



# Islamic Fund Management

Dr. Marjan Muhammad and Ruslena Ramli



**11<sup>th</sup> Meeting**  
**COMCEC Financial Cooperation Working Group**  
**25 October 2018**



# **PART 1: OVERVIEW OF ISLAMIC FUND MANAGEMENT INDUSTRY**



## **1 INTRODUCTION: SCOPE OF THE STUDY**



## **2 GLOBAL DEVELOPMENT OF ISLAMIC FUND MANAGEMENT INDUSTRY**



## **3 COMPREHENSIVE ANALYSIS OF ISLAMIC FUND MANAGEMENT INDUSTRY**



## Objective

To examine the working mechanisms, development, challenges and prospects of the Islamic fund management globally as well as in country-specific case studies.

Consist of 6 sections including introduction and conclusion



## Review of the Fund Management Industry

- Overview of the global fund management industry
- Role of fund management in Islamic capital markets
- Future trends of Islamic funds industry



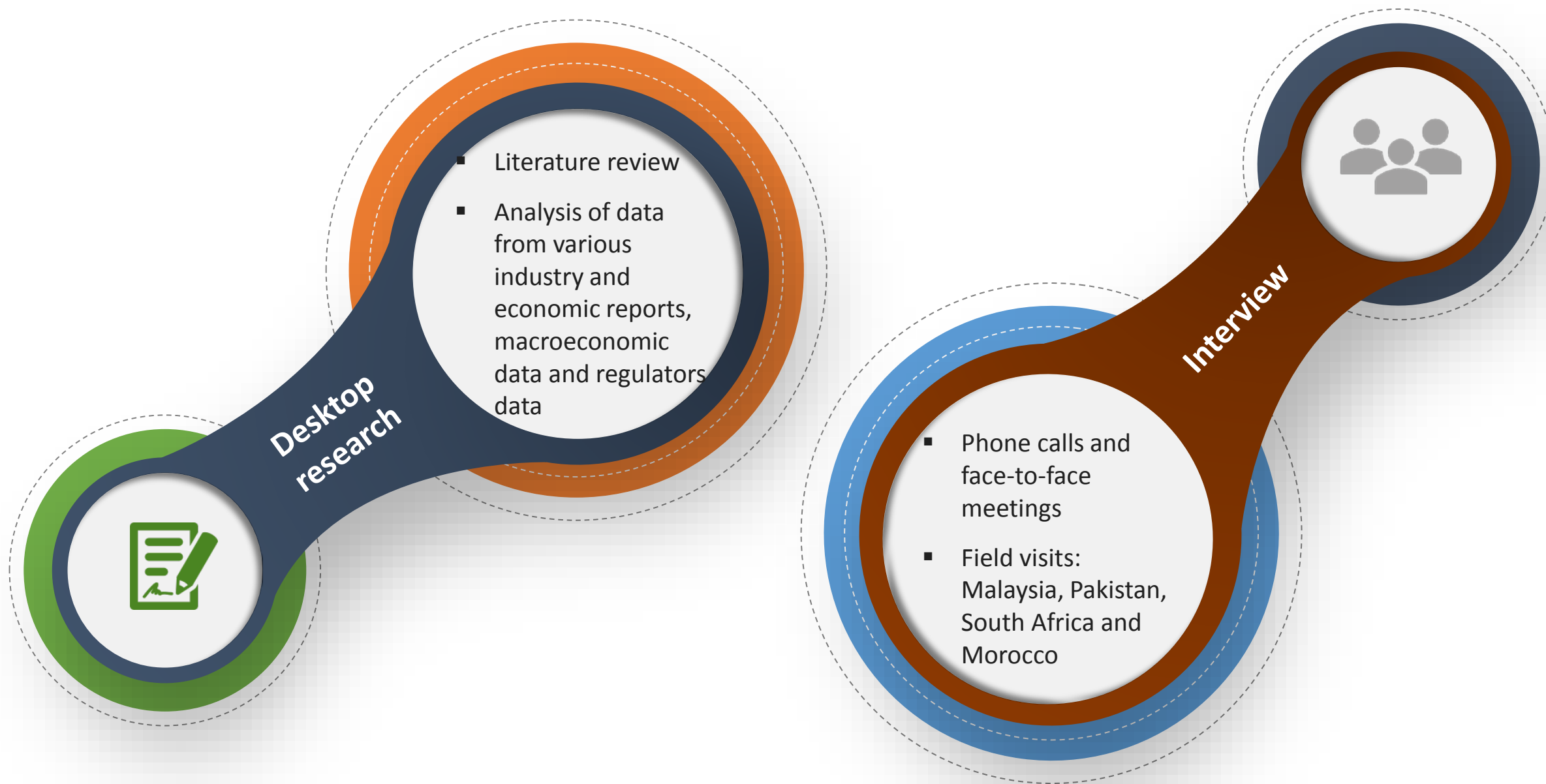
## Islamic Funds Infrastructure, Investments & Commercial Consideration

- Building blocks for long-term growth
- Key investor profiles
- Developmental challenges

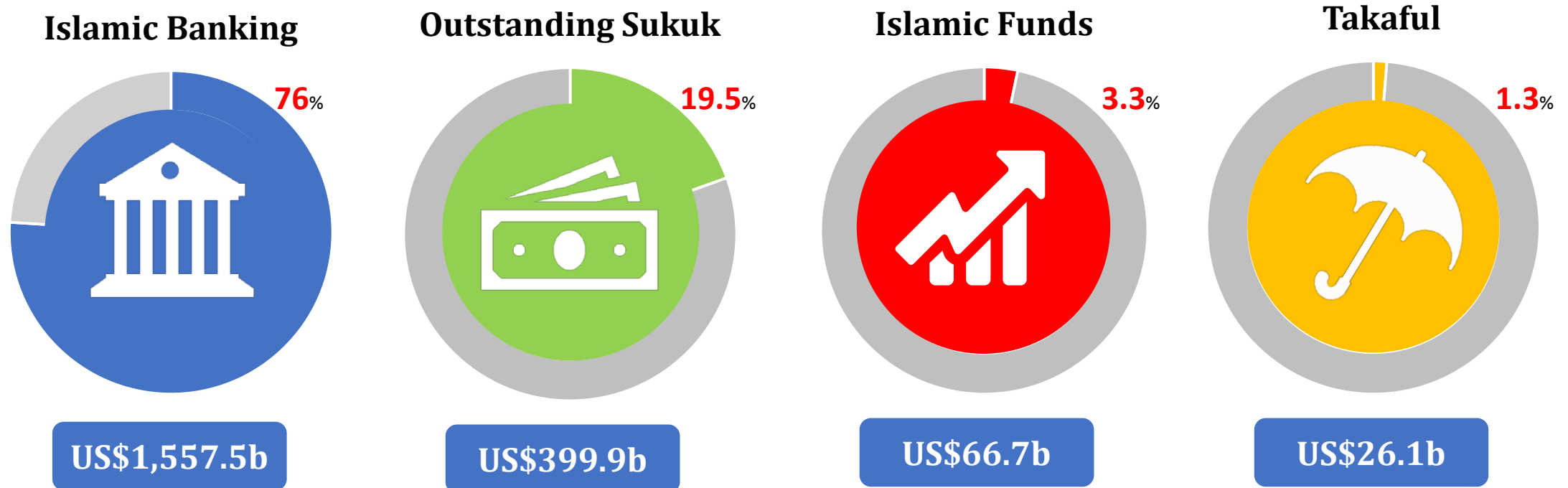


## Case Studies & Policy Recommendations

- Islamic fund evolution, analysis of investment and commercial consideration
- Factors & challenges affecting Islamic fund management and policy recommendations

