Global Islamic wealth management: trends and opportunities

Sohail Jaffer says there are several reasons why the Islamic niche of the industry is expected to outgrow conventional wealth management over the coming decade

Recent trends in the evolution of the global wealth management market have been mixed. According to the Boston Consulting Group (BCG)[1], in 2015 the global asset management industry recorded its worst performance since the 2008 financial crisis. Worldwide, assets under management (AUM) rose by just 1% in 2015 to $71.5 trillion from $70.5 trillion, which was a disappointing showing compared to the average annualized growth rate of 5% between 2008 and 2014.

By contrast, the narrower wealth management industry has continued to expand and prosper. In a White Paper on the *Global Wealth Market* published in May 2015, Datamonitor forecast that by the end of 2018, the assets of high net worth individuals (HNWIs) will surpass $40 trillion, an increase of over $18.5 trillion since the end of 2014. *"During the same period,"* the report adds, *"the assets of the affluent population as a whole will increase to almost $99 trillion. The forecast rate of 23.7% growth for 2014-18 is slightly lower than the 26.5% recorded in 2010-2014."*

With opportunities to generate alpha increasingly elusive, and with margins under pressure and uncertainty still prevailing about the regulatory outlook, it is small wonder that asset managers and their clients across the world are re-evaluating their strategies. As a consequence, EY estimates that four out of 10 clients are currently open to switching wealth managers under the right circumstances. *"This represents a $175 billion to $200 billion global revenue opportunity for those firms willing to make strategic investments to deliver a superior client experience, while others may find themselves at risk of losing a substantial portion of their business,"* EY advises.

Potential for Islamic wealth management

There are several reasons why the Islamic niche of the industry is expected to outgrow conventional wealth management over the coming decade.

One of the most fundamental of these is the demographic profile of the global Muslim population. According to the Pew Research Centre, while the world's population is projected to grow 35% in the coming decades, the number of Muslims is expected to increase by 73%, rising from 1.6 billion in 2010 to 2.8 billion in 2050.

One by-product of this demographic dynamic will be the rapid creation of wealth across the Islamic world, which will underpin the continued expansion of the broad market for Islamic finance.

A Datamonitor analysis forecasts that demographics and economic growth will be especially supportive of the growth of the wealth management industry in countries with majority or fast-expanding minority Muslim populations. Over the next few years, one of the world's fastest-growing wealth management markets, according to the

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Datamonitor projections, will be Pakistan, which will expand at a 10.27% compound annual growth rate (CAGR) between 2015 and 2018. This will be eclipsed by the projected CAGR of 10.62% over the same period in Nigeria.

Why is Islamic wealth management under-developed?

It is not just the demographics of the global Muslim population that will drive continued growth of the market for Islamic finance in general and Sharia-compliant wealth management in particular. Both markets are widely regarded as under-developed relative to their potential. Based on an estimated size of $1.66 trillion in 2014, for example, Islamic finance assets still represented just 1% of the total global financial market worth $127 trillion[2].

The reasons for the relative under-development of the Islamic wealth management industry are well understood and have been widely documented. One of these is that it cannot be assumed that there is a direct link between the size of the global Muslim population and demand for Sharia-compliant financial services. This is because many high net worth individuals (HNWIs) throughout the Islamic world are comfortable with wealth management offerings from providers of conventional financial services.

A number of other restrictions imposed by Islamic law also narrowed the range of opportunities accessible to investors committed to observing Sharia-compliant financial rules. For example, the prohibition on interest payments meant that opportunities to diversify into conventional fixed income instruments were limited. The Koranic ban on 'gharar' (defined as speculation) and on trading in products that an investor does not physically own, meanwhile, has traditionally been a stumbling block to the development of derivatives, structured products and Islamic hedge funds. This in turn has sharply reduced opportunities available to investors to protect themselves from falling prices and volatility in a way that is compatible with Sharia guidelines.

The result of these multiple restrictions has been that asset and wealth management in the Islamic finance universe has been overwhelmingly long-only equities-based, and vulnerable to macroeconomic uncertainty.

Another reason that has been advanced explaining the relative under-development of the Islamic wealth management sector is a so-called trust deficit, according to a recent survey published by the London-based think tank, Edbiz Consulting[3]. Almost half (48%) of respondents to this survey on the Knowledge, Attitude and Practices (KAP) of the industry indicated that they had never used any Islamic wealth management products and services. The reasons they gave included a lack of understanding, a shortage of trust and a preference for managing their own financial affairs.

An under-developed takaful sector

In the GCC, in particular, this deficit also appears to extend to another under-developed area for the more efficient long-term management of Muslim wealth, which is the life takaful (Sharia-compliant insurance) market. Although there is a relatively sophisticated family (life) takaful sector in Malaysia, inefficiencies in distribution, lack of differentiation between Islamic and conventional insurance, and a shortage of long-term investment opportunities have combined to impede its growth in the GCC. Data published by AM Best indicate that while life assurance accounts for 64% of total gross written contributions (GWC) in Malaysia, the share of family takaful in the Middle East is just 12%[4].

Closing the gap?

There are, however, a number of indications suggesting that recent developments in Islamic financial services is more supportive of growth in the Sharia-compliant wealth management industry than it has ever been. This may explain why the private banking and asset management industry in the GCC is attracting a rising flow of investment from global investment managers, many of which have been establishing joint ventures with regional banks.

