





# Islamic Fund Management

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### 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

# Scope of the study







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



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

# Case Studies & Policy Recommendations

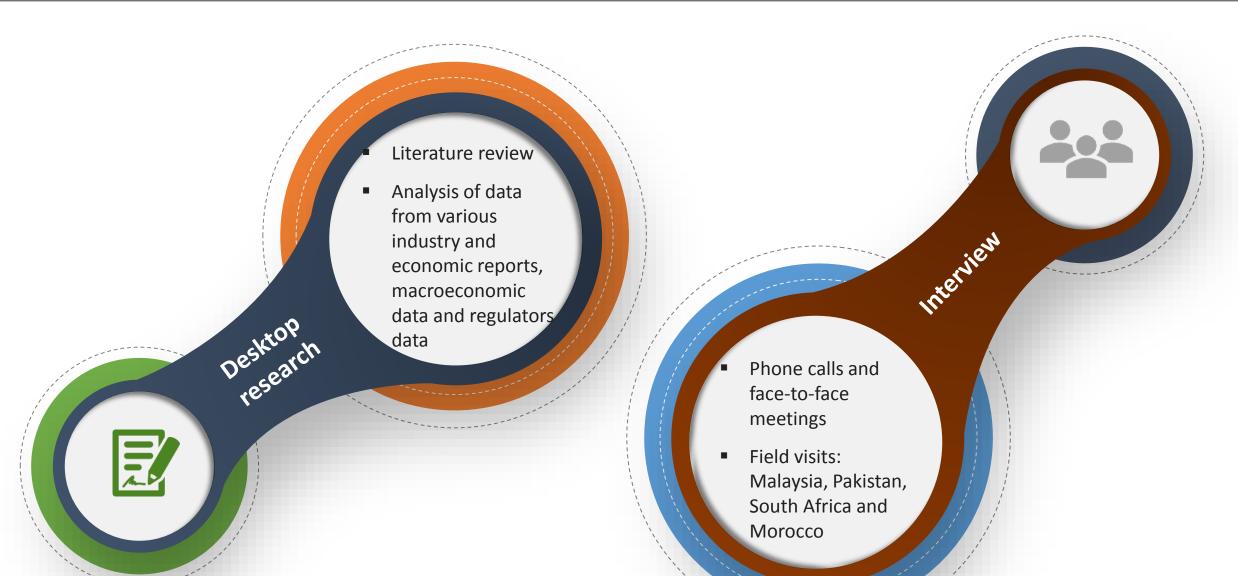
- Islamic fund evolution, analysis of investment and commercial consideration
- Factors & challenges affecting Islamic fund management and policy recommendations



