Overview of the unit trust industry in malaysia finance essay

In general, a unit trust is a collective investment plan where the money or capitals invested by the investors are combined into a legally formed trust fund. The money is managed by the professional fund managers acting on behalf of the investors. Unit rust investment offers reasonable amount of return with minimal risk. It is managed by qualified management team at minimal cost, minimizing, liquidity and capital appreciation.

The money received will be pooled and to be invested in a single diversified investment portfolio which consists of stocks, bond, money market instruments, properties and others in line with the fund's investment objective. Unit trusts are designed to provide an opportunity for individuals to invest relatively small amounts of money in a diversified portfolio. There are several general management groups such as PNB which manage a large number of unit trust funds created for a variety of different purposes and which offer specialist funds for investment overseas or in particular sectors or markets. Some of these have a specific flavor, such as environmental or ethnic content. Besides the various types of management group, unit trusts differ in their investment objectives. A number of categories are publicized and an indication of the range of specialties

Despite high returns by doing direct investment in the stock market, it is exposed to high degree of risk. Moreover, it requires considerable amount of time, knowledge and expertise to invest in the stock market and require wide range of financial and investment research and analysis, up-to-date economic reports and statistics, a defined and planned investment strategy and a good sense of timing. On top of that, a lot of time is spent subsequently in monitoring the investment, assessing its performance and from time to time deciding whether to change your portfolio of investment with every new corporate development or change in the market and economic condition. As such, the entire hurdles can be avoided by investing in the unit trust as it offers a more convenient and simpler method of investing than direct investment as the issue of selecting investment instrument being managed by the professionals. The professional will monitor the market trends closely and to ensure the investment bring good returns to the investors.

Unit Trust may not be a channel forgetting rich quickly, but investments in them are long-term growth avenues with many advantages just mentioned. In short, major advantages of investment through Unit Trust are:

economies of scale of operations,

spread of risk,

expert and professional management,

diversification of portfolio,

freedom from housekeeping,

low brokerage and transactions costs, and

good portfolio performance.

However, there are also some of disadvantages of investing in units trust as follows:-

load fee – sales charge when the unit is sold

high annual expense – the management fees is very expensive

transaction cost – management companies incur high expenses in purchasing large block of investment instrument.

The administrative charges and legal costs which will lower the price at which units will be bought and raise the price at which units will be sold. Managers usually have some discretion in the method of calculating the price of units so that like the bid/offer quotation of the stock market, the bid/offer prices of the unit trust will reflect the views and current stock position of the management. The bid prices will usually differ by about 5% to 7% from the offer prices.

Many unit trusts also offer ancillary services such as:

saving schemes for regular monthly investment in units,

some life insurance scheme whereby investment in units is linked to the regular, monthly or quarterly payment of premiums on a life policy,

a share exchange scheme,

a personal loan scheme, and

an automatic reinvestment of income distributions.

OVERVIEW OF UNIT TRUST INDUSTRY IN MALAYSIA

In Malaysia, unit trust industry started early in 1959 when the first unit trust named Malaysian Unit Trust managed by Malayan Unit Trust Limited was introduced. In 1963, the Malayan Unit Trust was transferred to the South East Asia Development Corporation Berhad. Later, the Singapore Unit Trust Limited and Asia Unit Trust Berhad were as a result of separation from this company.

In 1968, Amanah Saham MARA Unit Trust Management was established in 1968. The fund aimed to pool bumiputra savings, mainly from the rural areas. The introduction of the funds was so encouraging during that year. Amanah Saham MARA Unit Trust Management Berhad and Asia Unit Trust Berhad largely dominated the industry back in 1970’s.

