



ISLAMIC UNIT TRUST IN MALAYSIA:
AN EVALUATION FROM THE
SHARĪAH PERSPECTIVE

BY

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A dissertation submitted in partial fulfilment
of the requirements for the degree of
Doctor of Philosophy (Fiqh and Uṣūl al-Fiqh)

Kulliyyah of Islamic Revealed Knowledge
and Human Sciences
International Islamic University
Malaysia

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ABSTRACT

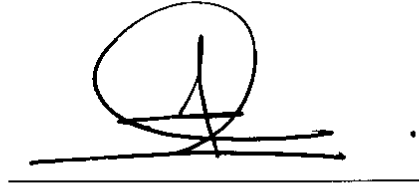
This research studies the Islamic unit trust funds, as one of the important components in the Islamic Capital Market in Malaysia, from the *Shari'ah* perspective. It examines three major aspects that differentiate the Islamic unit trust funds from the conventional funds. These aspects are the applicable contracts to the Islamic unit trust funds, the stocks screening process in Islamic unit trust funds and the purification of Islamic unit trust funds. This research employs the analytical method to analyze the data and information obtained from various sources. Samples of Islamic unit trust funds investment's contract, trust deeds and prospectuses are scrutinized in order to identify the applied Islamic principle in the Islamic unit trust funds' contract. Various contracts in Islamic law are then measured to the principles applied. As to the stocks screening process in the Islamic unit trust funds investment in Malaysia, data and information obtained are examined and compared to similar processes in other financial market practices across the globe such as the FTSE and Dow Jones Islamic Market. The principle of purification as applied in the Islamic unit trust funds investment in the Malaysian industry is studied and compared to the practices of the purification process in other jurisdictions. The finding of this research shows that in terms of the contract applied to the Islamic unit trust funds, no specific Islamic contracts are mentioned in the offering of the Islamic unit trust funds. However, the *wakālah* principle is the most suitable contract which can be associated with the offering of the funds. The screening process in the Malaysian practice, on the other hand, is more lenient compared to the FTSE and Dow Jones Islamic Market. As to the purification of the Islamic unit trust funds' income, the applied principle is that the investors have to carry out the purification process by means of *zakāt* or charitable funds.

ملخص البحث

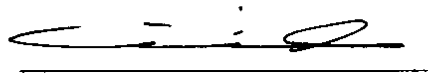
تناول هذا البحث موضوع الصناديق الاستثمارية الإسلامية، باعتبارها إحدى المكونات الهامة لسوق رأس المال الإسلامي في ماليزيا، من منظور الشريعة الإسلامية. ويدرس البحث الجوانب الرئيسية الثلاثة التي تميز الصناديق الاستثمارية الإسلامية عن الصناديق التقليدية، وتمثّل فيما يلي: العقود المطبقة على الصناديق الاستثمارية الإسلامية في ماليزيا، عملية فرز الأسهم في سوق رأس المال الإسلامي، وقضية تنقية الأرباح الحاصلة من عملية الاستثمار في هذه الصناديق. استخدم الباحث في بحثه هذا المنهج التحليلي لتحليل البيانات والمعلومات التي توفرت لديه من مصادر مختلفة، فقام بدراسة نماذج من عقود الصناديق الاستثمارية الإسلامية والوثائق المتعلقة بها والنشرات الوصفية، وذلك لتحديد المبادئ الإسلامية التي طبقت في تلك الصناديق الاستثمارية بماليزيا. أما بالنسبة لعملية فرز الأسهم فتتم دراسة هذه العملية من خلال سوق رأس المال الإسلامي في ماليزيا مقارنة مع مثيلاتها في الأسواق المالية الأخرى. أما ما يخص مبدأ تطهير الأرباح الحاصلة فيتم مقارنة هذه العملية بين ماهو مطبق في الصناديق الاستثمارية الإسلامية في ماليزيا وبين الممارسات العملية التطهيرية في البلدان الأخرى. والذي خلص إليه هذا البحث هو عدم ذكر نوع العقد المطبق في تلك الصناديق الاستثمارية الإسلامية. ومع ذلك، فإن مبدأ الوكالة هو أنسب العقود التي يمكن تطبيقها على هذه الصناديق. وعلى جانب آخر توصل الباحث إلى أن عملية الفرز في سوق رأس المال الإسلامي في ماليزيا أكثر تساهلاً مقارنة بمؤشر الفايانانشيال تايمز (Financial Times Stock Exchange) ومؤشرات داو جونز الإسلامية (Dow Jones Islamic Market). أما بالنسبة لقضية تنقية الأرباح الحاصلة من عملية الاستثمار في هذه الصناديق، فإن النظام السائد في ماليزيا يفترض أن المستثمر هو الذي يقوم بعملية تنقية الأرباح بنفسه إما عن طريق الزكاة أو الصدقة.