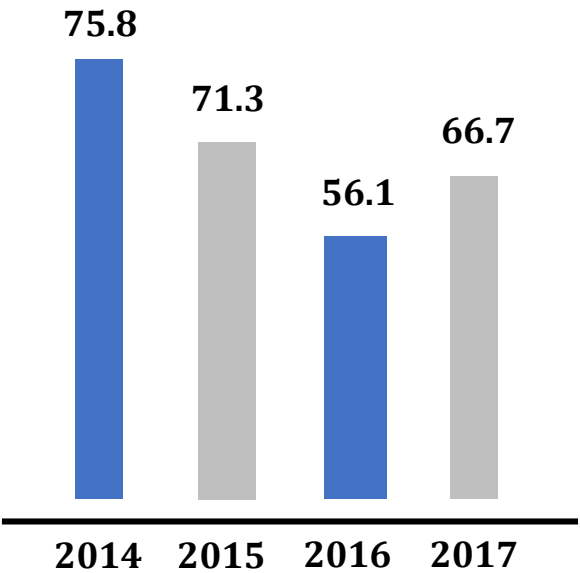


## Islamic finance assets by asset class (end-2017)

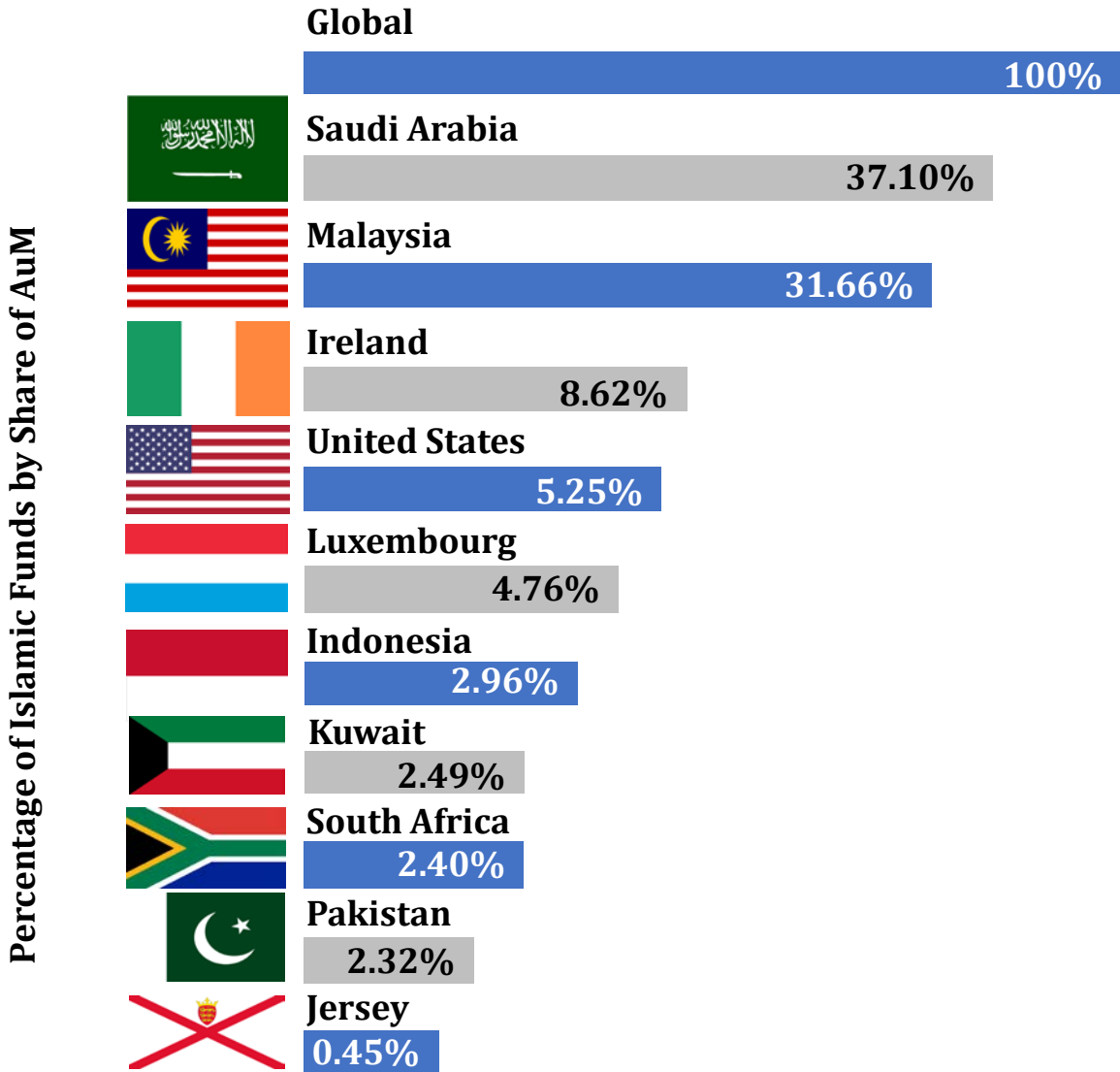


Total AuM of Global Islamic Funds (2014-2017)

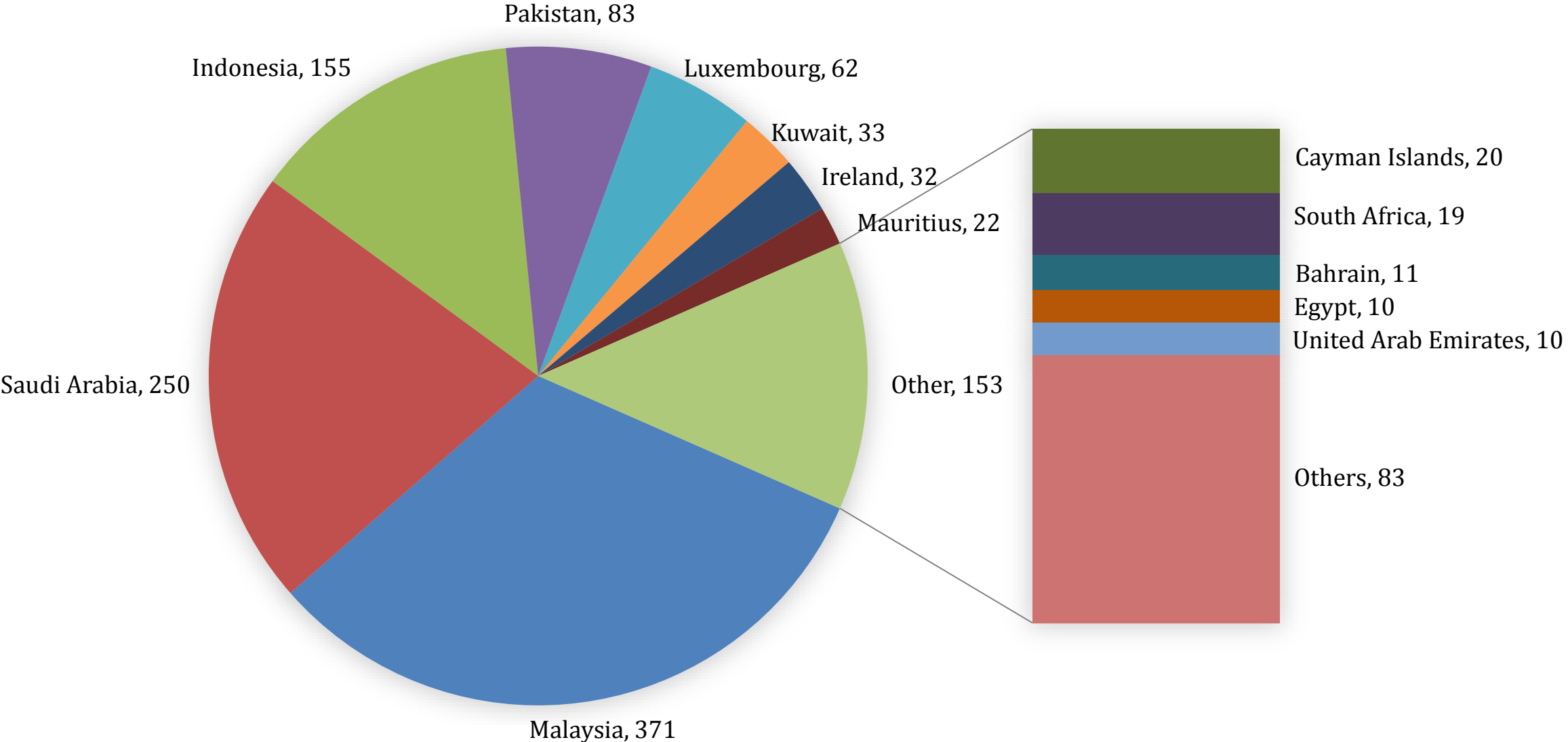
Total AuM of Islamic Funds (USD billion)



Distribution of Islamic Funds by Domicile (2017)

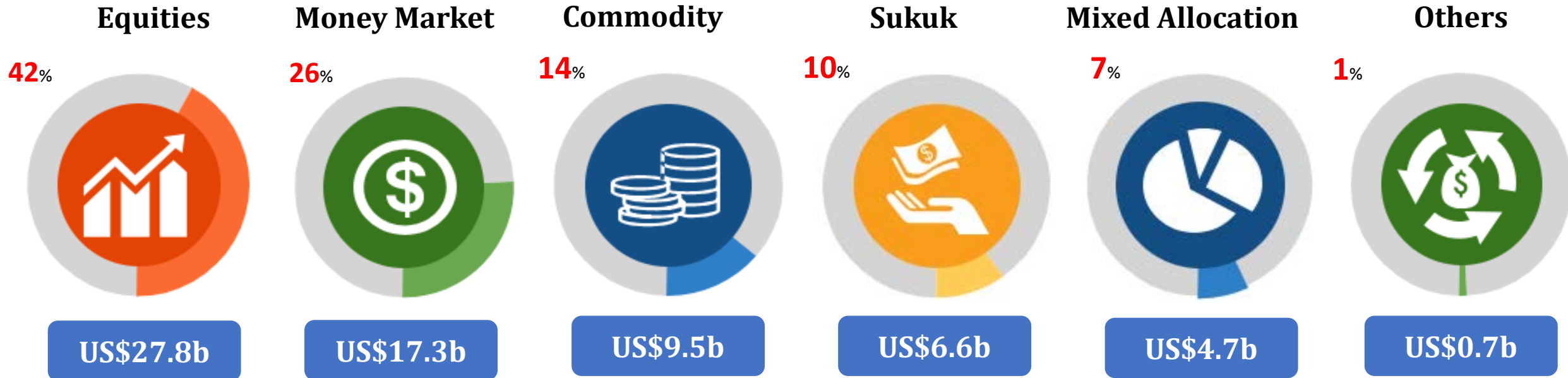


Number of Islamic funds by Domicile (2017)



