

## **Managing Halal and Haram Investment in The Case of EPF's Malaysia**

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### **ABSTRACT**

The main objective of this paper is to know the investment of EPF (Employee's Provident Fund) which are including halal and haram investment and the solution that EPF can be taken for manage their investment according Islamic Finance principles. As a provident fund, the EPF has attempted to operate as a portfolio investor and not as a promoter or a major shareholder in individual business. The EPF should be taking portfolio risk and not business risk based on the time-tested principles of portfolio management. Also the skills and resources at its disposal are better at managing portfolios (either directly or indirectly through fund managers) than at managing a diverse range of operating business. However, as domestic financial markets are under-developed and given the restrictions on international diversification, the EPF has been facing a serious constraint on the extent to which it has been able to invest in direct loans is due, for instance, to the inadequate supply of marketable securities. This increases the reliance of the EPF in an investing model that is based on market prices or contracts and hence on a system which may not be arm-length or transparent. This paper will discuss about the managing halal and haram investment in EPF since the board of director EPF was announced that EPF include both halal and haram elements, the public were quite concerned regarding their position in the investment. As a simple guide, Muslim contributors have not sinned as they do not have an option regarding the pension fund which it is the country's law and compulsory for every worker. From the Syariah point of view, we need to analyse the relationship between contributors and EPF. Hence, we need to find out the new instruments in Islamic Capital Market such as Gold Account which is relevant or not to replace the fund into gold after contributors become retired. This studies use a qualitative methods since the information provided from the secondary data for instance books, article journal, internet, newspaper, and from library. As we know, the EPF's contributors are of various age groups. As a conclusions, EPF should come out with the separate investment plan for at least three broad age groups ; one for young, a second for the middle – aged and a third for the old. To come out with separate investment plans for different age groups, the fund has to be reorganised. To ease the transition, choice can be given to the individual contributors to decide on which plan or what mix of plans they wish to opt for. The fund management under each plan can be contracted out to external fund managers for actively managed funds. On the other hand, the fund for passive management can be managed in-house, where necessary , by engaging external consultants to assist the EPF on such matters as the choice or construction of the benchmark or on how best the rebalancing of the portfolio can be effected.

Keywords: Halal and haram investments, Islamic Capital Market, EPF

### **OBJECTIVES**

The main objective of this paper is to know the investment of Employee's Provident Fund (EPF) which are including halal and haram investment and the solution that EPF can be taken for manage their investment according Islamic Finance principles.

## INTRODUCTION

### Overview on the Employees Provident Fund

The Employees Provident Fund (EPF) is a social security institution formed according to the Laws of Malaysia, Employees Provident Fund Act 1991 (Act 452) which provides retirement benefits for members through management of their savings in an efficient and reliable manner. It also provides other supplementary benefits such as pre-retirement at the age of 50 years to utilize 30% of their savings for house ownership, medical expenses, education for children and investment option schemes leaving the other 70% to be given once they reach the age of 55 years.

### MANDATORY CONTRIBUTION

The EPF members are the Private and the Non-Pensionable Public Sector employees. All employees in Malaysia who have reached the age of 16 and employed under a contract of service must contribute to the EPF. Usually the employer will contribute a proportion of the employee's wages and the employee contributes another proportion of his/her monthly wages towards the employee's account. As realized from the table above the rate of contribution varies from year to year according to the economic situation and according to the government decision.

### Current Investment of EPF

Currently all collected funds from the contributors of EPF are invested in a number of approved financial instruments in order to generate income. These financial instruments are; Malaysian Government Securities, Money Market Instruments, Loans & Bonds, Equity and Property as highlighted in the table below. The investment returns together with the principal are then paid to members on his/her retirement. These Fund's investments are guided by acts, policies, guidelines and processes in carrying out its investment function.

The Malaysian economy emerged from the tumultuous 2009 to make a strong recovery in 2010 to enable the EPF to deliver its best ever performance, yielding an impressive RM22.04 billion net investment income. The key performance was the fruition of the EPF's move in diversifying its maturing fixed income instrument investments into higher yielding assets such as equity to capitalise on the opportunities of a recovering economy. In addition, the year 2010 saw the EPF's total investment asset spurring pass the RM400 billion-mark to register an asset size of RM440.52 billion as at 31 December 2010. Over the course of 2010, the EPF's weightage in Fixed Income Instruments was gradually decrease as maturing assets were shifted into higher yielding instruments amidst the prevailing low interest rate regime. However, the majority of EPF's investments remained in fixed income assets with 32.47 per cent in Loans and Bonds and 26.90 per cent in Malaysia Government Securities. Equities emerged as the single largest asset class comprising about one third or 34.76 per cent of total assets, while the remaining 5.45 per cent and 0.42 per cent were invested in Money Market Instruments and Properties.