APPROVAL PAGE

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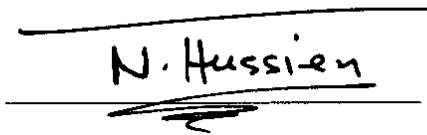
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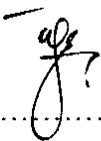
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Nasr Eldin Ibrahim Ahmad
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DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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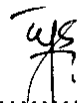
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SHARĪAH PERSPECTIVE**

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To my mother and my father who taught me how to give...

To my wife who supported me on the front line wholeheartedly...

To my daughters Syifa' and Aisyah who taught me patience and love...

To all of them I dedicate this work

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Many individuals contribute to the completion of a successful work, including the creation of this dissertation. Different members brought different thoughts, experiences, and expertise to the completion of this dissertation. I wish to thank all who made this work possible. The list of individuals who have provided support, advice, and time is extensive. Although I am not able to adequately recognise all on that list, I would like to acknowledge few of these individuals.

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LIST OF STATUTE

Securities Commission Act (1993)

Partnership Act (Act 135)

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ء	'	ض	d
ب	b	ط	t
ت	t	ظ	ẓ
ث	Th	ع	'
ج	j	غ	gh
ح	ḥ	ف	f
خ	Kh	ق	q
د	d	ك	k
ذ	Dh	ل	l
ر	r	م	m
ز	z	ن	n
س	s	هـ	h
ش	sh	و	w
ص	ṣ	ي	y

Short Vowel		Long Vowel	
اَ	a	اَ + ا	ā
اِ	i	اِ + ي	ī
اُ	u	اُ + و	ū

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CHAPTER ONE

INTRODUCTORY CHAPTER

INTRODUCTION

Since the beginning of the first revelation to our Prophet Muḥammad (peace be upon him), Islam has emphasized on distribution of wealth in a just manner. The circulation of wealth amongst the minority, as widely practised in today's capitalist economic system, has been forbidden by the *Shari'ah*. In *sūrah al-Ḥashr* Allah has said:

...كَيْ لَا يَكُونَ دُولَةً بَيْنَ الْأَغْنِيَاءِ مِنْكُمْ وَمَا آتَاكُمُ الرَّسُولُ فَخُذُوهُ وَمَا نَهَاكُمْ عَنْهُ فَانْتَهُوا وَاتَّقُوا اللَّهَ إِنَّ اللَّهَ شَدِيدُ الْعِقَابِ.¹

In order that it may not merely make a circulation between the wealthy among you. So take what the Apostle assigns to you and deny yourselves that which he withholds from you. And fear Allah; for Allah is strict in punishment.²

The failure of this capitalist system in ensuring wealth is distributed evenly between the common people is not something new to society. The instruments of interest, gambling, speculative transactions and the tools of exploiting desires of consumers to secure huge profits are allowed in the capitalistic system, which tend to create monopolies and in turn paralyze the forces of demand and supply. Ultimately, it has contributed to the inequities in the distribution of wealth. As most of the countries today have adopted the same system, we could see obviously that no poverty has been eliminated, or even the gap between the rich and the poor has been reduced.

¹ *Sūrah al-Ḥashr*, 7.

² Abdullah Yusuf Ali, *The Meaning of the Holy Qur'an* (Kuala Lumpur: Secretariat for Asia Assembly of Ulama, 2005), 510.

Islam, on the other hand, does not allow such instruments to be employed in the economic system. Islamic economic principles, as taught by the Qur'ān and Sunnah of the Prophet Muḥammad (peace be upon him), offers a system that complements the society with justice, righteousness and dignity, and enhances the community's economic well-being.

In order to achieve the above objectives, Islam has advised Muslims to invest their wealth and funds to keep them operative and to avoid the wealth being circulated amongst minority and hindered by monopolies. The use of the Islamic instruments like *mushārahah* (partnership) and *muḍārabah*, instead of interest, may provide a well considered system of distributive justice, which may eliminate the inequities and bring about a system in which profit motive works in tandem with the collective interest of society.

In the context of modern economic needs, a number of investment vehicles have been developed to help people invest their wealth and funds. One of the most common investment vehicles today is Unit Trusts.

According to modern economic theory, the main objective of an investment is to generate the highest returns within a tolerable level of risk. In order to achieve that objective, one should invest in several stocks, at least ten different stocks, or in a portfolio. By doing so the investor could enjoy the protection of adequate diversification of risks thus turn out the profits. This would require a substantial amount that is usually beyond the reach of average retail investors.³ As a result, unit trust fund is created to help investors generate capital and prevent them from “putting all their eggs into one basket”.