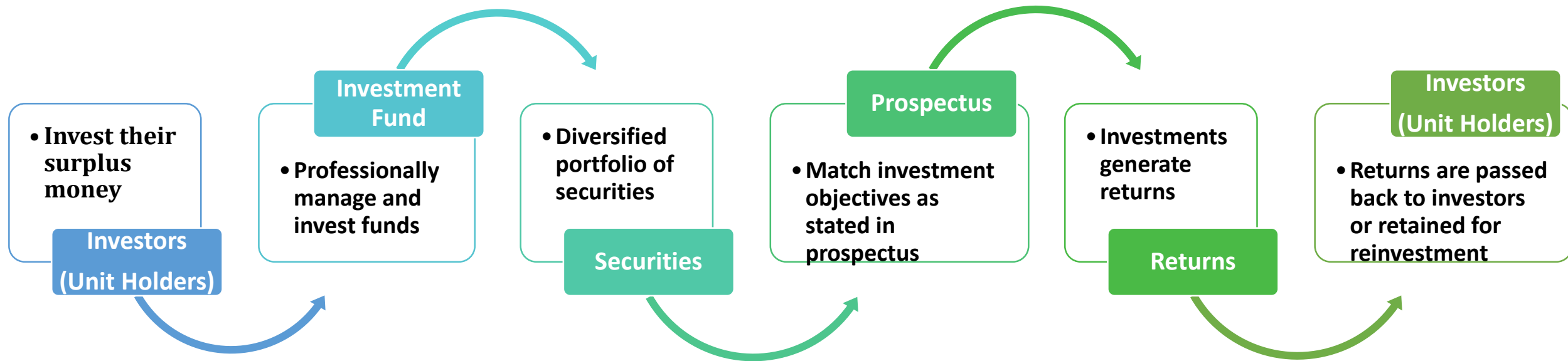
# Growth of global Islamic funds (Based on Asset Class)

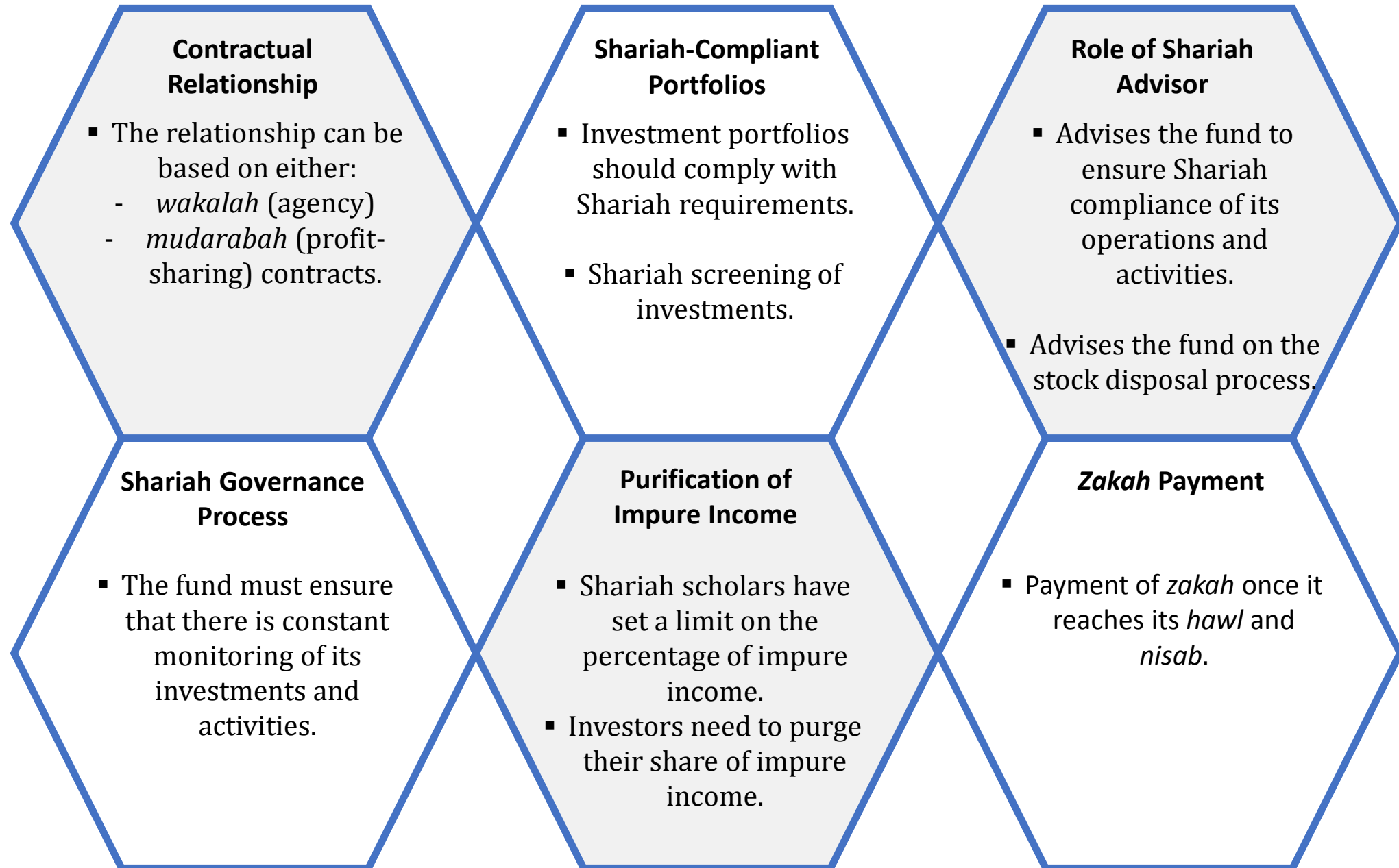
## Islamic funds by asset class (2017)





