Shariah compliant wealth management: on the right track

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In the wake of the financial meltdown, a global trend of ethics/value based investments has been on the rise globally. Renewed attention to social responsibility in economic markets, and advancing the idea of Financial Social Responsibility reached unprecedented momentum. The professional association USSIF: The Forum for Sustainable and Responsible Investment estimates in its *2010 Report on Socially Responsible Investing Trends* that around $3 trillion in assets under management subscribe to one or more of the aforementioned approaches to socially responsible investing.

Over 250 mutual funds in the United States alone, utilize a social screening process, with assets of approximately $316 billion. There are hedge and exchange-traded funds (ETFs) that adopt a socially conscious approach to investment, as well.

In Europe, as per a study conducted by KPMG (*European Responsible Investment Fund Survey*), 1,236 Responsible investment funds were identified with €129.49 billion assets under management.

Shariah compliant investments: the growing category within SRI

The growing importance of ethics within the investment industry and its convergence with the principles of shariah compliant finance is increasing the acceptance of the alternative financial segment in secular markets. Islamic finance has proven its potential and triggered interest globally. With a sizable the potential to manage assets worth $4,400 billion, growing at 10 per cent per year, while the actual size of the industry today is just $1,130 billion worldwide, according to the *Global Islamic Finance Report 2011*.

It has expanded geographically, setting footprint beyond its home markets and is likely to develop significantly in the coming years, with most global financial brands involved in shariah compliant finance either with own subsidiaries through strategic tie ups.

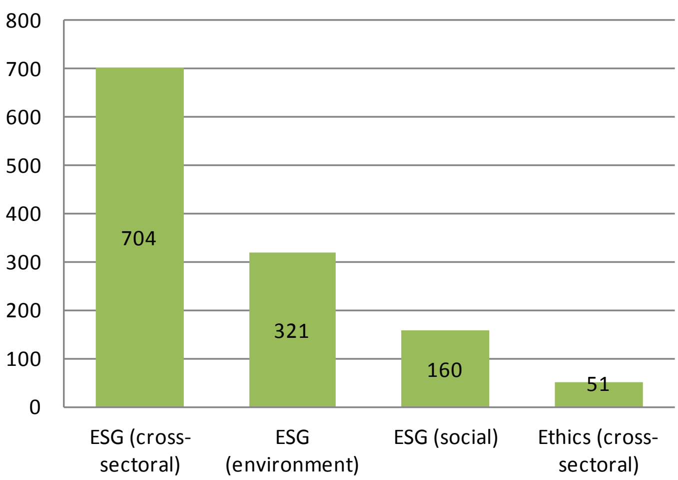
The KPMG SRI study has already identified 42 sharia compliant funds among the 'ethics' category of SRI funds, that comprises a total of 51 funds and an AUM of €2.5 billion representing the smallest of all categories of 1.9% of the total assets of SRI.

Growth prospects of Islamic wealth management industry are driven by a number of factors, organic liquidity driven by stable oil prices, younger more affluent population, growing sophistication of Islamic financial institutions and the increasing number of sharia-sensitive investors who until recently lacked proper shariah compliant opportunities to manage their wealth. There was also a significant surge

By categories

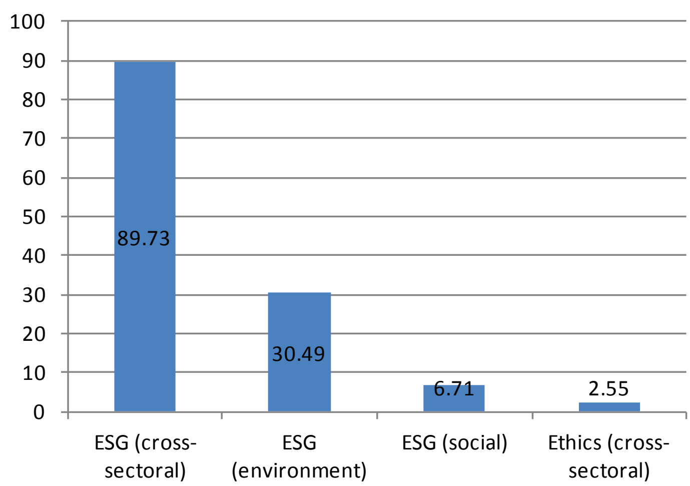
RI in nb of funds

Total = 1,236 funds



RI in AuMs

Total = €129.5 billion



Source: KPMG European Responsible Investment Fund Survey in the personal wealth in the Middle East region that still constitutes the largest market for Shariah compliant finance. As per the *World Wealth Report* the high net worth individuals (HNWIs) population increased by 10.4 per cent to 440,000, with a combined wealth growing at 12.5 per cent to $1.7 trillion, (Dh4.4 trillion) of investable assets.