³ *Smart Investors*, July 2001; see also *Prospectus Public Islamic Dividend Fund*, Public Mutual, Subsidiary of Public Bank, Kuala Lumpur, 14.

With the introduction of sector funds in Malaysia since 1959⁴, investors are given an alternative in making share investment decisions. By investing in unit trusts, investors make the decision of leaving the task of investing to fund managers who monitor the stock market full time. These investment professionals also have the ability to interpret the various economic indicators and carry out investment activities with foresight.

Unit trusts also play a very important role in the Malaysian capital market. They are among the major players in the market and are believed to be able to influence small investors to the capital market.⁵ It is more appealing and provides a wider investment base for small investors. Consequently, this has created intense competition among the unit trust fund management companies in the unit trust industry. As such, more innovative unit trust products have been developed and introduced in order to attract new investors.

In view of the growing demand from Islamic investors, the Islamic unit trust funds have been introduced in the mid nineties. *Tabung Amanah Bakti* (Bakti Amanah Fund) was the pioneer of Islamic unit trusts launched in May 1971 with Asia Unit Trust Berhad as its fund manager. Over the years, despite the volatile market, the Islamic funds managed to grow 102% from a small base of RM 834 million in 1995 to RM1.6 billion in 2000.⁶ As at September 30th, 1998, there were 13 Islamic unit trusts in operation. This figure has increased to 20 in June 2002 and 34 in February 2003 that comprises mostly of equity funds and several bond funds.⁷

⁴ The history of trust funds in Malaysia dated back to the establishment of the Malaysian Unit Trust Limited in 1959. See *Banker's Journal Malaysia*, February-March, 1995.

⁵ Leong, K. H., and Khoo, L. K., Performance of Property Trusts in the Kuala Lumpur Stock Exchange, *Capital Market Review*, Vol.5, No.2, 1997.

⁶ *Smart Investors*, May 2002.

⁷ *The Edge*, February 24th, 2003.

In 2005, the figure has increased tremendously to 83 approved funds of the total 340 funds in the industry, with the total approved fund size of 50.5 billion units.⁸

In 2006, the Securities Commission of Malaysia (SC) approved 17 new Islamic unit trust funds. This brought the total of Islamic unit trust funds to 100 or 24.0% of the total of 416 approved funds. Of the Islamic unit trust funds, 50 were equity funds, 18 were *sukuk*⁹ funds, 19 were balanced funds, while the remainder were money market funds, structured products, feeder funds and fixed income funds.¹⁰

The net asset value (NAV) of Islamic unit trust funds grew at a compounded annual growth rate of 33.8% from 1997 to 2006, outstripping the industry growth rate of 15.4%.¹¹ This reflected the strong latent demand for Islamic investment products.

STATEMENT OF PROBLEM

Although Islamic unit trusts have been introduced in the Malaysian capital market for quite some time, the level of ignorance regarding the Islamic unit trust is, unacceptably, high. According to a recent study conducted on investors' perception towards Islamic unit trust funds in Malaysia, the result, among others, shows that all ethnic groups in Malaysia still lacked information on Islamic unit trusts. Consequently, the lack of information has encouraged the investors to opt for

⁸ Securities Commission Annual Report 2006, 46.

⁹ *Sukuk* is the Arabic name for a financial certificate but can be seen as an Islamic equivalent of bond. However, fixed income, interest bearing bonds are not permissible in Islam, hence *Sukuk* are securities that comply with the Islamic law and its investment principles, which prohibits the charging, or paying of interest. Financial assets that comply with the Islamic law can be classified in accordance with their tradability and non-tradability in the secondary markets.

¹⁰ Security Commission Annual Report 2006, 45-46.

¹¹ Security Commission Annual Report 2006, 46.

conventional unit trusts as their key investment, for they believe in the lower risk and higher returns it offers.¹²

Apart from that, the researcher in preparing this proposal has noted the shortage of reference materials on the subject, i.e., unit trusts from the Islamic point of view. Only a few books specifically discussed the Islamic Unit Trust in the Malaysian context. Most of the books and writings looked at the subject from a conventional perspective.

Therefore, the researcher feels that there is a need for an extensive study on the subject. As such, this research deals with Islamic unit trust, its concept, rules and regulations, from the Islamic legal perspectives and Malaysian securities laws. It examines the crucial aspects regarding Islamic Unit Trust investment, such as compliance of the stocks and performance from Islamic point of view. Finally, this research will also highlight the importance of this fund and its role to enhance the economic activities in Muslim countries, especially Malaysia.