# Methodology of the study



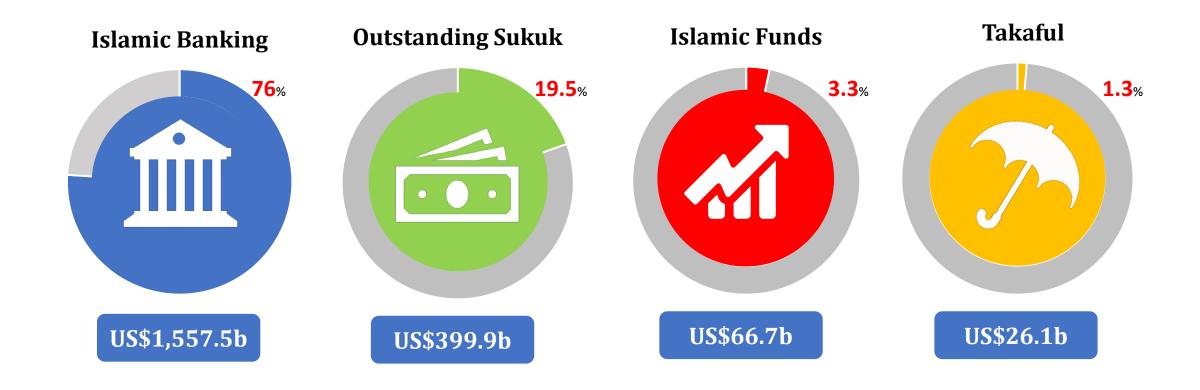








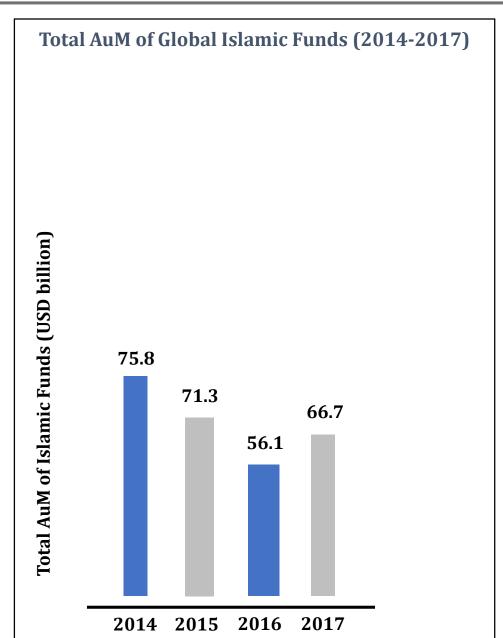
### Islamic finance assets by asset class (end-2017)