The year also marked the milestone of the EPF embarking on investing in global bonds and the completion of EPF's approved investments under the Malaysian International Islamic Financial Centre programme comprising US\$2 billion in overseas *Shariah*-compliant equity and global *sukuk* mandates. The EPF had also ventured into global properties investments with the purchase of three commercial buildings in London as at March 2011. The year 2011 is forecasted to be another year of growth with the uptrend picking up pace in the second half of the year mainly propelled by domestic demand when various projects under the Economic Transformation Plan (ETP) and the 10th Malaysia Plan take off while receiving a boost from the recovering external demand. According to this scenario, the EPF will again source for opportunities to further widen its investment reach for potentially high-yielding assets to again harvest a commendable income from the 2011 investments. As at 31 March 2011, the EPF's total investment fund stood at RM450.26 billion with the asset allocation as follows :

### ASSET ALLOCATION ISSUES

According to the Table 2 and Table 3, mostly the name of company are listed are Syariah non-compliant securities. This shows that EPF make some investment in conventional investment sources

and we know that many contributors in the EPF are Muslims, especially in Malaysia. Based on the Securities Commissioner Malaysia (SAC) has implemented a standard criterion in focusing on the activities of the companies listed on Bursa Malaysia. As such, subject to certain conditions, companies whose activities are not opposite to the *Shariah* principles will be classified as *Shariah*-compliant securities. On the other hand, companies will be classified as *Shariah* non-compliant securities if they are involved in the following core activities:

- (a) Financial services based on *riba* (interest);
- (b) Gambling and gaming;
- (c) Manufacture or sale of non-halal products or related products;
- (d) Conventional insurance
- (e) Entertainment activities that are non-permissible according to *Shariah*
- (f) Manufacture or sale of tobacco-based products or related products;
- (g) Stockbroking or share trading in *Shariah* non-compliant securities; and
- (h) Other activities deemed non-permissible according to *Shariah*.

The SAC also takes into account the level of contribution of interest income received by the company from conventional fixed deposits or other interest bearing financial instruments. In addition, dividends received from investment in *Shariah* non-compliant securities are also considered in the analysis carried out by the SAC. For companies with activities comprising both permissible and non-permissible elements, the SAC considers two additional criteria:

- (a) The public perception or image of the company must be good
- (b) The core activities of the company are important and considered *maslahah* ('benefit' in general) to the Muslim *ummah* (nation) and the country, and the non-permissible element is very small and involves matters such as *umum halwa* (common plight and difficult to avoid), *uruf* (custom) and the rights of the non-Muslim community which are accepted by Islam.

To determine the tolerable level of mixed contributions from permissible and non-permissible activities towards turnover and profit before tax of a company, the SAC has established several benchmarks based on *ijtihad* (reasoning from the source of *Shariah* by qualified *Shariah* scholars). If the contributions from non-permissible activities exceed the benchmark, the securities of the company will be classified as *Shariah* non-compliant. The benchmarks are :

**(a) The five-percent benchmark**

This benchmark is used to assess the level of mixed contributions from the activities that are clearly prohibited such as *riba* (interest-based companies like conventional banks), gambling, liquor and pork.

**(b) The 10-percent benchmark**

This benchmark is used to assess the level of mixed contributions from the activities that involve the element of "*umum balwa*" which is a prohibited element affecting most people and difficult to avoid. For instance, a contribution is the interest income from fixed deposits in conventional banks. This benchmark is also used for tobacco-related activities. *Shariah*-compliant securities include ordinary shares, warrants and Transferable Subscription Rights (TSRs). This means that warrants and TSRs are classified as *Shariah* compliant securities provided the underlying shares are also *Shariah*-compliant. On the other hand, loan stocks and bonds are *Shariah* non-compliant securities unless they are issued based on *Shariah* principles. As a guide to investors, the SAC would like to advise investors on the timing for the disposal of securities which have been classified as *Shariah* non-compliant.