REVIEW OF LITERATURE

The unit trust industry has been the subject of study by many researchers in the past. In Malaysia, most of previous studies were done in the 1990s by Mohamed, S. and Mohd Nasir, A., in *The Performance of Unit Trusts in Malaysia: Some Evidence* (1995)¹³, Tan in 1995, Kok and Khoo in *Performance of Property Trusts in the Kuala Lumpur Stock Exchange* (1995)¹⁴, Leong in *Unit Trust In Malaysia: Can It*

¹² Abdul Halim Mohd Ibrahim, et. al, *Investors Perception Towards Islamic Unit Trust in Malaysia*, unpublished paper, University Malaysia Sabah.

¹³ Shamser Mohd and Anuar Mohd Nassir, the Performance of Unit Trusts in Malaysia: Some Evidence, *Capital Market Review*; Vol.3, No.2, 1995, 51-69.

¹⁴ Kok, K.L., and Khoo, L.K., Performance of Property Trusts in the Kuala Lumpur Stock Exchange, *Capital Market Review*, Vol.3, No.2, 1995.

Outperform The Market? (1997)¹⁵, Leong and Aw in *Measuring Unit Trust Funds Performance Using Different Benchmarks* (1997)¹⁶, and Mohd Nawawi et. al., in *A Performance of Unit Trust Industry in Malaysia* (1999).¹⁷ These studies merely focus on the performance of conventional unit trust funds in comparison with the stock market performance where they are relevant for small investors, policy makers and practitioners in the financial industry.

The same point of study could also be found in Koh and Cheng in *An Empirical Analysis of the Performance of Unit Trusts in Singapore* (1987)¹⁸, Chua C.P. in *The Investment Performance of Unit Trusts In Malaysia* (1995)¹⁹, Ch'ng T.L. and Kok K.L. in *Performance of Unit Trusts in an Emerging Market, A Case Study of Malaysia* (1998)²⁰, Joseph H.H. Chia and Y.K. Tse in *An Empirical Analysis of the Performance of Unit Trust in Singapore* (2000)²¹, Taib F.M., et. al., in *Malaysian Unit Trust Performance* (2002)²², Low S.W. and Ghazali, N.A. in *An Evolution of Market-Timing and Security-Selection Performance of Mutual Funds: The Case of Malaysia* (2003)²³, Raja Nor Azilla Raja Kamaruzzaman in *Unit Trust Performance in Malaysia*

¹⁵ Leong, L.H., 'Unit Trust In Malaysia: Can It Outperform The Market?', Unpublished Master Dissertation, International Islamic University Malaysia, 1997.

¹⁶ Leong, K.H., and Aw, M.W., *Measuring Unit Trust Funds Performance Using Different Benchmarks*, *Capital Market Review*, Vol.5, No.2, 1997.

¹⁷ Mohd Nawawi, et. al., *A Performance of Unit Trust Industry in Malaysia (1984-1994)*, Seminar Proceeding, Business and Research Centre, MARA University of Technology.

¹⁸ Koh, F., et. al., *An Empirical Analysis of the Performance of Unit Trusts in Singapore*, *Securities Industry Review*, 13, 1987, pp. 1-13.

¹⁹ Chua, C.P., 'The Investment Performance of Unit Trusts In Malaysia', Unpublished MBA Thesis, School of Management, University Malaya, Kuala Lumpur, 1985.

²⁰ Ch'ng, T.L. and Kok, K.L., *Performance of Unit Trusts in an Emerging Market, A Case Study of Malaysia*, *Capital Market Review*, Vol.6, No.1 & 2, 1998, 1-17.

²¹ Joseph, H.H. Chia and Y.K.Tse, *An Empirical Analysis of the Performance of Unit Trust in Singapore*, 2000.

²² Taib, F.M., et. al., *Malaysian Unit Trust Performance*, Conference Proceedings, The Fourth Annual Malaysian Finance Association Symposium, 31st May - 1st June 2002.

²³ Low, S.W. and Ghazali, N.A., *An Evolution of Market-Timing and Security-Selection Performance of Mutual Funds: The Case of Malaysia*, Working Paper, Universiti Kebangsaan Malaysia, 2003.

(2003)²⁴, and Rafidah, et. al., in *The Performance of State Unit Trusts During and After 1997-1998 Currency Crisis* (2004).²⁵

Adapting either the quantitative or qualitative, or both methods of study, these researches are aimed at similar objectives, i.e. measuring the performance of unit trust investment in the capital market. The prominent differences that distinguished one from the other are the measurement tools and samples that are used.