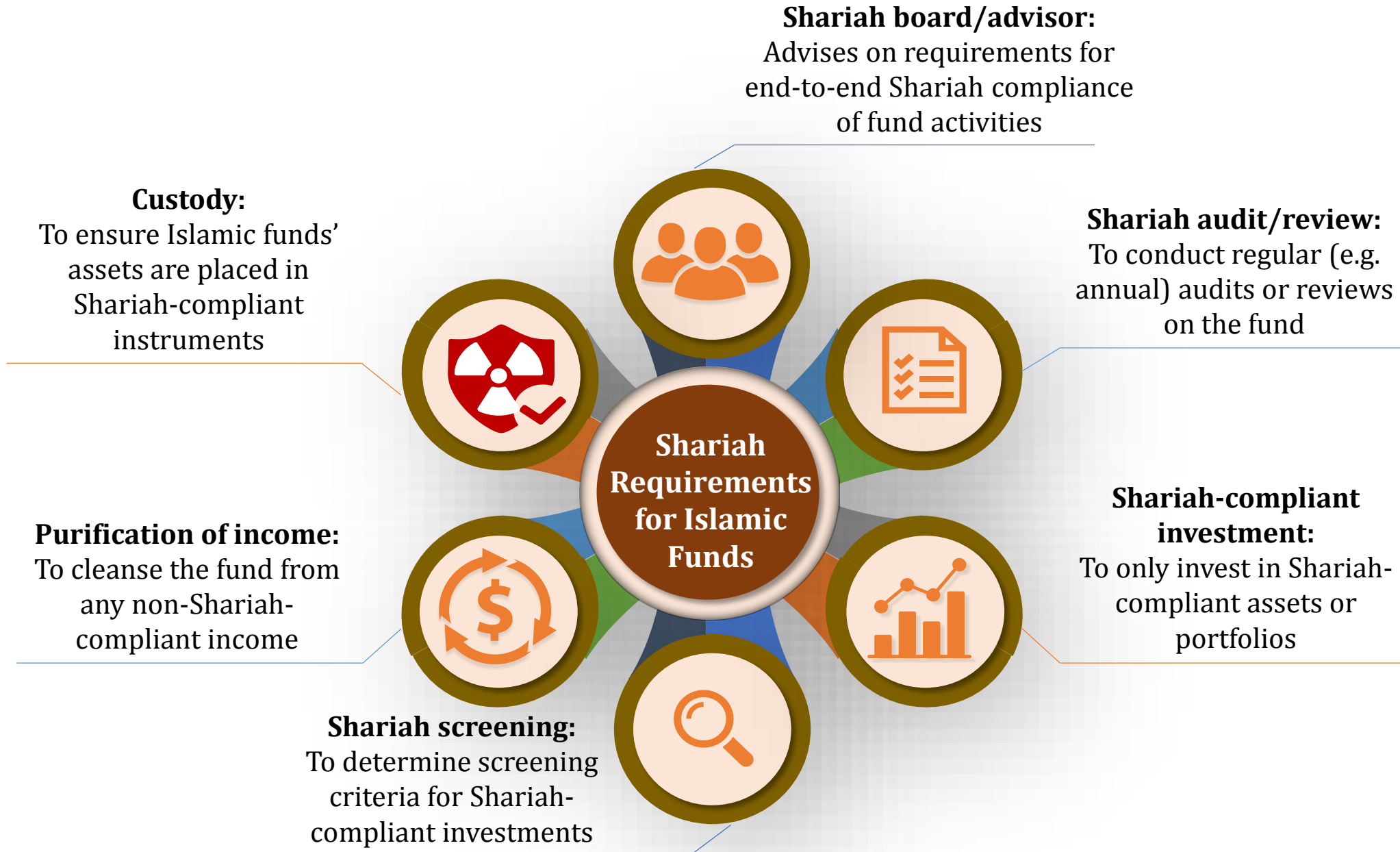
# Flow Chart of Fund Management Process



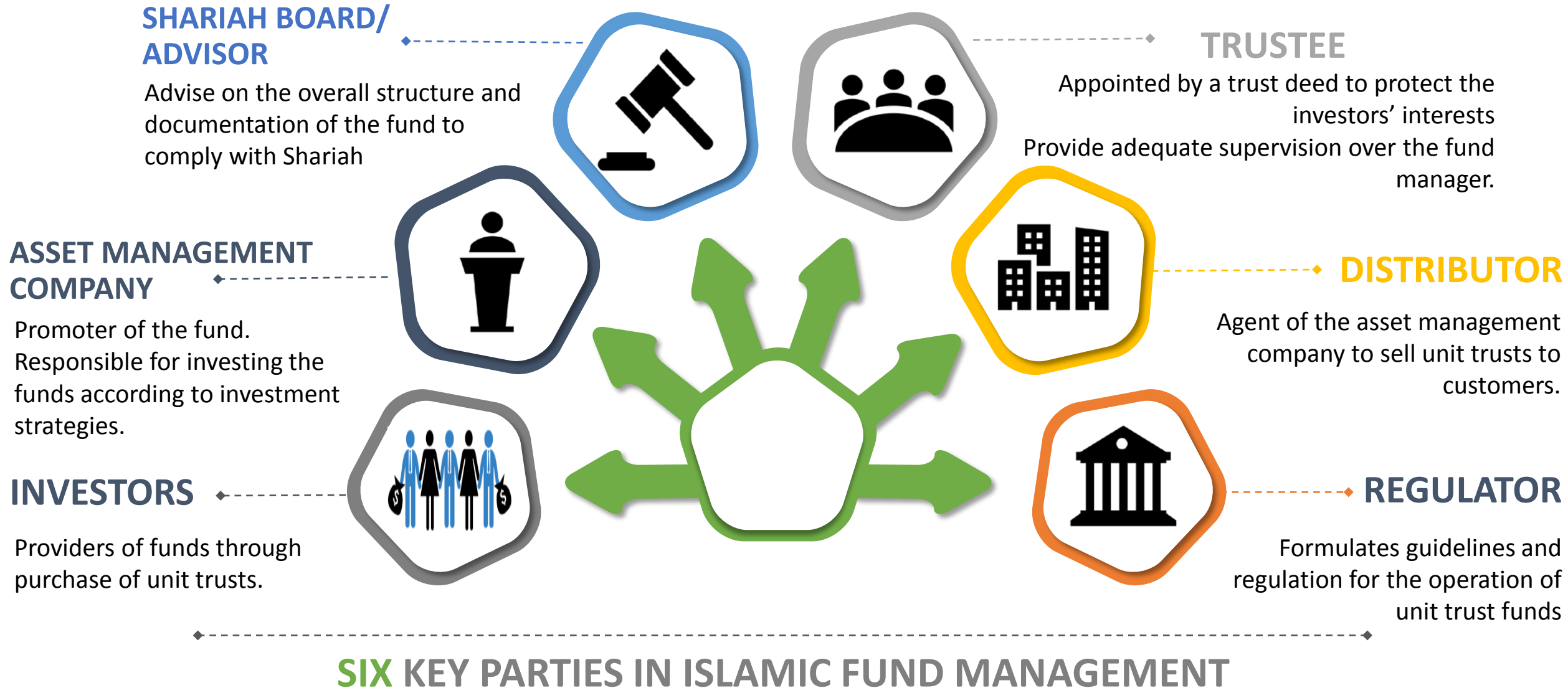


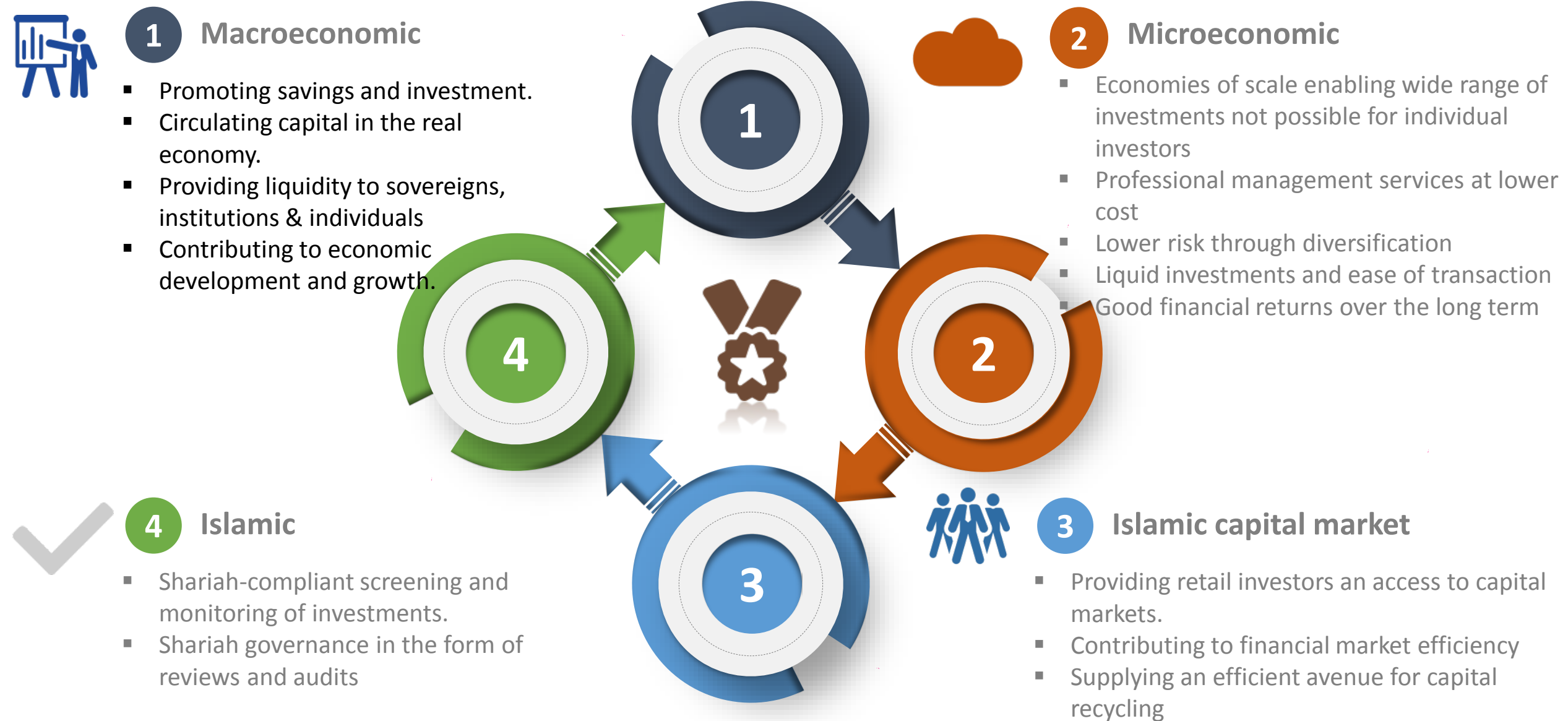
# Process flow of fund set-up

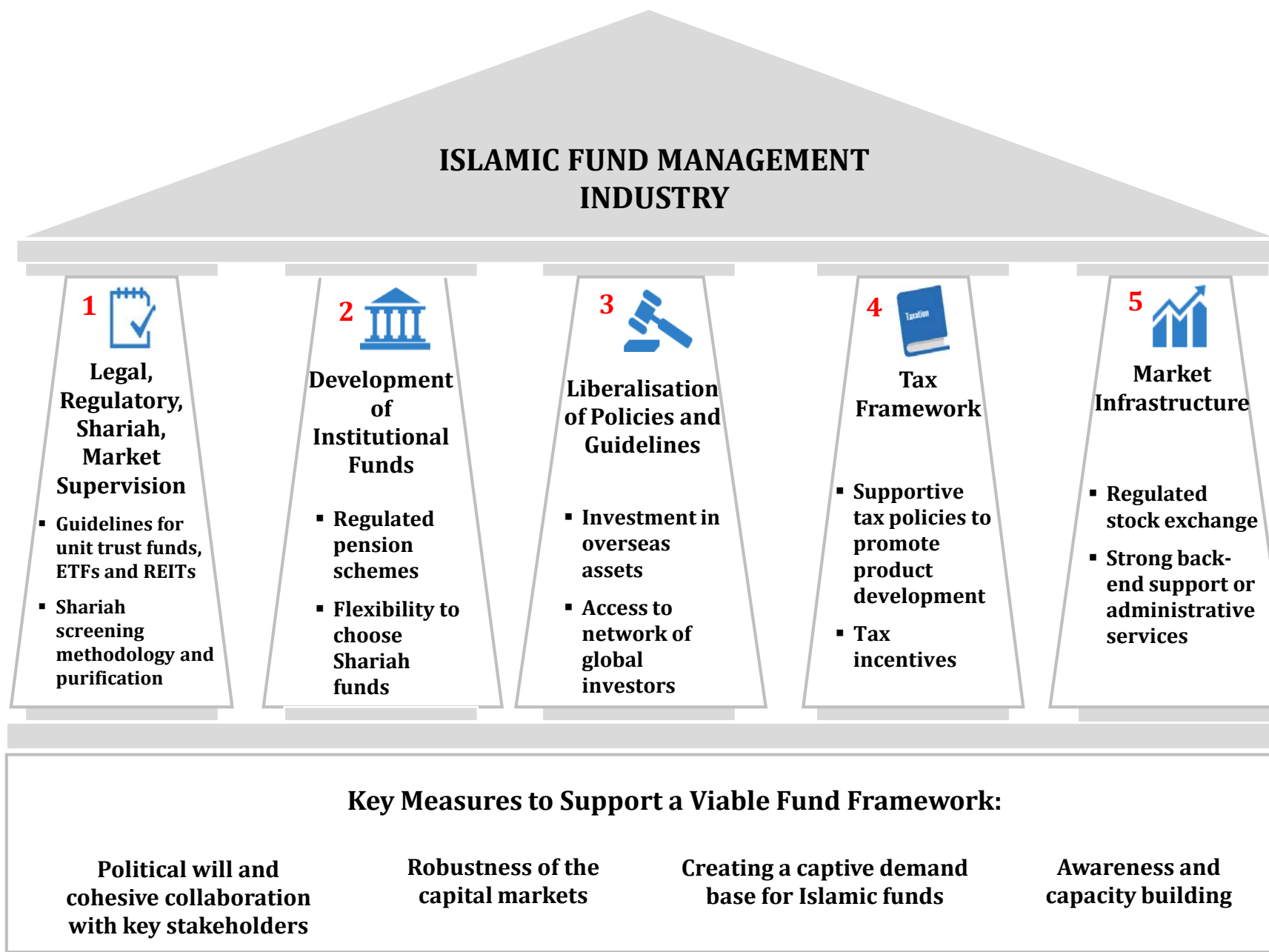
Stage 1: Conceptualisation	Stage 2: Planning	Stage 3: Regulatory Approval	Stage 4: Implementation	Stage 5: Monitoring
<b>Investment Analysis</b> <ul style="list-style-type: none"> <li>▪ Target investors – retail, sophisticated investors or wholesale.</li> <li>▪ Choice of Shariah assets.</li> <li>▪ Shariah screening and benchmark selection.</li> <li>▪ Select investment strategy.</li> </ul>	<b>Financial Analysis</b> <ul style="list-style-type: none"> <li>▪ Quantitative measures for risk and return.</li> <li>▪ Shariah screening methodology.</li> <li>▪ Shariah compliance procedures.</li> <li>▪ Define purification process.</li> <li>▪ Define compliance and audit review processes.</li> </ul>	<b>Submission</b> <ul style="list-style-type: none"> <li>▪ Guidelines and policies.</li> <li>▪ Checklist and submission for approval.</li> <li>▪ Proactive engagements with regulators.</li> </ul>	<b>Portfolio Development</b> <ul style="list-style-type: none"> <li>▪ Implement investment strategy.</li> <li>▪ Strategy optimisation – risk and return.</li> <li>▪ Shariah review and compliance.</li> <li>▪ Appointment of professional managers.</li> </ul>	<b>Performance Analysis and Portfolio Review</b> <ul style="list-style-type: none"> <li>▪ Performance measurement.</li> <li>▪ Peer benchmarks.</li> <li>▪ Rebalancing considerations.</li> <li>▪ Review of Shariah compliance.</li> <li>▪ Implement purification processes (if required).</li> <li>▪ Perform compliance and audit reviews.</li> <li>▪ Committee reporting and strategy update based on market conditions.</li> </ul>



# Key parties involved in Islamic fund management and their roles







# Shariah screening methodologies: A comparison

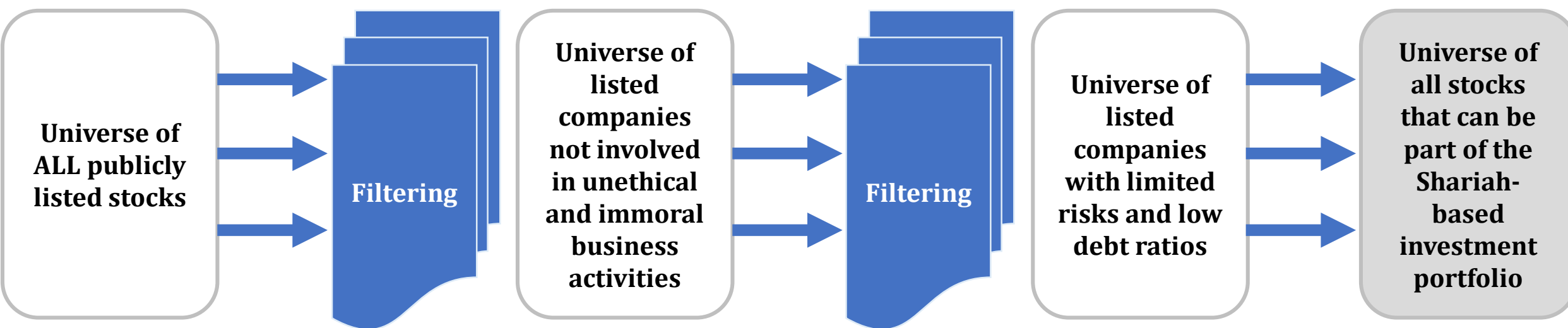
	SAC of SC (Malaysia)	S&P Dow Jones Shariah Indices	MSCI Islamic Index (Series)	MSCI Islamic Index (M-Series)	FTSE Shariah Global Equity Index Series
Scope	Malaysian stocks	Global stocks	Global stocks		Global stocks
Screener	Regulator	Index provider	Index provider		Index provider