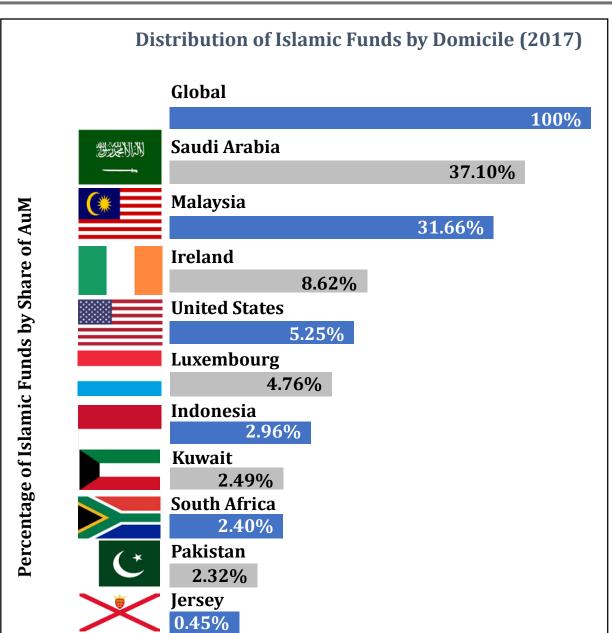


### **Growth of global Islamic funds (Based on AuM)**







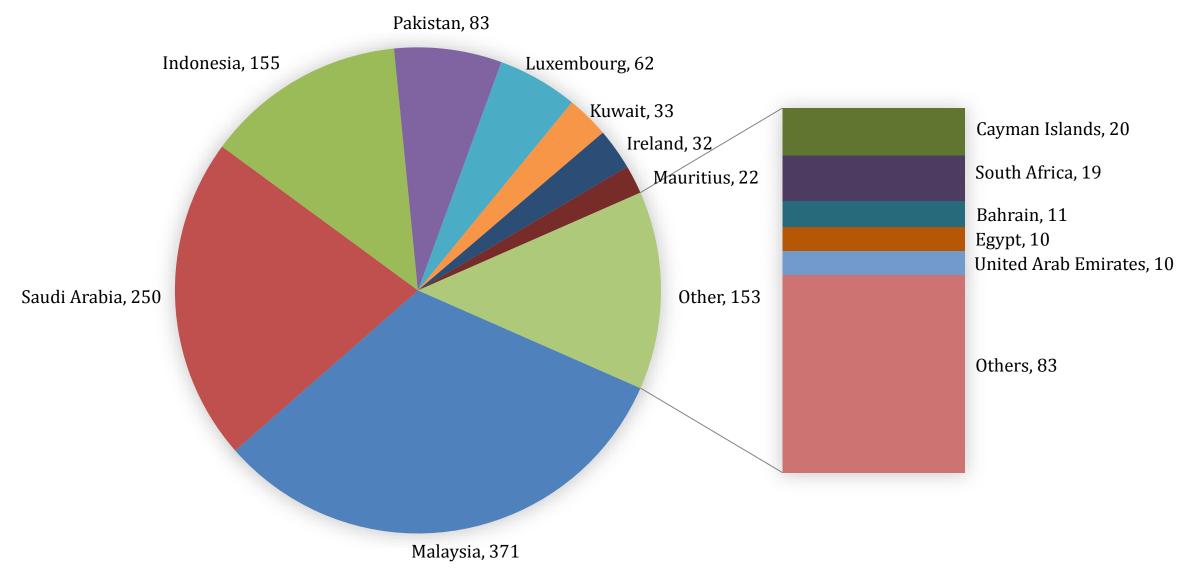


# **Growth of global Islamic funds (No. of Islamic Funds)**





### **Number of Islamic funds by Domicile (2017)**

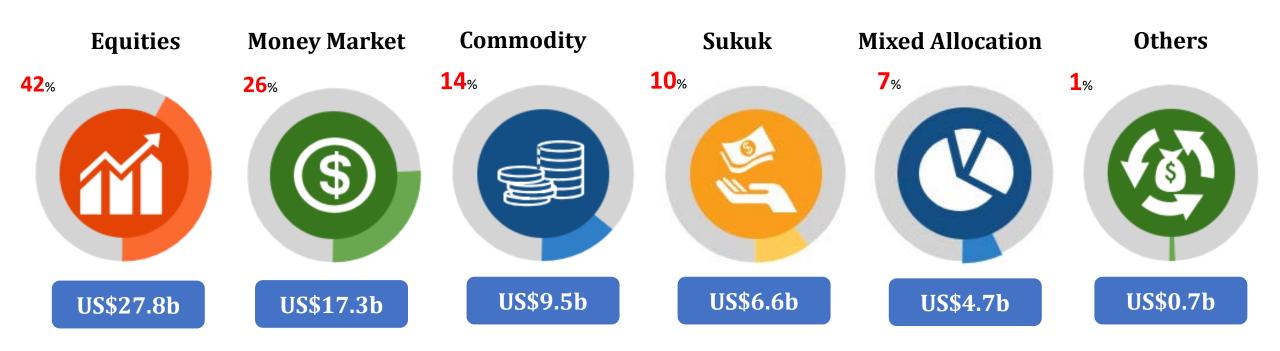


# **Growth of global Islamic funds (Based on Asset Class)**





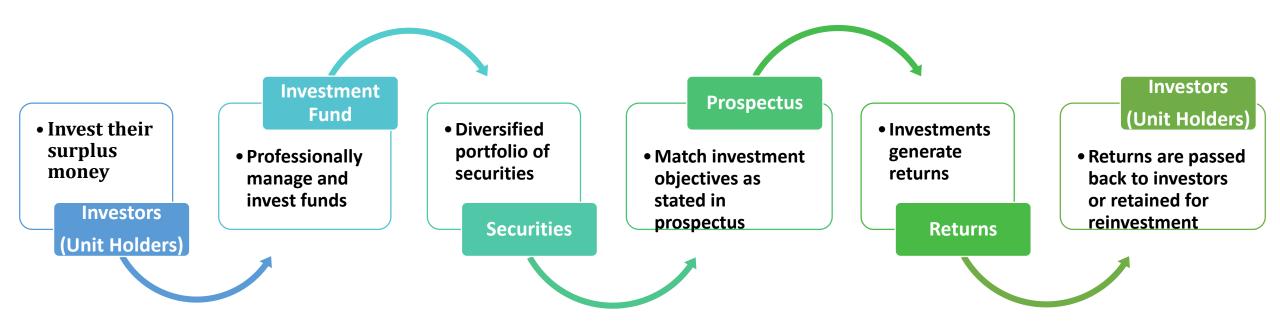
### Islamic funds by asset class (2017)



# **Flow Chart of Fund Management Process**







### Differences between Islamic and conventional funds





# **Contractual Relationship**

- The relationship can be based on either:
  - wakalah (agency)
  - *mudarabah* (profitsharing) contracts.

# Shariah-Compliant Portfolios

- Investment portfolios should comply with Shariah requirements.
- Shariah screening of investments.

### Purification of Impure Income

- Shariah scholars have set a limit on the percentage of impure income.
- Investors need to purge their share of impure income.

### Role of Shariah Advisor

- Advises the fund to ensure Shariah compliance of its operations and activities.
- Advises the fund on the stock disposal process.

#### Zakah Payment

Payment of zakah once it reaches its hawl and nisab.

