Does DCR relate to Islamic investment accounts?

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PROFIT motivation is one of the contributing factors that can lead to the sustainability and humanisation of Islamic banking from 1983 until today.

As for Islamic banks, the formed banking activities are not only in compliance with Shariah but also engendered profit that helps to optimise their potentials. The banks are asked to pay their staff a competitive rate, explaining why the profit-making is still essential for sustainability. Tellers are fundamental in driving the bank towards efficiency and competitiveness.

As for customers, their patronisation towards deposit products sourced from the financial incentives offered voluntarily and pre-determined for hiba (gifts) as well as the agreed lucrative profit rate, respectively. One of the issues related in this case is Displaced Commercial Risk (DCR)?

Two issues are shared. Issue #1 – What is DCR? Issue #2 – Does DCR still relevant after the introduction of the Islamic Financial Services Act (IFSA) 2013?

In conceding the profit taking by Islamic banks, there are two popular Islamic legal maxims, that provide judged appraisals whether certain banking operations should be compensated with a fair amount of profit or not. These include al-ghunmu bi al-ghurmi that denotes profit bears risk and al-kharaj bi al-dhaman that denotes profit depends on the loss or liability. Both signify that the entitlement to a return is related to the liability of risk. Simply put, if there is no risk, there shall be no gain – acknowledging risk for the approved justification of earnings in any economic venture.

These maxims are in tandem with Islamic investment accounts, presently available in Malaysia after it is captured in the IFSA 2013. For time being, the market share for Islamic investment accounts is stood at 4.74 per cent.

The well-versed clients understand that the taking of Islamic investment accounts will allow improved returns, higher than average but at the same time can consider losses when the venture has not shaped accordingly for the deliberation of risks linked to the nature of the business involved. More importantly, it is within the ambit of Shariah.

By definition, Displaced Commercial Risk (DCR) is referred to as the inability of Islamic banks to pay a competitive return to their depositors and investors in comparison to their conventional peers. This risk arises when the banks are incapable to produce adequate profits to pay their depositors and investors a competitive rate.

Hence, depositors and investors tend to move their funds to banks that can pay better results – be they Islamic or conventional banks. Generally, DCR is both occurred at two levels – deposit and investment products.

The introduction of the IFSA 2013, however, has differentiated "deposits" from "investments". The IFSA addresses that when a principal amount is guaranteed – it is therefore recognised as "deposit". When a principal is not guaranteed – it is therefore called as "investment".

The deposit products offered by Islamic banks are still subject to DCR, explained that conventional banks may lead the race if they offer a very competitive interest rate both for savings and fixed accounts.

It might also explain other Islamic banks that offer competitive hiba rate for savings and current accounts will be a priority and therefore rule the market. The same goes to a competitive profit rate for a tawarruq-based fixed deposit that can make a client stay calm within the realm of the system.

Given the new thought, Islamic investment accounts are no longer related to DCR. All techniques used to mitigate the risk like hiba, waiver of bank's profit share and the use of profit equalisation reserves (PER) are no longer in existence and phased out from the practice in governing the profits and losses related to the investment accounts.

Competition is opened to both Islamic and conventional banks, grounded on the betterment of their reward structure that creates a competitive weapon to a bank that has learnt it accordingly. The current financial landscape may suggest Islamic banks will earn added pressure when the offered deposit and investment products have lagged in terms of financial return to their clients. The competition is extended to both intra-competition and inter-competition.

DCR occurs at both Islamic banks and their conventional peers at varying degree of implications depending on how significant are the offered current, savings and fixed accounts (CASAFA) to them.

Since the introduction of the IFSA 2013, Islamic banks are no longer considered DCR as important, due to the principle of investment – high risk, high return in which the reward of the risk-taking has a stimulus to deny the capital protection of the investment accounts.

Yet, a fallacy exists in that DCR is still related to Islamic investment accounts and if the worst comes to the worst, some considered Islamic fixed deposits as Islamic investment accounts whilst they are not in tandem. Islamic investment accounts are not subject to DCR but Islamic fixed deposits are subjected to DCR.

The profit motivation for investment accounts is acknowledged by investors to earn greater returns whilst compromising an acceptable amount of risk. Investors weigh marginal view pertinent to the profit sourced from the investment instead of expecting some blessing points drawn from Islamic banks to give them financial rewards, which are unrelated to their actual investment ventures.

Still, the offered CASAFA structured according to qard and tawarruq is profitable, safe, secured and for that provide strengthened weightage to secure place in the marketplace. The offered Islamic investment accounts offer value-added to the industry that provides over the average return than that of Islamic CASAFA and their conventional counterparts.

To sum it up, the role of DCR for Islamic investment accounts has been minimal and somewhat eroded but considered indispensable for both Islamic CASAFA and their conventional counterparts, where the healthy competition is brought into play, at least.

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