Focus	Business activity and financial ratio benchmarks	Sector-based and accounting-based screens	Business activity and financial screening		Business sector and financial screening
Dividend Purification Ratio	n.a	Dividend x (Non- permissible revenue/Total revenue)	(Total earnings – (Income from prohibited activities + Interest income))/Total earnings		Purification of dividends at 5%



# Shariah screening methodologies (con't)

	SAC of SC (Malaysia)	S&P Dow Jones Shariah Indices	MSCI Islamic Index (Series)	MSCI Islamic Index (M-Series)	FTSE Shariah Global Equity Index Series
Financial Ratio	<ul style="list-style-type: none"> <li>Total debts/ Total assets = &lt; 33%</li> <li>Cash/Total assets = &lt; 33%</li> </ul>	<ul style="list-style-type: none"> <li>Total debts/ Market capitalisation = &lt; 33%</li> <li>Accounts receivables/ Market capitalisation = &lt; 49%</li> <li>Cash + Interest-bearing securities/ Market capitalisation = &lt; 33%</li> <li>Non-permissible income other than interest income/Total revenue = &lt; 5%</li> </ul>	<ul style="list-style-type: none"> <li>Total debts/ Total assets = &lt; 33.33%</li> <li>Cash + Interest-bearing securities/ Total assets = &lt; 33.33%</li> <li>Accounts receivables + Cash/Total assets = &lt; 33.33%</li> </ul>	<ul style="list-style-type: none"> <li>Total debts/ Average market capitalisation = &lt; 33.33%</li> <li>Cash + Interest-bearing securities/ Average market capitalisation = &lt; 33.33%</li> <li>Accounts receivables + Cash/Average market capitalisation = &lt; 49.00%</li> </ul>	<ul style="list-style-type: none"> <li>Total debts/Total assets = &lt; 33.333%</li> <li>Accounts receivables + Cash/Total assets = &lt; 50%</li> <li>Cash + Interest-bearing securities/ Total assets = &lt; 33.333%</li> <li>Total interest and non-compliant activities/ Total revenue = &lt; 5%</li> </ul>

# Islamic equity fund screening process in Malaysia



First Stage

**Qualitative Screening**

## Business Activity Benchmarks

5%

Conventional banking, conventional insurance, gambling, liquor and liquor-related activities, pork and pork-related activities, non-*halal* food and beverages, Shariah non-compliant entertainment, interest income from conventional accounts and instruments, tobacco and tobacco-related activities, and other activities deemed non-compliant according to Shariah.

