,562	80,428	263,637
Investment asset:				
House financing	33,039	-	18,499	51,538
Hire purchase receivables	20,111	-	11,260	31,371
Trade financing	43,094	-	24,128	67,222
Other term financing	31,602	39,562	17,694	88,858
Marketable securities	15,801	-	8,847	24,648
Total investment	143,647	39,562	80,428	263,637



**Appendix 7                      Illustration of Profit Sharing Ratio, Rate of Return and  
Performance Incentive Fee in the Notes to Accounts**

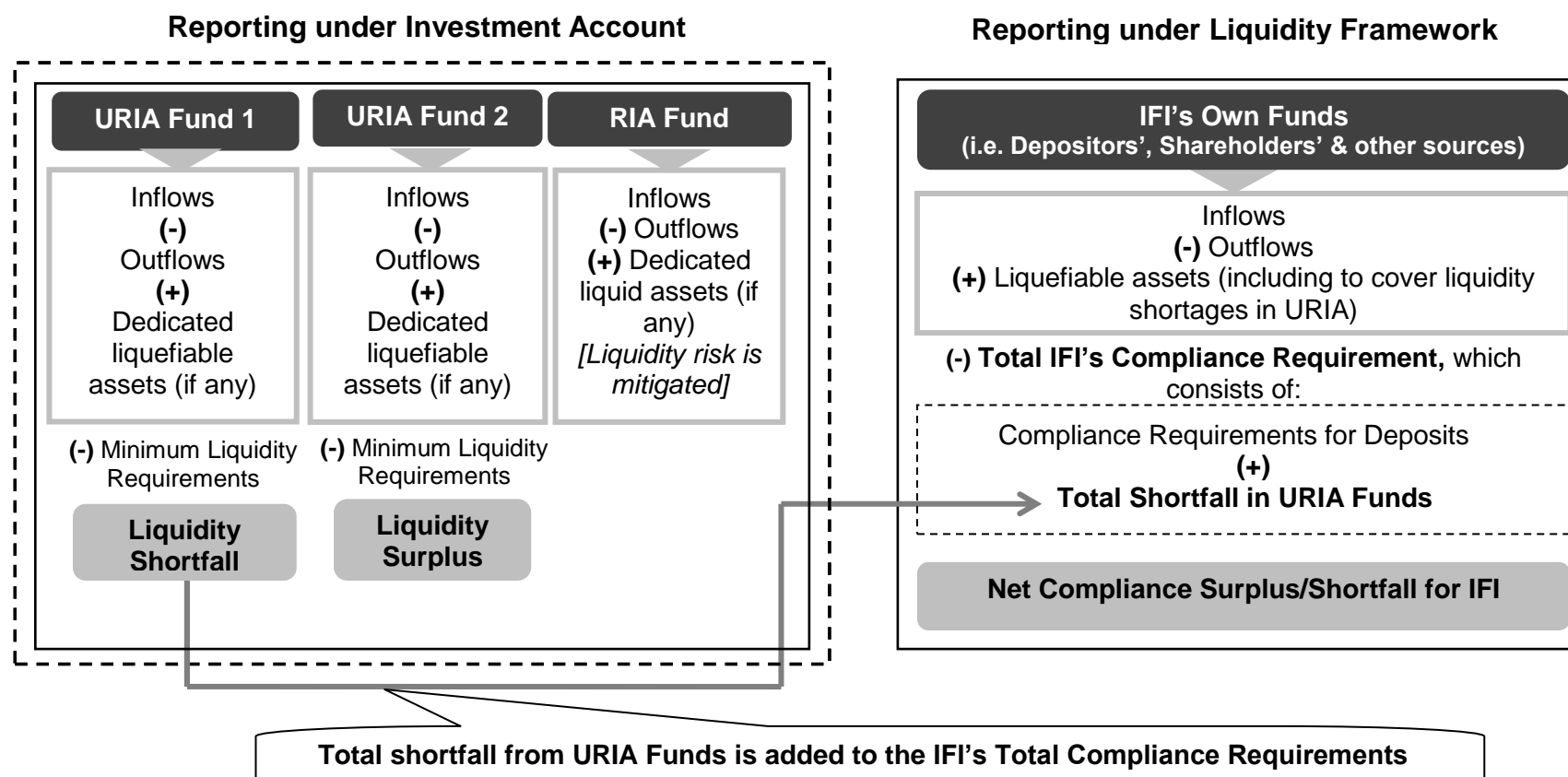
	<b>Investment account holder</b>		
	<b>Average profit sharing ratio (%)</b>	<b>Average rate of return (%)</b>	<b>Performance incentive fee (%)</b>
<b>Unrestricted investment accounts:</b>			
less than 3 months	50	3.00	2.15
between 3 to 12 months	55	3.25	2.25
between 1 to 2 years	55	3.75	2.50
more than 2 years	75	4.25	2.80
<b>Restricted investment accounts:</b>			
between 1 to 2 years	55	3.75	-
between 2 to 5 years	65	4.25	-