## EPF'S INVESTMENT ISSUES

When the Vive CEO of the Malaysian EPF wrote a formal letter gave explanation that EPF include both halal and haram elements, the public were quite concerned regarding their position in the investment. As a simple guide, Muslim contributors have not sinned as they do not have an option according the pension fund which it is the country's law and compulsory for every worker. From the *Syariah* point of view, we need to analyse the relationship between contributors and EPF. The following analysis will clarify whether it is a saving method or an investment scheme :

1) The name of the fund itself.

Employee's Provident Fund (EPF) is clearly indicates a savings scheme. Even the website indicates a saving rather than an investment scheme. In the websites also not mentioned that EPF is a fund manager. Rather is stated that EPF acts as a saving management institution. Therefore, we are not investing our money each time we place premiums with the EPF. It is true that EPF mentions investment allocation in their website as in the Table 2, Table 3 and Table 4.

This, from a *Syariah* point of view, is considered an additional contract which is an initiative by EPF to manage our savings. Therefore, the primary relationship between the contributor and EPF is a savings relationship and does not change into an investment relationship. On that basis, I believe that the relationship between the contributor and EPF is on the basis of *wadiah* ( saving for old days). Thus it is responsibility of EPF to guarantee our savings for usage during our golden age. If they do not provide this guarantee, then it contradicts their role as a savings management institution. If EPF gains any return, they would distribute the dividends to the contributors. From the *Syariah* perspective, this dividend is known as *hibah* or gift to the contributors. The only concern that arises here is whether we can accept and use the dividend received EPF. Since EPF has mixed investments, a portion of the dividend (based on haram investment) must be given to charity. We are free to use the principal portion and dividend from halal investments.

## PROBLEMS IN MAKING INVESTMENTS IN ISLAMIC ECONOMIC FINANCIAL

### Limited Asset Classes

Nowadays, limited asset classes make it difficult for existing distributors to remain profitable given the reliance on the money markets as an asset class. To be compared to fixed income from capital markets, equity returns could provide distributors with much higher rates of return. Yavar Moini, Senior Advisor, Global Capital Markets of Morgan Stanley, Dubai, UAE said that from the capital market perspectives, we should need more products, more different types of *sukuk* structures, greater depth of the Islamic debt capital market and more money market products to expand our economics by using the instrument of Islamic finance. He also added that there should be more standardisation in Islamic finance instruments to enhance the prospects of the finance sector. Yavar also stressed the importance of having a greater secondary market in the Islamic finance sector. Beyond this, the restraint number of Islamic funds and investment asset classes is a major constraint for the growth of the sector especially in Malaysia.

### Lack of Product Offerings

The reason why EPF not invest more in Islamic instrument because of the lack of the products. The Islamic products for wealth distribution are also largely under-developed. The limited offerings available are based on basic *Fiqh* concepts that are accepted under existing civil laws whereas conventional products are comparatively more developed and have greater variety. The KFH said before, the concept of trust can be applied to various objectives for instance living trust, family trust, education trusts, and unit trusts. A conventional trust deed does not confine the assets settled to be *Shariah*-compliant which is not listed at Security Commissioner Malaysia.

## THE RULING ON DISTRIBUTION OF EPF (THE EMPLOYEES PROVIDENT FUND) MONEY TO CONVERTED MUSLIM

According to the 61<sup>st</sup> Muzakarah (Conference) of the Fatwa Committee National Council of Islamic Religious Affairs Malaysia held on 27th January 2004 has discussed the ruling on distribution of EPF money to converted Muslim. The Committee has decided that:

1. According to Islamic law, non-Muslim does not inherit from Muslim and vice versa.
2. If a Muslim convert has EPF savings and has nominated a non-Muslim as the nominee, he/she has to change the nominee to other Muslim nominee. If there is no Muslim nominee and no Muslim heir entitled to the property, the property should be given to the Baitul Mal and it is not the property of the non-Muslim heirs.
3. Muslim can make a will for non -Muslim but not more than 1/3 of the property

### Definition of Islamic investment and services

Malaysia offers a holistic set of Islamic capital market infrastructure, including products, stockbrokers, trust funds and debt securities (*sukuk*). Currently, there is one full-fledged Islamic stockbroking company and two conventional stockbroking companies that provide Islamic windows in the Islamic capital market. In fulfilling the specific needs of private investors, there are also asset management companies that manage funds in accordance to the Shariah principles. These funds offer various investment mandates and invest in Malaysian and foreign capital markets, and are open to eligible local and foreign investors. (R.Thillalinathan, 2003)