20%

Share trading, stockbroking business, rental received from Shariah non-complaint activities, and other activities deemed non-compliant according to Shariah.

Second Stage

**Quantitative Screening**

## Financial Ratio Benchmarks

Cash

$$= \frac{\text{Cash}}{\text{Total Assets}}$$








Cash can only include cash deposited in conventional accounts and instruments. Cash placed in Islamic accounts and instruments is excluded from the calculation. Ratio must be lower than **33%**.

Debt

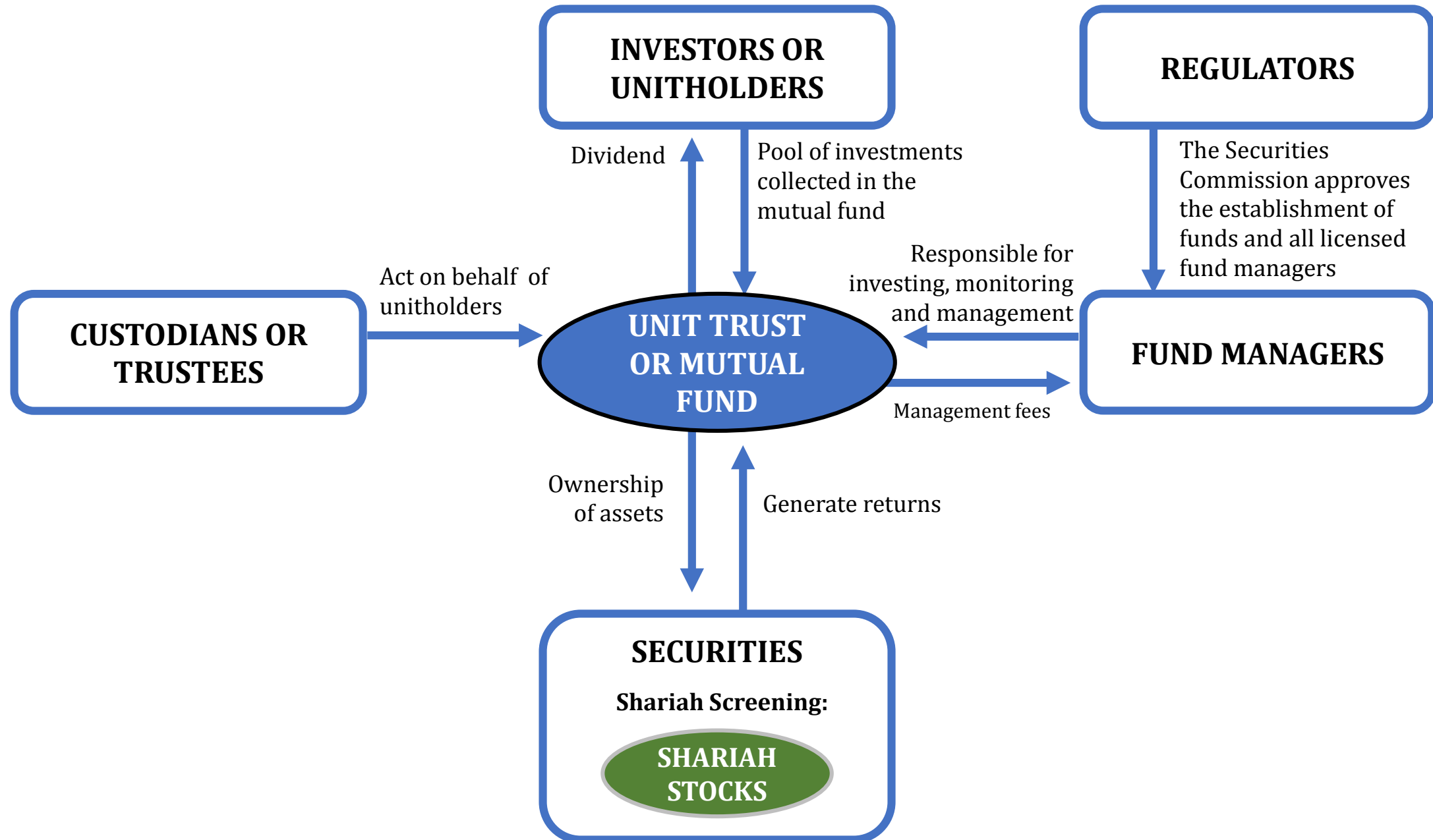
$$= \frac{\text{Debt}}{\text{Total Assets}}$$

Debt can only include interest-bearing debt. Islamic debt/financing or sukuk is excluded from the calculation. Ratio must be lower than **33%**.

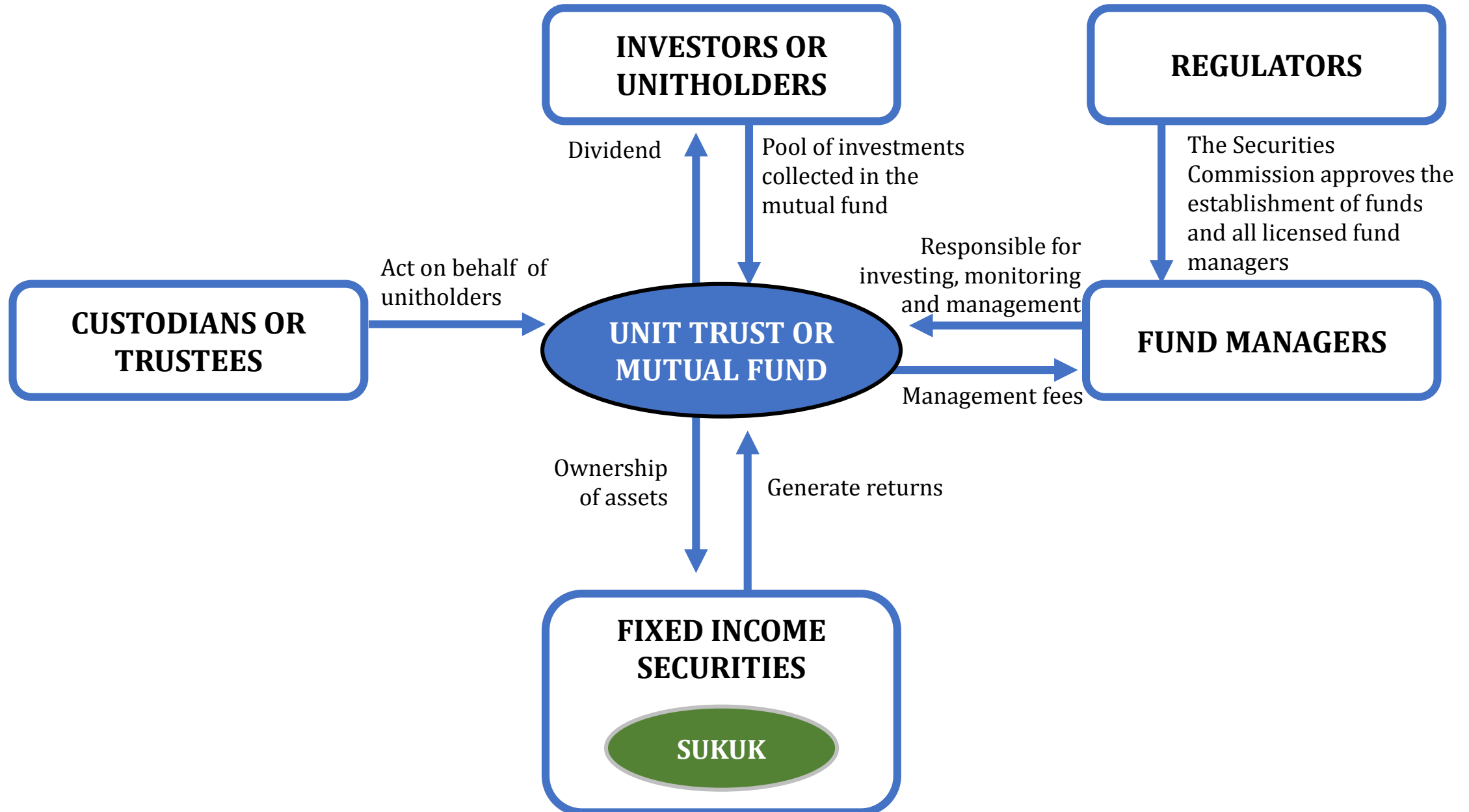
# Analysis of various types of funds by investment portfolio