In terms of product availability, Islamic wealth management is closing the gap on the conventional industry in a number of ways. In the equity market, for example, the increased diversity of product available to investors is being driven by liberalisation, most notably in Saudi Arabia.

Meanwhile, a promising development for the sukuk market is the recent decision by JP Morgan to include a number of sukuk in its flagship Emerging Markets Bond Global Diversified Index, which is widely expected to bolster demand from conventional investors and support liquidity in the market.

Another reason for the positive longer term outlook for sukuk issuance is the high funding requirements that are likely to be created in areas such as the GCC as a result of depressed oil prices. Standard & Poor's (S&P), for example, has estimated that weak energy prices will mean that the GCC will have some $560 billion of funding needs between 2015 and 2019[5]. If only a modest share of this total is raised in the sukuk market, it will have a significant impact on issuance volumes and liquidity.

SRI – a driver for Islamic wealth management?

Another potential driver of growth in the sukuk market is the growing conviction that there is a clear overlap between Islamic financial tenets and socially responsible investment (SRI), which is becoming increasingly appealing to HNWIs across the global investment community, irrespective of their religious beliefs.

This overlap is not just a reflection of the koranic prohibition on investment in a number of industries that are increasingly regarded as socially taboo in non-Muslim as well as Muslim majority countries. It is also a function of the structure of Sharia-compliant investment instruments, many of which are based on real asset ownership. Speaking at the World Energy Summit in Abu Dhabi in January 2015, Sean Kidney, CEO of the Climate Bonds Initiative, commented that *"the asset-focused nature of all sukuk makes it a good fit with the green bonds concept, which is also asset-focused*[6]*."* This mirrors a broader belief that growth in demand for asset-based investments is likely to continue against the backdrop of fiscal uncertainty, supporting further increases in the popularity of Sharia-compliant instruments among Muslim and non-Muslim investors alike.

More products needed

Nevertheless, while the growth in the sukuk market is encouraging, if Islamic wealth management is to flourish, it is essential that practitioners and their advisors explore a broader repertoire of products such as Sharia-compliant exchange traded funds (ETFs), real estate investment trusts (REITs), private equity funds and liquid alternatives.

Harnessing growth opportunities in Islamic wealth management

The clear potential for growth in the Sharia-compliant wealth management industry is attracting the attention of policymakers in a number of Islamic finance hubs as well as regional and international private banks and asset management groups.

Malaysia has made no secret of its ambitions to strengthen its position as South-East Asia's dominant centre for Islamic finance in general and Sharia-compliant wealth management in particular.

The Malaysian financial services sector has responded constructively to the government's push to promote Islamic wealth management. In September 2016, for example, the Kuala Lumpur Stock Exchange opened the world's first end-to-end Islamic exchange platform, named Bursa Malaysia-I.

Leading asset managers are also supportive of Malaysia's ambitions in the wealth management arena. When it launched its new Sharia-compliant ASEAN Megatrend Fund in April 2016, for example, RHB International Asset Management announced that this was aimed at complementing the government's efforts in *"developing and growing the Islamic Finance marketplace with the aspiration to position Malaysia as a key player*[7]*."*

Significantly, RHB is reported to be planning to follow the launch of the Megatrend Fund with a range of Sharia-compliant products offering investors exposure to private equity, real estate and sukuk, as well as equities.

Progress in Dubai

In the Middle East, meanwhile, Dubai is committed to expanding its financial centre, with Islamic private banking, asset and wealth management all expected to play a pivotal role in supporting this growth by exploring a range of new Sharia-compliant versions of conventional instruments. For example, the Fatwa and Sharia Supervisory Board of the Dubai Financial Market (DFM) has recently published a draft paper on *Hedging against Investment and Finance Risks*[8]. This outlines the DFM's standard on hedging which forms a *"point of reference for Islamic banks and financial institutions to safeguard their funds without violating the rules of Sharia."*

As well as being committed to providing a growing repertoire of Sharia-compliant investment funds for local investors, Dubai's leading asset managers are also offering HNWI investors an increasingly international suite of products, often in joint ventures with overseas managers.

Another growth area for wealth managers focusing on opportunities in the Middle East is the private equity market.

Increased investment in the private equity sphere is being driven by innovative players such as the Dubai-based principal investments firm, Fajr Capital, which is focusing on investment opportunities in the high growth markets in the Organisation of Islamic Cooperation (OIC).

Conclusion: holistic wealth planning and management offerings

While offering Islamic investment funds across a range of asset classes is a key pillar of the wealth management service offered by leading asset managers and private banks, the winners in this fast-expanding market will be those that are able to offer a more holistic Sharia-compliant wealth planning and management package to Muslim clients.

As the Labuan International Business and Financial Centre explains[9], *"the process involves the creation of wealth through (inter alia) a business, profession or trade and/or savings with financial institutions, the investment of the wealth created to generate returns, the protection of wealth through risk management, takaful and trusts, and the distribution of wealth through gifts (hibah), wills and trusts. The range of activities comprises financial analysis, Sharia compliant asset and securities selection, investment planning and ongoing monitoring of investments, as well as estate planning, tax planning and retirement planning."* ■

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Endnotes

1. www.bcgperspectives.com

2. Ibid www.islamicfinance.com

3. www.zawya.com/story/Global_Islamic_Wealth_Management_Industry_Faces_Trust_Deficit-ZAWYA20160324091858/

4. AM Best – "The Dynamics of Takaful Markets of the Middle East and Malaysia: Similar Models, Different Approaches, Contrasting Fortunes", April 2016

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