## Appendix 8 Calculating Liquidity Requirements for Investment Account

Scenario: In this example, the sources of funding for Islamic Bank ABC consist of two broad categories as follows:

- (i) The IFI's own funds which is sourced from depositors, shareholders & others; and
- (ii) Investment account funds which is sourced from investment account holders. Islamic Bank ABC operates two URIA funds (namely URIA Fund 1 and URIA Fund 2) as well as a RIA Fund.

Steps to calculate compliance with the liquidity requirements are depicted in the illustration below:



BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 55/60
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## 1. Calculation

- (a) Calculate “Available Cumulative Mismatch to Accommodate Liquidity Shocks”<sup>37</sup> by each investment account fund (ie. separately by URIA Fund 1, URIA Fund 2 and RIA Fund), and “Available Cumulative Mismatch to Accommodate Liquidity Shocks”<sup>38</sup> for the IFI’s own funds. The amounts already calculated for each investment account fund **shall not be included** in the computation at the IFI’s own funds level.
- (b) Apply minimum liquidity requirements for **each URIA fund**, which are, 3% and 5% of the fund’s NAV for ‘up to 1 week’ and ‘1 week to 1 month’ maturity buckets respectively or as agreed with the Bank. There are **no liquidity requirements** for RIA as the liquidity risk is mitigated as required under paragraph 30.6. Therefore, mismatch reporting for RIA funds is for monitoring purposes only.
- (c) Any surplus of liquidity in a URIA fund (ie. URIA Fund 2) shall **not be aggregated** with other investment account funds or with the IFI’s own funds.
- (d) Any shortfall of liquidity in a URIA fund (ie. URIA Fund 1) shall **be aggregated** with the IFI’s own funds Compliance Requirement<sup>39</sup>, resulting in **either** a reduction to the IFI’s own funds Net Compliance Surplus or an increase to the IFI’s own funds Net Compliance Shortfall.

## 2. Reporting and submission

- (a) The IFI shall use the Liquidity Framework reporting requirements for the purpose of calculating and reporting the liquidity requirements at the IFI’s own funds level, which shall include an adjustment for any shortfall of liquidity from the URIA funds as explained in paragraph 1(d). This represents the entity (domestic) level reporting done by the IFI under the Liquidity Framework.

For better clarity, numerical illustration of the steps above is given below:

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<sup>37</sup> The methodology and requirements to calculate “Available Cumulative Mismatch to Accommodate Liquidity Shocks” are specified in the Liquidity Framework.

<sup>38</sup> The methodology and requirements to calculate “Available Cumulative Mismatch to Accommodate Liquidity Shocks” are specified in the Liquidity Framework.

<sup>39</sup> As per the requirements in the Liquidity Framework, this shall be 3% and 5% of total outstanding deposits for ≤1 week and 1 week to 1 month buckets respectively, or any other rate/amount agreed with the Bank.

**Scenario:** As above

For purposes of liquidity reporting and compliance requirements, Islamic Bank ABC has to calculate separately the requirements for each of the funds above ie. The IFI's own funds, URIA Fund 1 and URIA Fund 2. The example in Diagram 1 below is for the calculation for the ≤1 week bucket:

Diagram 1: Liquidity calculation on "Per Fund Basis" for each URIA funds and impact to liquidity requirements at IFI's Fund level

Items (in RM '000):	URIA Fund 1	URIA Fund 2	IFI's Own Fund (ie. funding from depositors, shareholders & others)
	≤1 week	≤1 week	≤1 week
Inflows from assets and off balance sheet items:	5,000	2,500	300,000**
(-) Outflows from liabilities & off balance sheet items:	7,500	10,000	1,257,000**
Total Net Maturity Mismatch Under Normal Circumstances	-2,500	-7,500	-957,000
(+) Discounted value of liquefiable securities and undrawn portion of formally available credit lines (if any)	5,000 <sup>#</sup>	2,000 <sup>#</sup>	250,000 <sup>^^</sup>
Available cumulative mismatch to accommodate liquidity shocks	2,500	-5,500	707,000
(-) Compliance/Minimum Liquidity requirement as agreed with BNM	1,500*	1,500*	607,000
Net compliance/ surplus/ (shortfall) of Fund	1,000	-7,000	100,000

Shortfall needs to be incorporated into IFI's own fund level calculation

**Important notes:**

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 57/60
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\*\* The inflows and outflows reported at the IFI's own fund level **exclude** the inflows and outflows of all the URIA funds (hence no double counting).