However there has not been much research conducted on the performance of Islamic capital instruments. This is because Islamic unit trust funds are comparatively new in both the world market and Malaysia; therefore there may not be enough historical data to offer an unbiased study.²⁶ Nevertheless, the study on the Islamic unit trust that was conducted by Arbi in *The Characteristics and Performance of Islamic Unit Trust Funds in Malaysia Within the Capital Asset Pricing Model Framework* (1999)²⁷, followed by Shariff in *The Financial Performance of Islamic Unit Trusts: A Malaysian Perspective* (2002)²⁸ and Maslina Ahmad in *The Comparison of Performance of Islamic and Conventional Unit Trust Funds in Malaysia* (2003)²⁹ have provided some insight into the performance of Islamic unit trust industry in Malaysia.

Having mentioned all the earlier studies done on Unit Trust industry in Malaysia, it must be noted that all these studies were conducted under pure economics

²⁴ Raja Nor Azilla Raja Kamaruzzaman, 'Unit Trust Performance in Malaysia', Unpublished BBA Finance Project Paper, Mara University of Technology Malaysia, 2003.

²⁵ Rafidah, et. al., 'The Performance of State Unit Trusts During and After 1997-1998 Currency Crisis', Unpublished MBA Term Paper, Mara University of Technology Malaysia, 2004.

²⁶ Arbi, K. R., 'The Characteristics and Performance of Islamic Unit Trust Funds in Malaysia within the Capital Asset Pricing Model Framework', Unpublished Master Dissertation, International Islamic University Malaysia, Kuala Lumpur, 1999.

²⁷ Arbi, K.R., *The Characteristics and Performance of Islamic Unit Trust Funds in Malaysia Within the Capital Asset Pricing Model Framework*, Ibid.

²⁸ Shariff, N., 'The Financial Performance of Islamic Unit Trusts: A Malaysian Perspective', Unpublished Master Dissertation, Mara University of Technology, Shah Alam, 2002.

²⁹ Maslina Ahmad, 'The Comparison of Performance of Islamic and Conventional Unit Trust Funds in Malaysia', Unpublished Masters Thesis, Kuala Lumpur: Mara University of Technology, 2003.

approach. Thus, while the research experts studied and measured the performance of Islamic Unit Trusts, they had not had thorough and extensive discussions on its theoretical aspects.

As far as the theory of Islamic Unit Trust is concerned, there are some works done by scholars such as Ashraf Muḥammad Dawābeh in *Sanādīq al-Istithmār fī al-Bunūk al-Islāmiyyah Bayna al-Nazariyyah wa al-Tatbiq*.³⁰ The author addressed major problems in Islamic banks in his designated country with regards to the capital investments. Discussing those problems, the author suggested several solutions and the prominent one is Islamic Unit Trust. The author then discussed major characteristics of Unit Trust as an investment vehicle.

‘Abd al-Sattār Abū Ghuddah, in his study *al-Takyīf al-Shar‘ī li Sanādīq al-Istithmār wa Mashrū‘iyyatuhā*³¹, had embarked on the discussion about the Islamic Unit Trusts. The author discussed briefly in his paper the elements of unit trust and how this fund could benefit Islamic economy. He outlined numerous characteristics of Islamic unit trusts in his paper and provided a brief explanation on each character. The study however needed further explanation.

Another important work on the subject is done by Muḥammad Ṣalāh Muḥammad al-Ṣawā in his book *Mushkilāt al-Istithmār fī al-Bunūk al-Islāmiyyah*.³² The book originally was a doctoral thesis submitted to Faculty of Shari‘ah and Law, al-Azhar University and has gained “*al-sharaf al-‘ūlā*” award (a very distinguished award) from the same faculty. In this book the author discussed extensively the

³⁰ Dawābeh, Ashraf Muḥammad, *Sanādīq al-Istithmār fī al-Bunūk al-Islāmiyyah Bayna al-Nazariyyah wa al-Tatbiq* (al-Qāhirah: Dār al-Salām, 1st ed., 2004).

³¹ Abū Ghuddah, ‘Abd al-Sattār, *al-Takyīf al-Shar‘ī li al-Sanādīq al-Istithmār wa Mashrū‘iyyatuhā*, paper presented in Seminar on Unit Trust in Egypt: Present and Future. Organized by Salih Abdullah Kamil Centre for Islamic Economy, al-Azhar University, Cairo on 22nd March 1997.

³² Al-Ṣawā, Muḥammad Ṣalāh Muḥammad, *Mushkilāt al-Istithmār fī al-Bunūk al-Islāmiyyah* (Cairo: Dar al-Mujtama‘, 1st ed., 1990).