Equity Funds	Fixed-Income Funds	Balanced Funds	Money Market Funds	REITs	ETFs	Alternatives
						
100% invested in stocks	100% invested in fixed-income securities	Mixture of fixed income and equities	100% in short-term fixed-income securities	100% invested in properties	100% invested in stocks	Investments in venture capital, private equity, hedge funds, specialist funds
Average annual returns: 15%-20% medium risk, higher risk compared to other funds	Average annual returns: 6%-10%	Average annual returns: 6%-10%	Average annual returns: 1%-2%	Average annual returns: > 10%	Average annual returns: 1%-10%	Varies depending on the performance of respective funds
For aggressive investors	Medium risk, lower risk compared to other funds	Medium risk, lower risk compared to other funds	Medium risk, even lower risk compared to other funds	Medium risk, lower risk compared to other funds	Medium risk, even lower risk compared to other funds	High risk
Ideal for long-term growth (5 years or more)	For conservative investors	For conservative investors	For very conservative investors	For conservative investors	For conservative investors	For high-risk investors

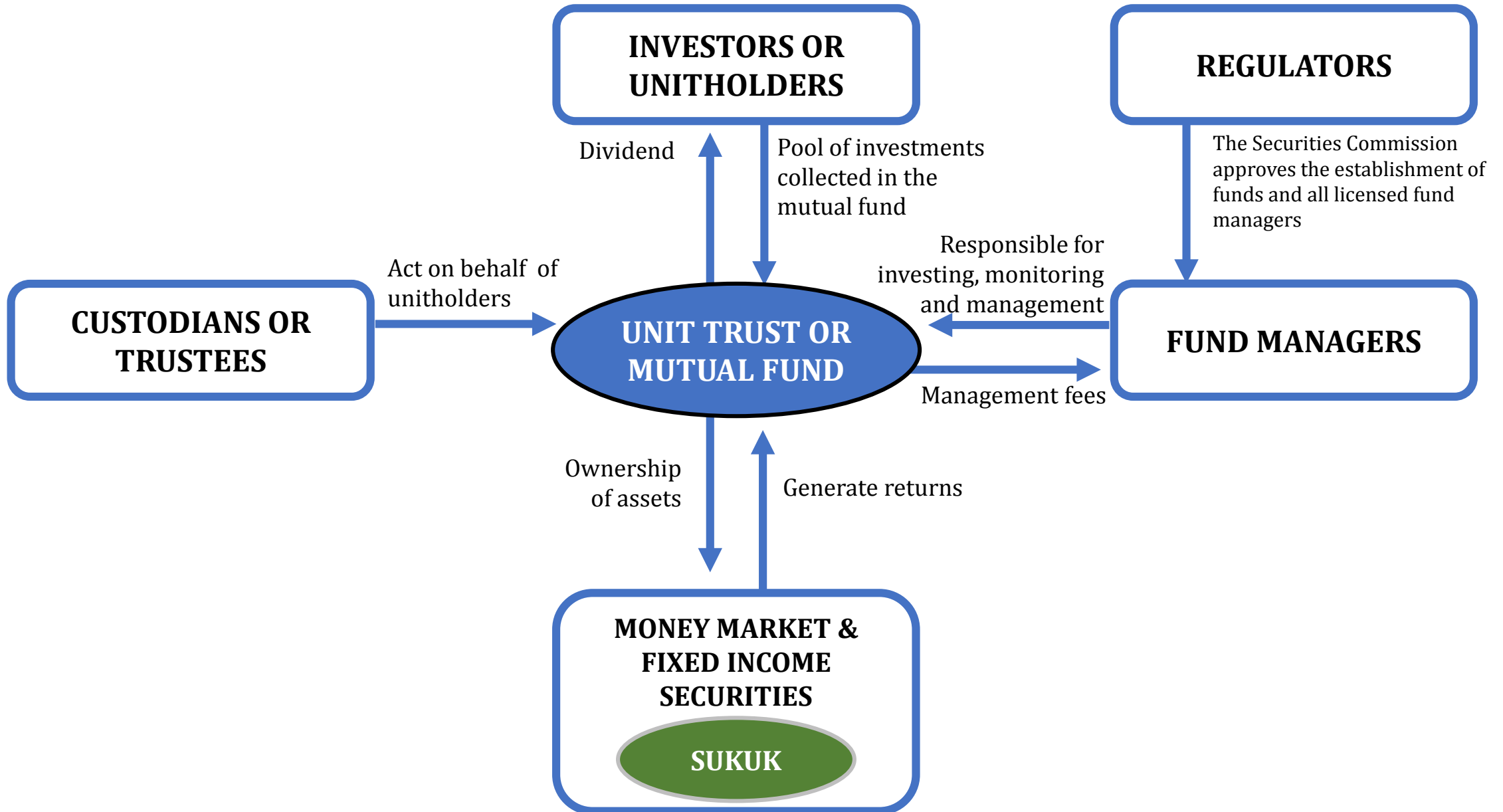
# Basic structure of an Islamic equity-based fund



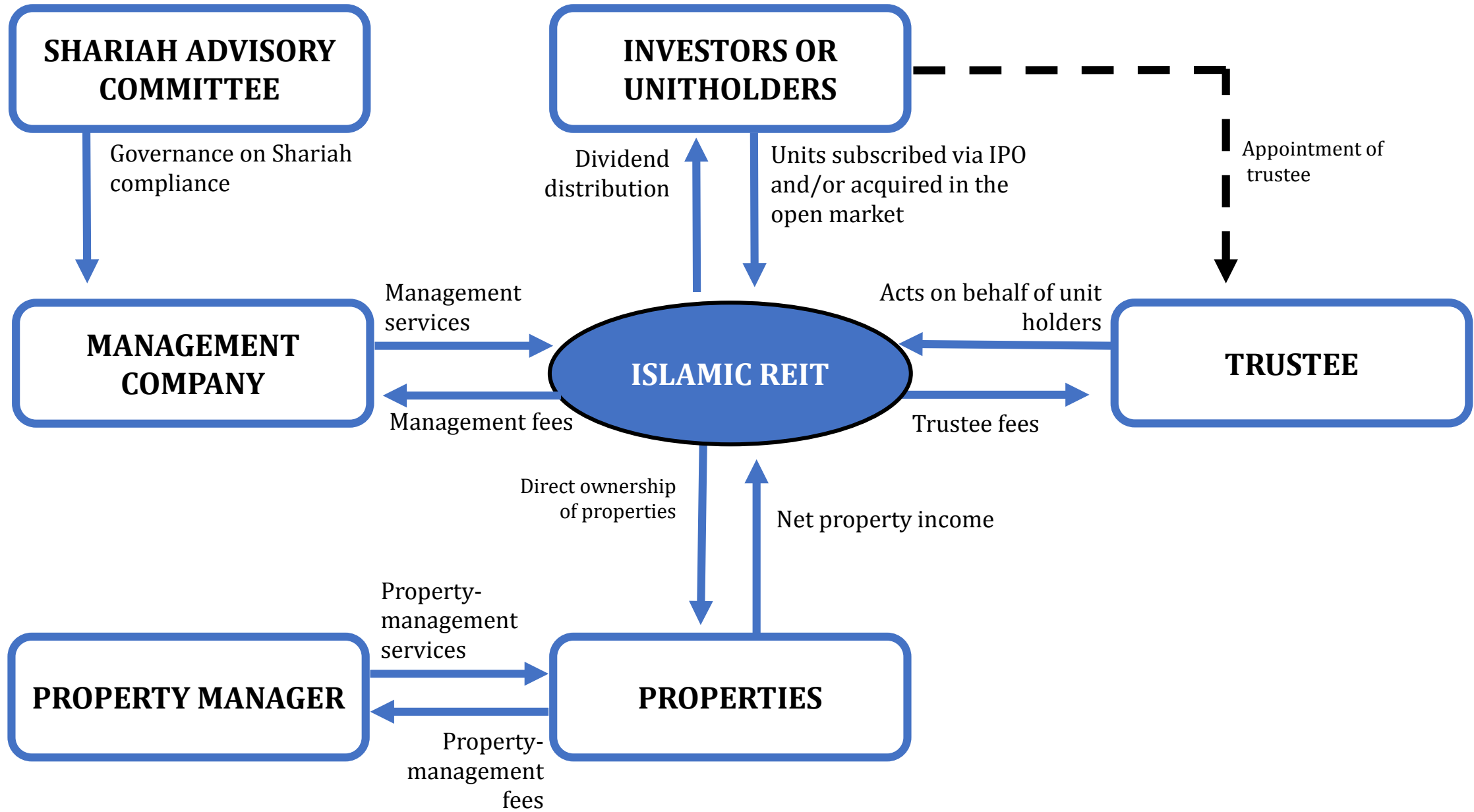
# Basic structure of an Islamic fixed-income (sukuk) fund