# Islamic Bank ABC maintains liquefiable assets dedicated for each URIA fund (ie. dedicated liquid assets) as described in paragraph 22.4. Hence, these are the amounts of dedicated liquid assets for each URIA fund.

^^ This amount consists of liquefiable assets to manage liquidity at the IFI's funds level (eg. depositors withdrawal) and the "pooled liquefiable assets" to manage liquidity for URIA funds, **if any**, as described under paragraph 22.7. In other words, since inflows and liquefiable assets in URIA Fund 2 are insufficient to meet its liquidity needs, Islamic Bank ABC is **employing** the strategy of maintaining **both** "dedicated liquid asset" and "pooled liquid asset" approach to manage liquidity risk for URIA Fund 2.

\* 3% of the URIA Fund's NAV as at reporting date (assumption: each URIA Fund's NAV is RM50mil)

### **Assessment**

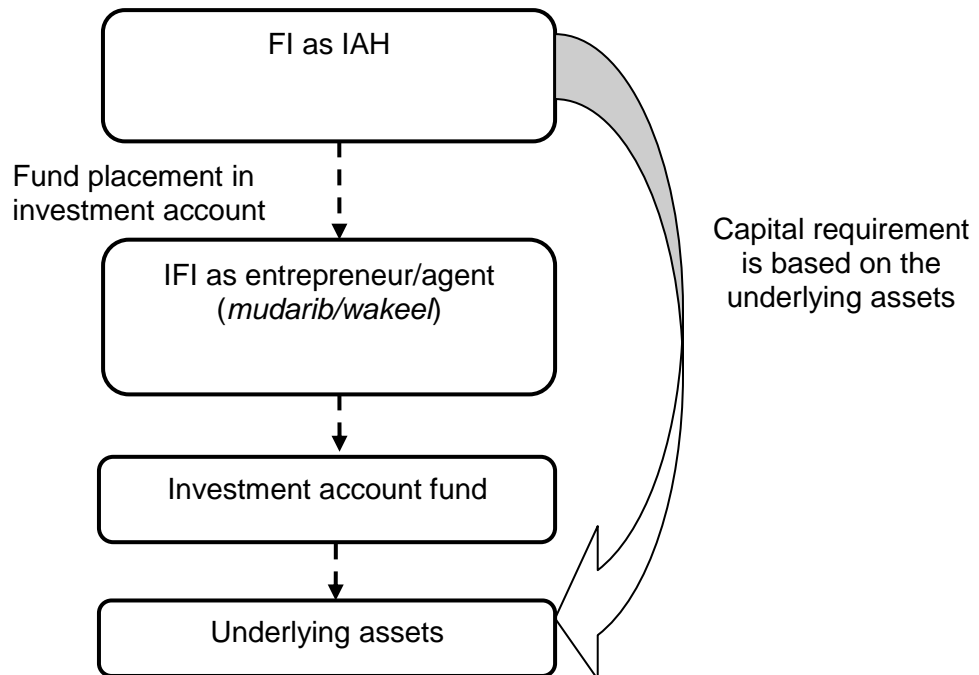
URIA Fund 1 has a net surplus of RM1mil which is available for usage of Fund 1 only. Usage of these surplus funds by other than for purposes of URIA Fund 1 will have to be done on arm's length basis as clarified under paragraph 22.5.

Meanwhile, URIA Fund 2 has a net shortfall of RM7mil which needs to be covered by the IFI as mentioned under paragraph 30.4. Assuming the IFI accepts a total deposit RM20billion, the IFI's **compliance requirement** for up to 1 week bucket is:

$$\begin{aligned}
 &= \boxed{\begin{array}{c} \text{Compliance requirement to} \\ \text{accommodate deposits withdrawal} \\ \text{(ie. 3\% x Total Deposits or as} \\ \text{agreed with the Bank)} \end{array}} + \boxed{\begin{array}{c} \text{Total net shortfall of} \\ \text{URIA Funds} \\ \text{(ie. RM7m)} \end{array}} \\
 &= (3\% \times \text{RM } 20,000,000,000) + \text{RM } 7,000,000 \\
 &= 600,000,000 + 7,000,000 \\
 &= \underline{\underline{\text{RM 607million}}}
 \end{aligned}$$

**Conclusion:** The shortfall in URIA funds **increases** the IFI's Total Compliance Requirements to RM607mil as reflected in the table above. This results in a **reduction** to the IFI's Net Compliance Surplus to RM100million.