In our efforts to continuously increase the breadth of Islamic capital market investment offerings, the world's first Islamic real estate investment trust (Islamic REIT), the *Al-'Aqar* KPJ REIT was listed on Bursa Malaysia on 10 August 2006. It was set up by KPJ Healthcare which injected six of its hospitals into the fund. The 2nd Islamic REIT, the world's 1st Islamic Plantation REIT called *Al-Hadharah* Boustead REIT was subsequently listed on Bursa Malaysia in early 2007. MyETF, Asia's 1st *Shariah* compliant Exchange Traded Fund (ETF) was listed on Bursa Malaysia on 31 January 2008. MyETF tracks the Dow Jones Islamic Market Malaysia Titans 25 Index (MyETF DJ) and comprises a blue-chip index tracking the 25 largest listed Malaysian companies that comply with *Shariah* investment guidelines. More Islamic REITs and ETFs are anticipated to deepen the offerings as these are attractive asset classes for investors who seek diversification.

### **PROPOSAL FOR ISLAMIC INVESTMENT FOR EPF**

Such as that we already know, Malaysia country is heading towards Islamic Economic Finance growth with the growing need of Islamic finance it is also important to Islamize the EPF investment portfolio and make it *shariah* compliant. This can be done by creating an Islamic investment division within the EPF investment structure that looks after the Islamic investment. (R. Thillalinathan, 2000)

### **REVISING THE STRUCTURE OF THE INVESTMENT PORTFOLIO**

The investment portfolio of EPF can be structured according to a new strategic asset allocation by creating a dual investment portfolio, whereby the fund collected by EPF is separated into two different pool of fund conventional and Islamic, and invested in the market accordingly. The management of the pool can be done at the early stage during the opening of the account, whereby EPF grant the choice to the member to select the type of their investment they want (whether conventional investment or Islamic investment). The mentioned choice provided will enable the members to make their choice and participate respectively to the establishment of the fund from an Islamic investment. The dual investment will be according to the following strategic asset allocation:

### **PROPOSED INVESTMENT STRUCTURE**

According to the investment structure highlighted in Figure 1, the members of EPF will have the chance to invest their fund through Islamic investment instruments, whereby the EPF produced two different pool of fund through two separated accounts, a conventional account and Islamic account. Each account will be channel to different pool of fund that will be investment according to the nature of the account. Therefore fund mobilized under the Islamic account will be invested in *Shariah* compliant products and instruments, which make the return and profit generated permissible and acceptable from *Shariah* perspective. The list of *Shariah* compliant instruments that can be used for investment is as follows:

- Malaysian Government Islamic Securities
- Islamic Bonds / *Sukuk*
- Islamic Money Market Instruments
- *Shariah* Stock
- Islamic Property
- International Islamic Investments

In addition to the above list of products, EPF may select other types of Islamic products offer in the market such as Islamic structured products in order to diversify the investment portfolio when it is needed. *Shariah* governance can be addressed as well when it comes of the Islamic investment, whereby EPF is advised to have a *Shariah* advisory committee on the matter related to the Investment to ensure *Shariah* compliance procedure in the investment, and bring confident to the members of EPF and credibility to the investment structure.

### ISLAMIC INVESTMENT UNDER *SHARIAH* GOVERNANCE FRAMEWORK

The *Shariah* committees will only advice on the Islamic investment portfolio and guide the performance of the investment as shown in Figure 2. Besides that, to provide advice and guideline to the matter related to the investment of the fund when it is needed the incorporation of *Shariah* governance structure into the investment structure will ensure the *Shariah* compliance in the investment. (R.Thillalinathan, 2000)

### CONCLUSION AND RECOMMENDATION FOR FUTURE RESEARCH

As we know, the EPF's contributors are of various age groups. So the minimum EPF should do is to come out with the separate investment plan for at least three broad age groups; one for young, a second for the middle – aged and a third for the old. To come out with separate investment plans for different age groups, the fund has to be reorganised. To ease the transition, choice can be given to the individual contributors to decide on which plan or what mix of plans they wish to opt for. The fund management under each plan can be contracted out to external fund managers for actively managed funds. On the other hand, the fund for passive management can be managed in-house, where necessary, by engaging external consultants to assist the EPF on such matters as the choice or construction of the benchmark or on how best the rebalancing of the portfolio can be effected.