The expansion continued on April 20, 1981 when Permodalan Nasional Berhad (PNB) first introduces Sekim Amanah Saham Nasional. It was aimed to mobilize the savings and increase the corporate wealth of the bumiputra as according to the New Economic Policy. The fund from the unit trusts was largely invested into the various companies ran by bumiputra. As a result of this, PNB managed to attract about 170, 000 of bumiputra to participate, just a week after it was launched. A week after that, about 1 million bumiputra invested in the Amanah Saham Nasional which worth RM600 million. This is a record for the unit trust industry since its establishment. Later, the government believed unit trust could be a powerful tool to abolish economic differences among races.

The growth in economy in 1990s as a result of growing per capita income, new international ventures, corporatization, rising consumer affluence, booming stock market and such reflects a greater heights of growth for unit trust industry.

The government is very concerns about the growth and development of the industry. So, they introduced several regulatory frameworks and body to monitor the industry. Securities Commission (SC) was established in March 1, 1993 as a regulatory agency to monitor all the unit trust transaction within the market. Among their role is to rationalize and strengthen the fragmented regulatory framework in the industry

Diagram 1

ORGANISATION OF UNIT TRUST/MUTUAL FUNDS

Mutual funds have a typical organization in which key parties or players or special bodies or constituents are involved. They are:

Trust Deed

Trust Deed involve the agreement that connect 3 main parties namely the Unit Trust Management companies, the trustee and the unit trust fund's investors (unit holders) to the deed. This agreement need to be registered with the Securities Commission.

Trustee

A trustee is trustworthy institutions appointed by the deed of trust to ensure the interest of unit holder is being safe guard. In addition, the trustee is also require to ensure the management company will comply with regulation set by Securities Commission guidelines on Unit Trust Funds and Securities Commission (Unit Trust Scheme) Regulations 1996. The trustee is also to ensure that the fund managers will only invest the fund based on the trust deed. The trustee can be the Public trustee of Malaysia or any independent trustee of Malaysia or any independent trustee companies.

Management Company

The Management Company is the promoter of the hub to the public and provides investment expertise to manage the fund and responsible to ensure the fund being invested based on its objective. The management company also advertises the sale of units, although the terms and claims made in the advertisement are monitored by the trustee to ensure that no misleading information is given to the investing public. There are units which are not allowed to advertise, and these may be formed for specialist investment or for a group of private investors wishing to pool their resources. To distinguish between the types of unit trust, the term authorized is used in respect of those trusts whose activities have been authorized by the Department of Trade and Industry. Authorization involves acceptance of restraints on investment policy as regards the concentration of assets in one investment or the type of asset held.

Investors or Unit holders

The Investors is the one who purchase the trust or provide the capital to the trust. The investors are expecting the return from their investment in the trust. Once they purchase the trust, they can also sell the trusts back to the management company.

In general, the investors of unit trust consist of retail investors who are have limited time and knowledge know how to invest directly into investment portfolio. A part from that, the investors also consist of for those looking for long terms investment for future requirement i. e. during retirement as unit trust is considered save investment with good return.

MODUS OPERANDI OF UNIT TRUST

A unit trust fund works by pooling the financial resources of individual or institutional investors for the purpose of making large-scale investments in a selected portfolio of Permitted Investments. The following is the modus operandi of unit trust.

1.

The investor reads the Prospectus, completes the application form and returns it with his / her application money.

2.

The Trustee receives the investor’s money, pools it with other investors’ money and

purchases investments selected by the Manager. The Manager issues statements of investment to investors showing the number of units purchased in the Fund.

3.

The Manager looks after the day-to-day management and administration of the Fund’s investments to ensure optimal returns.

4.

The Fund’s investments are valued daily and the capital growth achieved is passed on to the investors through an increase in the value of units.

The Trustee distributes profits from the Fund annually through cash dividends and/or by issuing additional units to investors.

The investors receive the cash dividends or if he/she so decides to build up his/her investment, he/she can use the dividends to purchase additional units in the Fund.

The Parties Involved In a Unit Trust Agreement

The tri-partite relationship between the Manager, the Trustee and the Unit holder is legally bound by the terms and conditions specified in the Trust Deed.