## Appendix 9 Look-through Approach (LTA) for Capital Adequacy



- S** 32.2 In the application of LTA, the FI as the IAH shall adopt the approach applicable for similar asset classes in its portfolio as if the underlying assets are directly held by the FI, using the relevant rules in the Capital Adequacy Framework (CAF)<sup>40</sup>.

### **Market risk**

- S** 32.3 Under the standardised approach, the FI as the IAH shall use the appropriate capital charge of the underlying assets. Under the IMA, the FI as IAH shall calculate the capital requirements of the underlying assets.
- S** 32.4 Subject to the conditions specified under CAF as well as there being no obstacles to timely recoverability of funds from the IFI as *mudarib/wakeel*, the FI as the IAH may offset its own position against positions arising from the underlying assets. Consequently, the IFI as *mudarib/wakeel* is not allowed to recognise such position

<sup>40</sup> Capital Adequacy Framework for Islamic Banks (Risk-Weighted Assets) (CAF RWA) or the Capital Adequacy Framework (Basel II Risk-Weighted Assets) or Capital Adequacy Framework for Development Financial Institutions.

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 59/60
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arising from the underlying assets to offset against its own positions.

### **Credit risk**

- S** 32.5 Under the standardised approach, the FI as the IAH shall calculate the capital requirements based on the risk weight applicable to the obligor of the underlying assets.
- S** 32.6 Under the Internal Ratings Based (IRB) approach the FI as the IAH shall calculate the IRB risk components (i.e. the probability of default (PD) of the underlying exposures and, where applicable, loss given default (LGD) and exposure at default (EAD)) associated with the fund's underlying exposures. The FI shall ensure that the minimum requirements of the IRB approach are complied with for the underlying assets. Notwithstanding this, the FI as the IAH using the IRB approach may use the standardised approach for exposures on the underlying assets if the FI is allowed to do so under the permanent exemptions from IRB approach under CAF.
- 32.7 The FI as the IAH shall take into account the effect of any Credit Risk Mitigation (CRM) attached to the underlying assets only when the following conditions can be fulfilled:
- (a) The FI as the IAH is satisfied that the IFI as *mudarib/wakeel* fulfils the applicable requirements for recognition of CRM under CAF <sup>41</sup> so as to ensure enforceability of the documentation and recoverability of the CRM attached to the underlying assets; and
  - (b) The investment account is supported by clear and robust legal documentation to ensure that the proceeds/realisable value from the CRM will be passed on to the fund provider in accordance with the arrangement.

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<sup>41</sup> For example, the FI as the IAH is satisfied that the legal documentation and operational arrangement for CRM is binding on the parties involved (i.e. the IFI as *mudarib/wakeel* and the obligor).

BNM/RH/STD 029-4	Islamic Banking and Takaful Department	Investment account	Page 60/60
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## Appendix 10      **Computation of Capital Adequacy Ratio incorporating effect from Investment Accounts**

The Capital Adequacy Ratio of the IFI shall be computed as follows:

Modified Formula<sup>42</sup>: Incorporating the Risk Nature of Investment Accounts

$\text{Total Capital Ratio}_{\text{Islamic}} = \frac{\text{Total Capital}_{\text{Islamic}}}{\text{Total Risk Weighted Assets}_{\text{Islamic}}}$ <p style="text-align: center;"><b>Less</b></p> <p style="text-align: center;">(1-<math>\alpha</math>)<sup>44</sup> (Credit and Market Risk Weighted Assets funded by Investment Accounts)</p>
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<sup>42</sup> This formula applies for calculating Common Equity Tier 1 capital, Tier 1 capital and Total Capital ratios accordingly.

<sup>43</sup> Total risk weighted assets is the sum of credit, market and operational risk weighted assets of IFIs.

<sup>44</sup> (1- $\alpha$ ) represents the quantum of investment account recognised as risk absorbent for capital adequacy ratio computation purposes.