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TABLE 1: Contribution Rates

Year	Employee (%)	Employer (%)	Total (%)
1952-Jun1975	5	5	10
Jul 1975-Nov1980	6	7	13
Dec1980-Dec1992	9	11	20
Jan 1993-Dec 1995	10	12	22
Jan 1996-Mar 2001	11	12	23
Apr 2001-Mar 2002	9	12	21
Apr 2002-May 2003	11	12	23
Jun 2003-May 2004	9	12	21
Jun 2004-Dec 2008	11	12	23
Jan 2009-Dec2020	8	12	20

Sources: [http://www.kwsp.gov.my/index.php?ch=p2reports&pg=en\\_p2reports\\_statistic&ac=1015](http://www.kwsp.gov.my/index.php?ch=p2reports&pg=en_p2reports_statistic&ac=1015)

CHART 1: Breakdown of Asset Allocation for 2010  
Asset Total: RM442.52 Billion

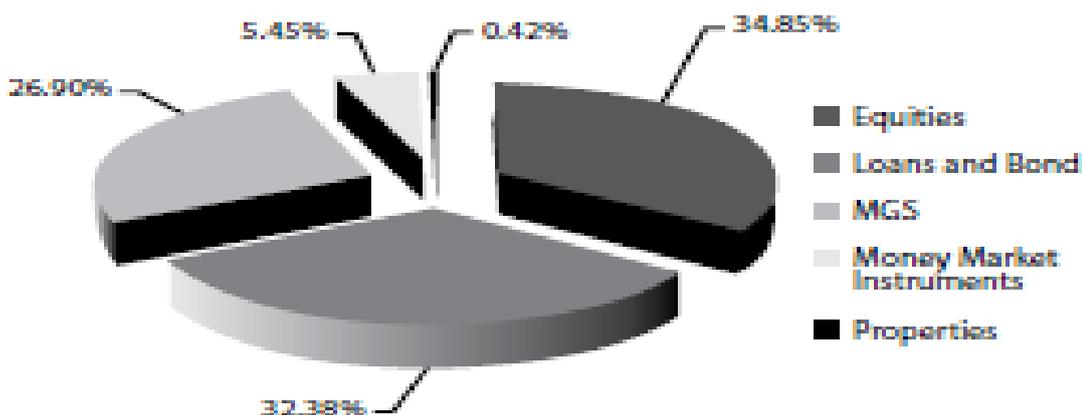


TABLE 2: List of EPF’s Top 10 Equity Investments by Percentage Holdings as at 31 December 2010

NO	COMPANY	HOLDING (%)
1	Malaysian Building Society Bhd	66.4
2	RHB Capital Bhd	48.0
3	Malaysian Resources Corporation Bhd	41.58
4	Media Prima Bhd	20.90
5	WCT Bhd	18.47
6	Cycle & Carriage Bintang Bhd	17.19
7	IJM Corporation Bhd	16.90
8	Digi.Com Bhd	16.83
9	Genting Plantations Bhd	16.24
10	UMW Holdings Bhd	16.00%

TABLE 3: List of EPF's Top 10 Equity Investments by Market Value as at 31<sup>st</sup> December 2010

NO	COMPANY	MARKET VALUE (RM BILLION)
1	RHB Capital Bhd	9.03
2	CIMB Group Holdings Bhd	8.70
3	Malayan Banking Bhd	7.97
4	Sime Darby Bhd	7.37
5	Axiata Group Bhd	5.96
6	Tenaga Nasional Bhd	5.17
7	Public Bank Bhd	5.06
8	IOI Corporation Bhd	4.54
9	MISC Bhd	4.14
10	Petronas Chemical Group Bhd	3.32

TABLE 4: The EPF's Total Investment Fund at 31<sup>st</sup> March 2011

Types of Investments	RM billion	Asset Allocation (%)
Malaysian Government Securities	125.15	27.79
Loans and Bonds	145.51	32.32
Equities	160.05	35.55
Money Market Instruments	17.71	3.93
Property	1.84	0.41
<b>Total</b>	<b>450.26</b>	<b>100.00</b>

Table 5: Strategic Asset Allocation

Type Investment	Market Space	Strategic Asset Allocation (%)	Variation (%)
Conventional	Malaysian Government Securities	-	-
<b>Islamic</b>	<b>Malaysian Government Islamic Securities</b>	-	-
Conventional	Loans and Bonds	-	-
<b>Islamic</b>	<b>Islamic Bonds / Sukuk</b>	-	-
Conventional	Money Market Instruments	-	-
<b>Islamic</b>	<b>Islamic Money Market Instruments</b>	-	-
Conventional	Equities	-	-
<b>Islamic</b>	<b>Shariah Stock</b>	-	-
Conventional	Property	-	-
<b>Islamic</b>	<b>Islamic Property</b>	-	-
Conventional	International Investments	-	-
<b>Islamic</b>	<b>International Islamic Investments</b>	-	-