The principal legislative body governing the establishment, operation and administration of unit trust funds is the Securities Commission (SC).

Federation of Malaysian Unit Trust Managers (FMUTM) handles registration of persons dealing in unit trusts. For more information, please refer to www. fmutm. com. my.

The principal laws and regulations that govern the unit trust industry are the Securities Commission Act 1993, the Securities Commission Guidelines on Unit Trust Funds and the Securities Commission (Unit Trust Scheme) Regulations 1996.

The other governing legislatures are the Securities Industry Act 1983, the Companies Act 1965 and the Futures Industry Act 1993.

TYPES OF UNIT TRUST FUNDS

There are 2 types of unit trust management the managed and unmanaged companies. The managed company consists of Open-end Management and Closed end Management company respectively. Meanwhile, the unmanaged company is known as Unit Investment Unit

Open-End Fund

Open End fund is also known as mutual funds. This type of unit trust is the most popular form of Management Company among the investor. The name of open end is derived from their modus operandi that allows the owner of the trust to sell the shares back to the company at any time required. The number of units can be created by the management company to meet the demand. The Open end is legally obliged to buy back the shares.

The price of the unit is not determined by the normal share price which is based on supply and demand but based on Net Asset Value (NAV) which is calculated on daily basis.

The following is how the calculation of NAV is been done.

NAV is determined by taking the total market value of all investment held by the fund less any liabilities and divided by the number of units on issue.

NAV = Value of Assets – Liabilities

No of units outstanding

Example

A unit trust company issued 300 million units at RM1. 0 each. After several months, it was fully subscribed by all the investors. The manager of the funds plan to segregate the investment into 70% on stocks, 15% on bonds and the remaining money of 15% to be invested in the money market.

After one year, the returns obtained from the investment are as follows:-

Shares – 18%, Bond – 13% and money market -8%. What is the new NAV

300 million units @ 1. 00 = RM300. 0 million available for investment

Investment

Stock market – 70% of RM300m = RM210m

Bonds – 15% of RM300m = RM45m

Money market- 15% of RM300m = RM45m

Total Investment RM300m

Return after one year

Stock market – 18% of RM210m = RM37. 8m

Bonds – 13% of RM45m = RM5. 85m

Money market- 8% of RM45m = RM3. 6m

Total RM47. 25

NAV = Value of Assets – Liabilities

No of units outstanding

RM300m + RM47. 25

=

300 m

= RM1. 16

Note :- Price of unit trust fund is based on the NAV. Nevertheless, the highest price that can be sold is 10% above the NAV. Meanwhile the lowest price that can be sold is 5 cents below NAV. Fund Manager is allowable to determine the price to be sold within the range.

Closed- End Fund

This type of fund was introduced on November 1995 when SC released the guidelines for the Public Offering of Securities of Close- end funds.

Closed-end fund is different from opened-end fund as the price of the fund is not based on the NAV. Closed end fund is a company which its principle business activities of investment based. The Management Company will collect funds from the public through IPO and utilize the fund by investing in the stock market. It is called closed-end fund because it issued a predetermined number of shares during the particular period (during IPO) and will not buy back the units from the public. As a result, the unit holders will only be allowed to buy or sell the shares through a licensed broker which normally the remisier. As such, the price of closed end fund will be depending on the supply and demand as other shares listed on Bursa Malaysia such namely Maybank, Air Asia, RHB Bank and others.

CATEGORIES UNIT TRUST FUNDS

Equity Funds

These funds primarily invest in the stock market. Equity funds expected to offer a high yield of return however its expose high level of risk. The examples of Funds that are categorized under equity funds are Growth and Index funds respectively.

Income Funds

The selection of investment instrument is only focusing towards fixed income securities that offering high dividend yield. In general, these funds have lower risk as compared to equity fund and the investors of these funds are expected to earned yearly dividend.