### Shariah Governance Process

 The fund must ensure that there is constant monitoring of its investments and activities.

### **Process flow of fund set-up**





# Stage 1: Conceptualisation

#### **Investment Analysis**

- Target investors retail, sophisticated investors or wholesale.
- Choice of Shariah assets.
- Shariah screening and benchmark selection.
- Select investment strategy.

# Stage 2: Planning

#### **Financial Analysis**

- Quantitative measures for risk and return.
- Shariah screening methodology.
- Shariah compliance procedures.
- Define purification process.
- Define compliance and audit review processes.

### Stage 3: Regulatory Approval

#### **Submission**

- Guidelines and policies.
- Checklist and submission for approval.
- Proactive engagements with regulators.

# Stage 4: Implementation

### Portfolio Development

- Implement investment strategy.
- Strategy optimisationrisk and return.
- Shariah review and compliance.
- Appointment of professional managers.

# Stage 5: Monitoring

# Performance Analysis and Portfolio Review

- Performance measurement.
- Peer benchmarks.
- Rebalancing considerations.
- Review of Shariah compliance.
- Implement purification processes (if required).
- Perform compliance and audit reviews.
- Committee reporting and strategy update based on market conditions.

# Basic Shariah requirements of an Islamic fund





### Shariah board/advisor:

Advises on requirements for end-to-end Shariah compliance of fund activities

### **Custody:**

To ensure Islamic funds' assets are placed in Shariah-compliant instruments

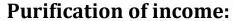


Shariah Requirements for Islamic Funds



#### **Shariah audit/review:**

To conduct regular (e.g. annual) audits or reviews on the fund



To cleanse the fund from any non-Shariah-compliant income



### **Shariah screening:**

To determine screening criteria for Shariah-compliant investments



# Shariah-compliant investment:

To only invest in Shariahcompliant assets or portfolios

# Key parties involved in Islamic fund management and their roles





# SHARIAH BOARD/ADVISOR Advise on the overall st

Advise on the overall structure and documentation of the fund to comply with Shariah

# ASSET MANAGEMENT COMPANY

Promoter of the fund. Responsible for investing the funds according to investment strategies.

### **INVESTORS**

Providers of funds through purchase of unit trusts.



Appointed by a trust deed to protect the investors' interests
Provide adequate supervision over the fund manager.



Agent of the asset management company to sell unit trusts to customers.



### **REGULATOR**

Formulates guidelines and regulation for the operation of unit trust funds

**SIX KEY PARTIES IN ISLAMIC FUND MANAGEMENT** 

# Role of fund management from various perspectives







# 1 Macroeconomic

Promoting savings and investment.

Circulating capital in the real economy.

 Providing liquidity to sovereigns, institutions & individuals

 Contributing to economic development and growth.

# 2 Microeconomic

Economies of scale enabling wide range of investments not possible for individual investors

Professional management services at lower cost

Lower risk through diversification

Liquid investments and ease of transaction

Good financial returns over the long term

# 4 Islamic

 Shariah-compliant screening and monitoring of investments.

 Shariah governance in the form of reviews and audits



# 3 Islamic capital market

Providing retail investors an access to capital markets.

Contributing to financial market efficiency

Supplying an efficient avenue for capital recycling

# Building blocks to sustain the long-term growth of Islamic fund management





# ISLAMIC FUND MANAGEMENT INDUSTRY

1

Legal, Regulatory, Shariah, Market Supervision

- Guidelines for unit trust funds, ETFs and REITs
- Shariah screening methodology and purification

2 1

Development of Institutional Funds

- Regulated pension schemes
- Flexibility to choose Shariah funds

\*

Liberalisation of Policies and Guidelines

- Investment in overseas assets
- Access to network of global investors

Taxation

Tax Framework

- Supportive tax policies to promote product development
- Tax incentives

5 Market Infrastructure

- Regulated stock exchange
- Strong backend support or administrative services

#### **Key Measures to Support a Viable Fund Framework:**

Political will and cohesive collaboration with key stakeholders

Robustness of the capital markets

Creating a captive demand base for Islamic funds

Awareness and capacity building

# **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	pased		Business sector and financial screening
Dividend Purification Ratio	n.a	Dividend x (Non- permissible revenue/Total revenue)		come from prohibited st income))/Total ings	Purification of dividends at 5%