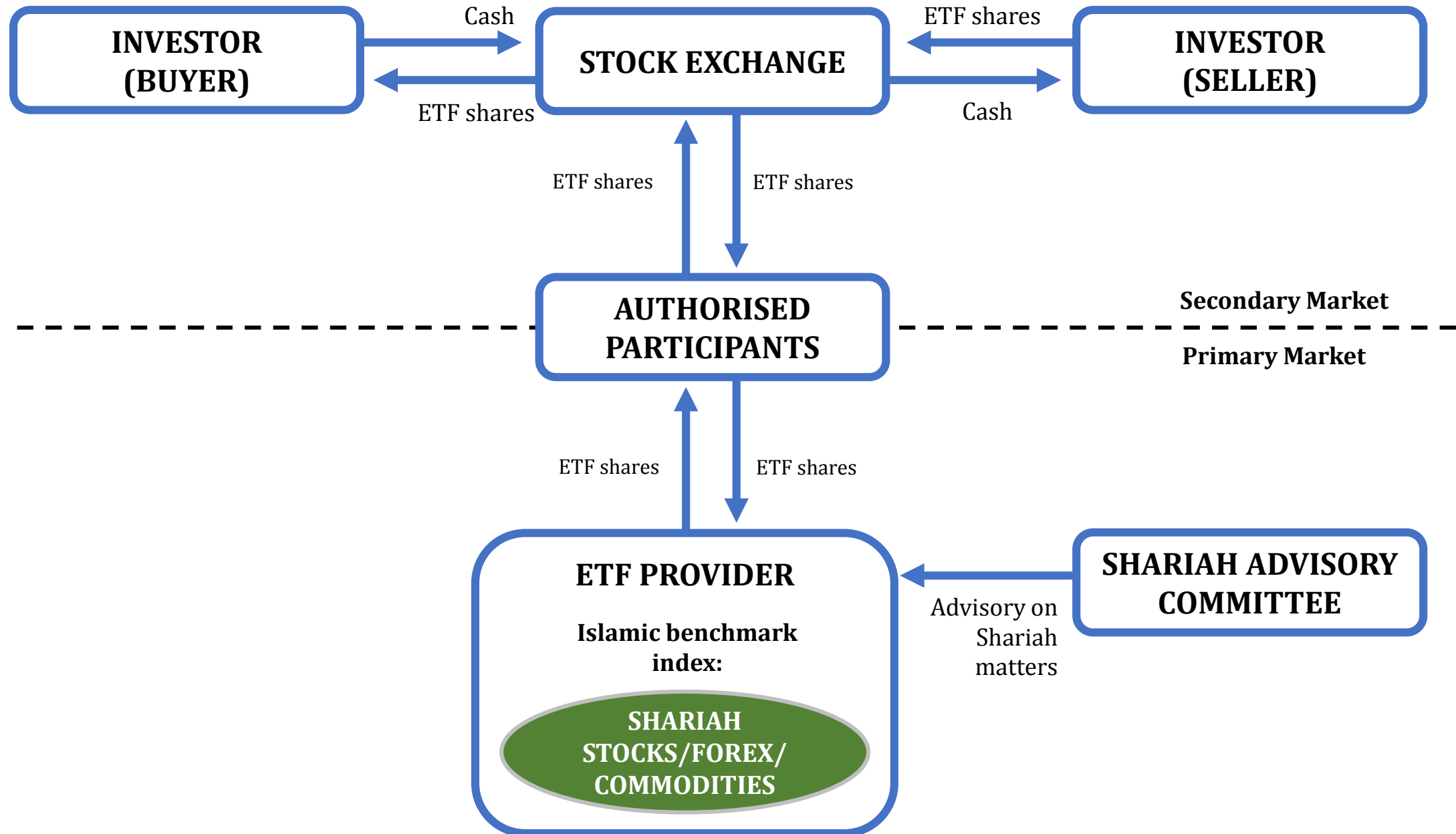
# Basic structure of an Islamic money market fund



# Basic structure of an Islamic REIT

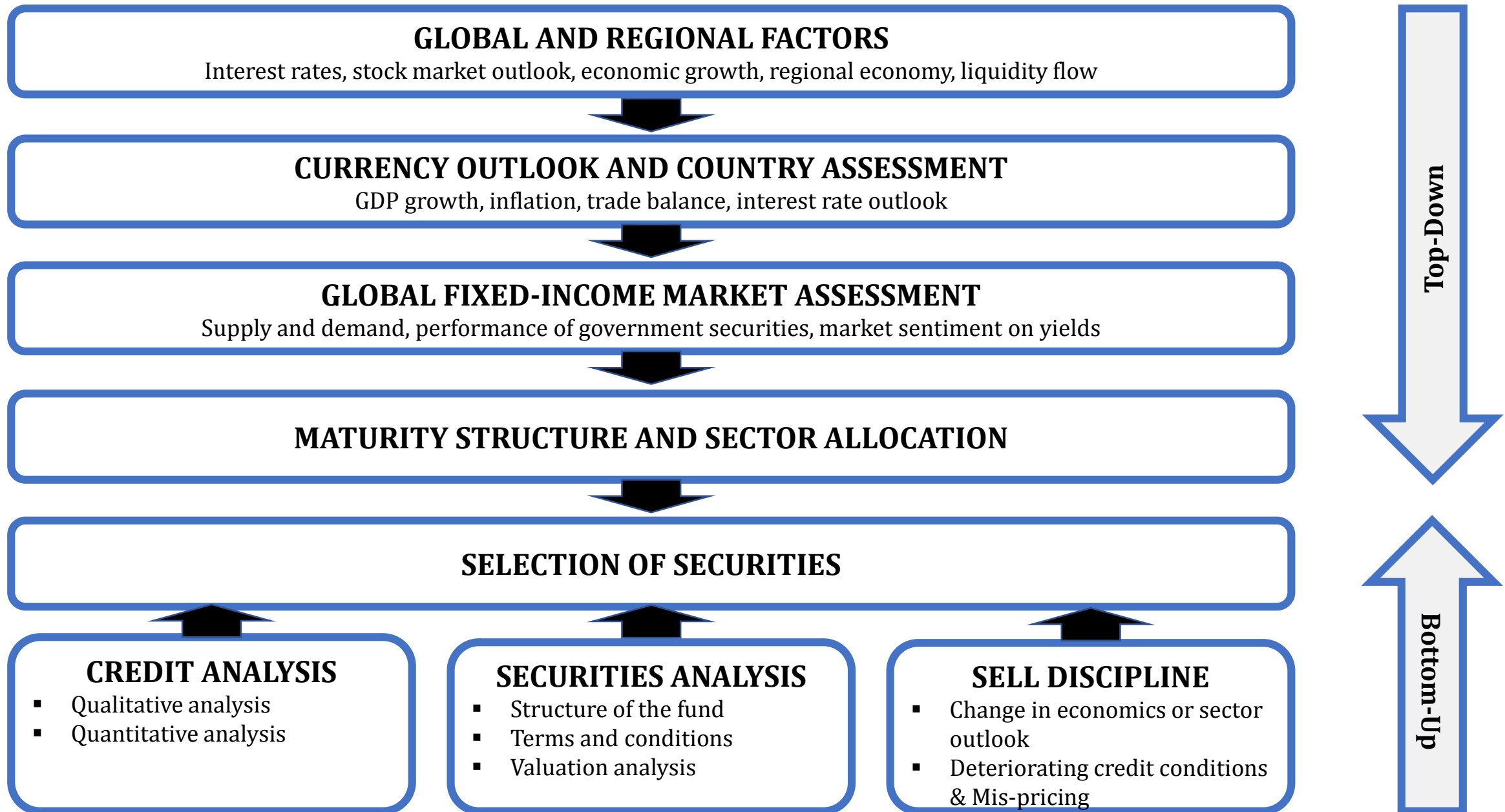


# Basic structure of an Islamic ETF





# Example of an investment process



1

## Regulatory framework

- Lack of regulation & transparency
- Inadequate disclosure

2

## Talent & Technology

- Lack of talented human capital
- Adaptation of Fintech

3

## Scalability

- Achieving a minimum level of scale efficiency is a challenge.

4

## Investible Assets

- Lack of investment opportunities and Shariah-compliant financial assets

5

## Reclassification of Securities

- Shariah-compliant portfolio might become non-compliant with time

Thank you



Suite 20.01, Level 20, The Gardens  
South Tower, Mid Valley City,  
Lingkaran Syed Putra, 59200 Kuala  
Lumpur, Malaysia  
Tel: +603-7628 1010  
Fax: +603-7620 8251  
[www.ram.com.my](http://www.ram.com.my)



Lorong Universiti A,  
59100 Kuala Lumpur, Malaysia  
Tel: +603-7651 4200  
Fax: +603-7651 4242  
ISRA: [www.isra.my](http://www.isra.my)  
I-FIKR: [www.ifikr.isra.my](http://www.ifikr.isra.my)