Balanced Funds

As reflected by the fund’s name, Balance Funds is offering a combination return of both current income and long term capital gains. These funds will invest on both investment instrument of equity and fixed income shares. The portfolio of investment will include bonds, preferred shares and ordinary shares. This fund is suitable for those who prefer tolerable average risk.

Growth fund

The investors that purchased these funds are expected to earn capital gain and long term growth on their investment. These funds are very unlikely to give good dividend yield as the money needs to expand the business for long terms prospect.

Aggressive growth Fund

This is highly speculative and seeks substantial return from capital gains. These Funds will select small capital stock that have high prospect for long term growth. In addition, the selection of stock will also include under value stock i. e. low P/E ratio as compared to the industry average. In general, this fund is more riskier that normal growth fund.

Bond Funds

This fund is only invested in fixed income /debt instrument namely bond. Thus is offer fixed level of current income. These funds are considered very safe / low risk but the return is also very low in conjunction with the risk .

Islamic Funds

This fund is only allowed to invest in shares which comply with shariah principles. As such, any stocks that violate shariah principles i. e. involved in interest, gambling, liquor etc is not permitted to be invested.

ISLAMIC UNIT TRUST

The Islamic unit trust schemes are collective investment funds which offer investors the opportunity to invest in a diversified portfolio of Shariah-compliant securities which are managed by professional managers in accordance with the Shariah. The trusts are offering similar categories of fund as conventional funds i. e. growth, balance, income and etc

The only difference is that Islamic Unit Trust only invests in companies that are in compliance with the Shariah principles as outlined by the Shariah Advisory Council (SAC) of the Malaysian Securities Commission. The Islamic unit trust schemes are required to appoint a Shariah committee or Shariah adviser to ensure that their operations are in accordance with Shariah principles.

Like all the other non-Islamic Funds in Malaysia, Shariah Funds are regulated by the Securities Commission and placed under the same stringent regulatory criteria.

The main objective of an Islamic Unit Trust is to invest in a portfolio of “ halal” stocks which comply with the principles of The Syariah. Such “ halal” stocks will exclude companies involved in activities, products or services related to conventional banking, insurance and financial services, gambling, alcoholic beverages and non-halal food products.

The securities that are excluded from:

Financial services based on riba (interest)

Gambling

Manufacture or sale of non-halal products or related products

Conventional insurance

Entertainment activities that are non-permissible according to Shariah

Manufacture or sale of tobacco-based products or related to Shariah

Strockbroking or share trading in Shariah non-approved securities

Other activities deemed non-permissible according to Shariah

Diagram 2

Shariah Compliance Shares

Islamic unit trust is only invested in Shariah compliance securities which the listing of the companies is issued and updated by Shariah Advisory Council (SAC) twice a year namely in May and November respectively. Please refer to the web site of Secuties Commision on the list of Shariah compliance companies.

SAC uses both qualitative and quantitative approach in classifying the securities from time to time.

Qualitative Approach

Once the company is involved in the non compliance shariah activities, automatically the company will be included as the Shariah compliance shares. The list of core non Shariah compliance activities are as follows:

Financial services based on riba (interest)

Gambling

Manufacture or sale of non-halal products or related products

Conventional insurance

Entertainment activities that are non-permissible according to Shariah

Manufacture or sale of tobacco-based products or related to Shariah

Strockbroking or share trading in Shariah non-approved securities

Other activities deemed non-permissible according to Shariah

Quantitative Approach

Besides qualitative approach, SAC also uses quantitative approach in determining shariah compliance stock. This is applicable on mixed companies which are defined by SAC as having both activities of permissible and non permissible by shariah.

Under this approach, SAC is applying the concept of maximum benchmarks is its afford to classify the halalness of the underlying mixed companies(Securities Commission 2007)

The 5% benchmark

The maximum benchmark is used to assess the level of mixed contribution from prohibition activities i. e. riba, gambling, liquar and pork

If the company’s sales from the above activities are less than 5% of the total company’s turnover/sales, it considered as shariah Compliance Company.