# Shariah screening methodologies (con't)



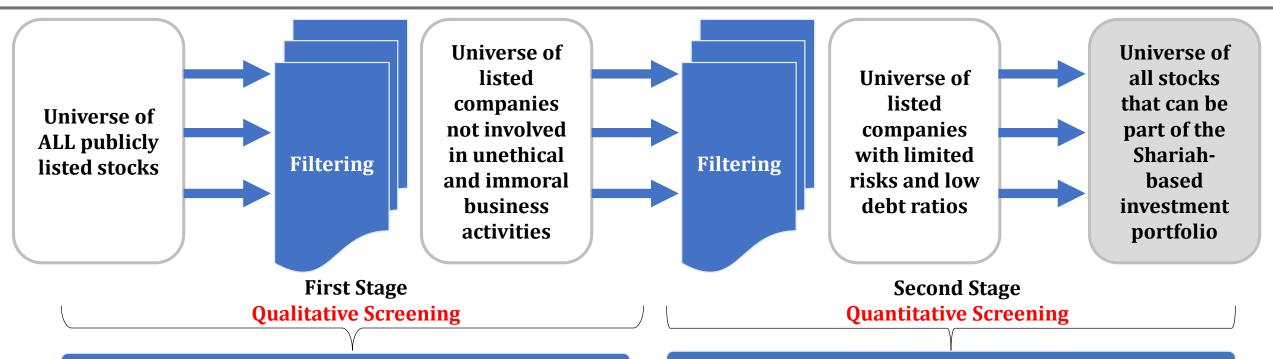


	SAC of SC (Malaysia)	S&P Dow Jones Shariah Indices	MSCI Islamic Index (Series)	MSCI Islamic Index (M-Series)	FTSE Shariah Global Equity Index Series
Financial Ratio	<ul> <li>Total debts/ Total assets = &lt; 33%</li> <li>Cash/Total assets = &lt; 33%</li> </ul>	<ul> <li>Total debts/ Market capitalisation         = &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> <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> <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> <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







### **Business Activity Benchmarks**

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.