Relatively, the range of shariah compliant products and services remains limited within few classes and geographies but the depth and breadth of Islamic finance products have increased significantly from basic savings account to more sophisticated instruments on the capital market such as sukuk and Islamic real estate investment trusts.

There also has been significant growth in shariah compliant structured products such as undertaking collective investments in transferable securities (UCITS) funds. In addition, more flexible structures in Luxembourg such as the Specialised Investment Fund (SIF), which allows a wide variety of different investment strategies, can be used for shariah compliant private equity, property or other alternative investment schemes mainly aimed at institutional or high net worth investors. SIFs used either for shariah compliant funds or for conventional funds, have proven to be highly successful with Middle Eastern investors as per the Association of the Luxembourg Fund Industry.

Luxembourg has always been a first European mover in shariah compliant finance since the 80s, ranks today fifth worldwide by number of shariah compliant funds. The number of Middle East-based managers launching investment funds in the European country has increasedsteadily. There are 41 regulated shariah compliant investment funds domiciled in Luxembourg and total assets under management in shariah compliant funds are estimated at $5.3 billion.

Another pioneering initiative in Luxembourg was launched by four Luxembourg-based companies that are joining forces to create a specialised platform that will service shariah compliant investment funds. Amanie Advisors, ADEPA Asset Management, Theisen Law, and KBL European Private Bankers have launched a service that will be branded ALIF (Alliance for Luxembourg Islamic Finance), offering fund managers a service to have their custodianship and fund servicing carried out in a shariah compliant manner. Specifically assets will be held in segregated pools and prohibited from being used for short-selling or as security for interest-based lending, two activities prohibited under shariah.

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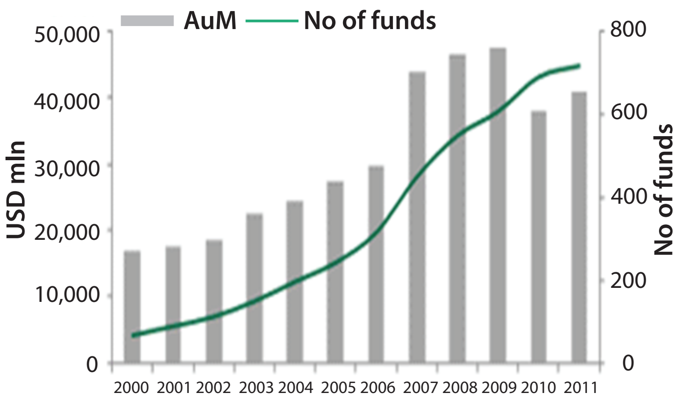
Global Islamic funds growth trend



Source: Bloomberg, IFIS, Zawya, KFHR

Conclusion

The global wealth management sector is expected to grow with an annual average up to 6% from 2012-2015 to reach $162 trillion, despite expected slowdown in global economy.

Emerging markets are thought to be leading this growth. With financial assets growing robustly and influencing the global demand for equity products, HNWIs are expected to increase allocations to riskier assets such as equities and real estate, and their appetite for local equity products will grow as they become more willing to put money at risk in order to achieve higher rates of return, in line with improved investment confidence and especially if the global economy continue showing signs of recovery.

Shariah compliant wealth management is shining with an obvious continuous growth driven mainly by the increasing demand and preference for shariah compliant financial products, proactive measures taken by governments and jurisdictions worldwide to promote the development of Islamic finance in their respective countries, and the favourable demographics with growing young populations in most majority Muslim countries.

Many financial analysts believe that there is likely to be a bigger migration to Islamic financial services in certain markets due to the loss of faith in the conventional system arising from the global economic and financial crisis. As market conditions continue to improve, shariah compliant investment options are likely to be more attractive to larger audiences who will be looking for opportunities which are more transparent and ethically structured.

The outlook is certainly positive, however, for the industry to thrive, more products need to be developed, more innovation needs to be done to cater to the sophisticated needs of private banking clients. And most importantly the right regulation so these products can be facilitated. ■