FIGURE 1: EPF Investment Portfolio

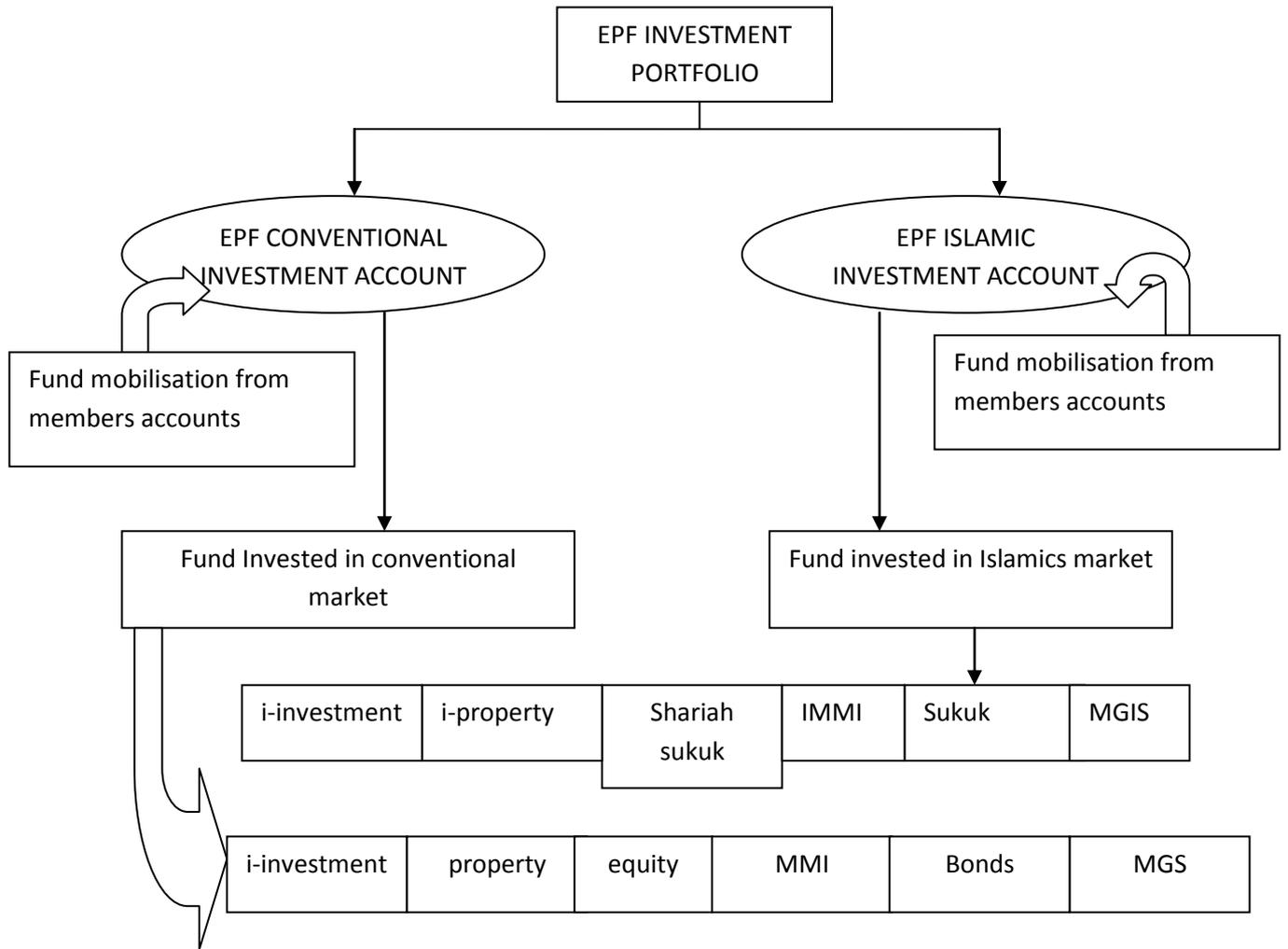


FIGURE 2: EPF Investment Portfolio & Shariah Governance Framework