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

#### **Financial Ratio Benchmarks**

Cash

#### **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** 

**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%.

**5**%

20%

# Analysis of various types of funds by investment portfolio



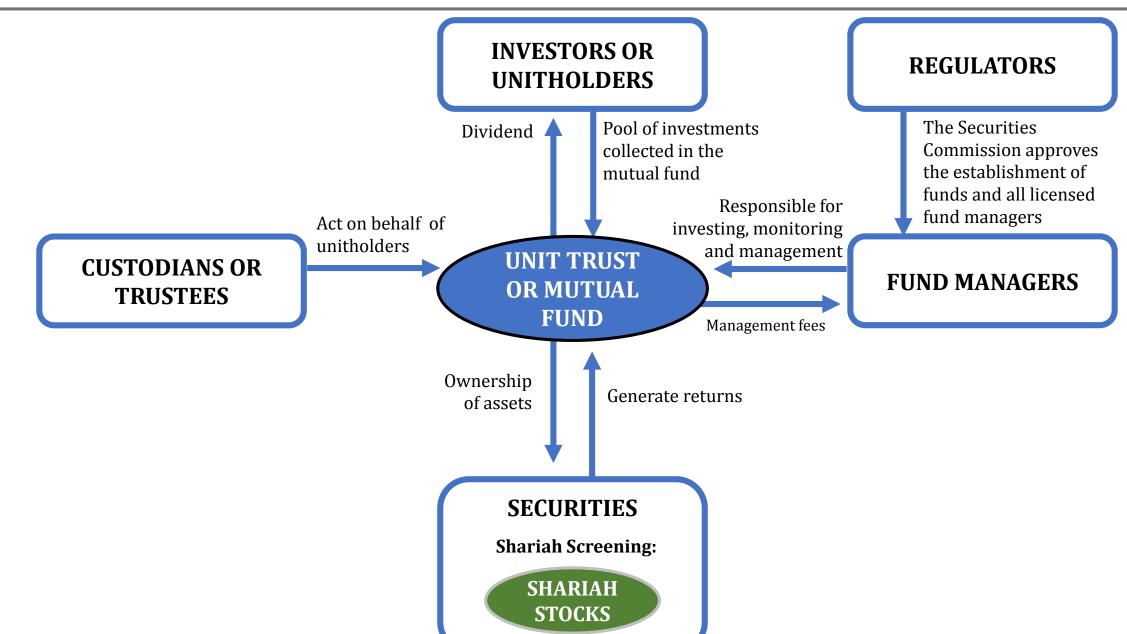


RATINGS  **RETINGS***  **RETINGS***  **RETINGS***  **RETINGS***  **RETINGS***  **RETINGS***  **RETINGS***  **RETINGS***  **RETINGS**  *							
Equity Funds	Fixed-Income Funds	Balanced Funds	Money Market Funds	REITs	ETFs	Alternatives	
100% invested in stocks	100% invested in fixed-income securities	Mixture 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