The 10% benchmark

The maximum benchmark is used to assess the level of mixed contribution from interest income earned from investment made in the convention financial institution i. e. fixed deposit and also contributions received from mixed companies from tobacco related activities

If the company’s sales from the above activities are less than 10% of the total company’s turnover/sales, it considered as shariah Compliance Company.

The 20% benchmark

This maximum benchmark is used to access the level of contributions from mixed companies that activities related to rental payment received from the premised used in the non compliance shariah activities i. e. gambling, liquor etc.

If the company's sales from the above activities are less than 20% of the total company's turnover/sales, it considered as shariah Compliance Company.

The 25% benchmark

This maximum benchmark is used to access the level of contributions from mixed companies that activities related to hotel and resort, shares trading, share broking and others that are deemed as non permissible to the shariah.

If the company's sales from the above activities are less than 25% of the total company's turnover/sales, it considered as shariah Compliance Company.

Illustration for determining the status of Shariah Compliance Company[1]

Group A Group B

(RM million) (RM million)

Group Turnover 300 150

Subsidiary's Turnover

– liquor 3 0

– pork related 15 0

– gambling 0 0

– Interest income 0 16. 5

– Hotel Business 10 0

– Stock Broking 50 0

Status of the company

Group A Group B

(RM million) (RM million)

Group Turnover 300 150

Subsidiary’s Turnover

– liquor 3 0

– pork related 15 0

– gambling 0 0

— — 18 0

Company A = 18/300 @ 6% Company B = 0/150 @ 0%

– Interest income 0 16. 5

Company A = 0/300 @ 0% Company B = 16. 5/150 @ 11%

– Hotel Business 10 0

– Stock Broking 50 0

Company A = 60/300 @ 20% Company B = 0/150 @ 0%

Based on the above, company A breach the 5% benchmark for riba, liquor and pork but still below 25% for business mixed companies activities related to hotel and resort, shares trading, share broking. – Not shariah compliance

Company B breach the 10% benchmark for interest – Not shariah compliance

JUSTIFICATIONS OF UNIT TRUSTS ACCORDING TO SHARIAH RULINGS

In Islam, investment under the unit trust concept is in line with the shariah rule. The concept of risks and rewards shared by the unitholders employing the expertise of professional managers conforms to Islamic Principles and already being applied in within the Islamic Financial System. This can be related to specific financial contracts and products namely Murabaha and Musharakah.

Firstly, it comply the concept of Mudaraba. This concept is one of well-known investments permissible under Islamic sharia and widely used by the country practising Islamic system of banking such as Iraq. Generally, Murabaha is a concept in profit sharing where capital and one party is providing labour. Then, the other party will act to manage the money. The profit is shared by both parties according to the agreed ratio this concept can be implied to the unit trust. In unit trust, the capital of a venture is provided by the Trust and the business expertise and management will be responsible for the third party, in this case a unitholders. Then, the profit is divided between the unitholders and the trust as according to the agreement. In addition to this, some unique elements of Mudaraha concept are it is limited to the self liquidating transasctions, the assets must be easily recognisable and must be realised and liquidated so that the profits are easily distributed and its accounts must be recorded properly and be audited.

Next, the concept of Musharaka also can be applied in the unit trust. Within this concept, two or more financiers will engaged in a new project or participate in an established project. All the partners have a right to share total profits from a venture as in the agreement. The managers who manage a fund will be remunerated in the form of service charge. This is in line the unit trust concept, in which the mechanisms are the same. The main difference is mainly the avenue of the funds; where the funds are being invested. In Islamic Unit Trust for example, the funds are allocated in the authorised investments approved by the Security Commission as well as the Shariah Board. In addition to this, the profit is shared after deducting management fees and payment for zakat.