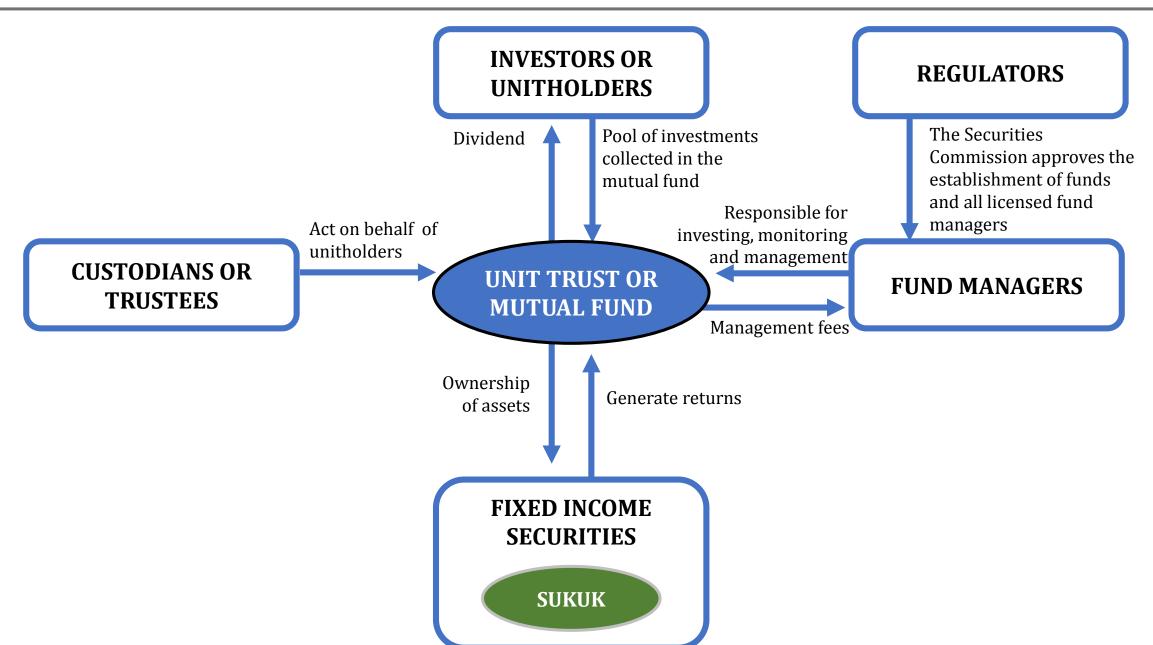




# Basic structure of an Islamic fixed-income (sukuk) fund



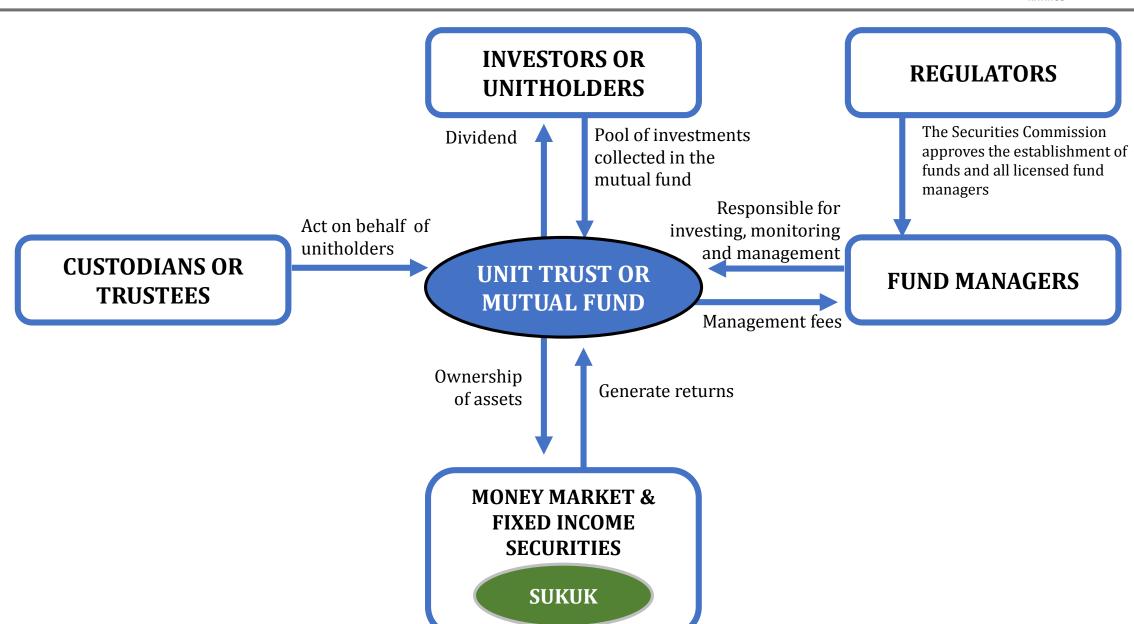




# Basic structure of an Islamic money market fund



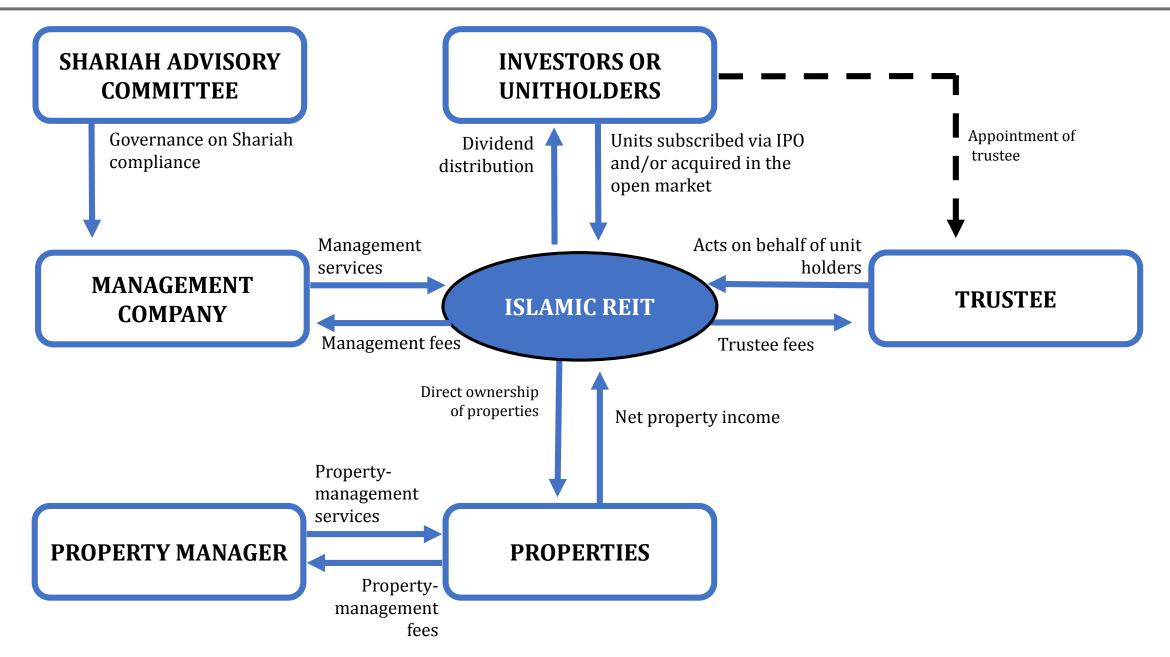




### **Basic structure of an Islamic REIT**



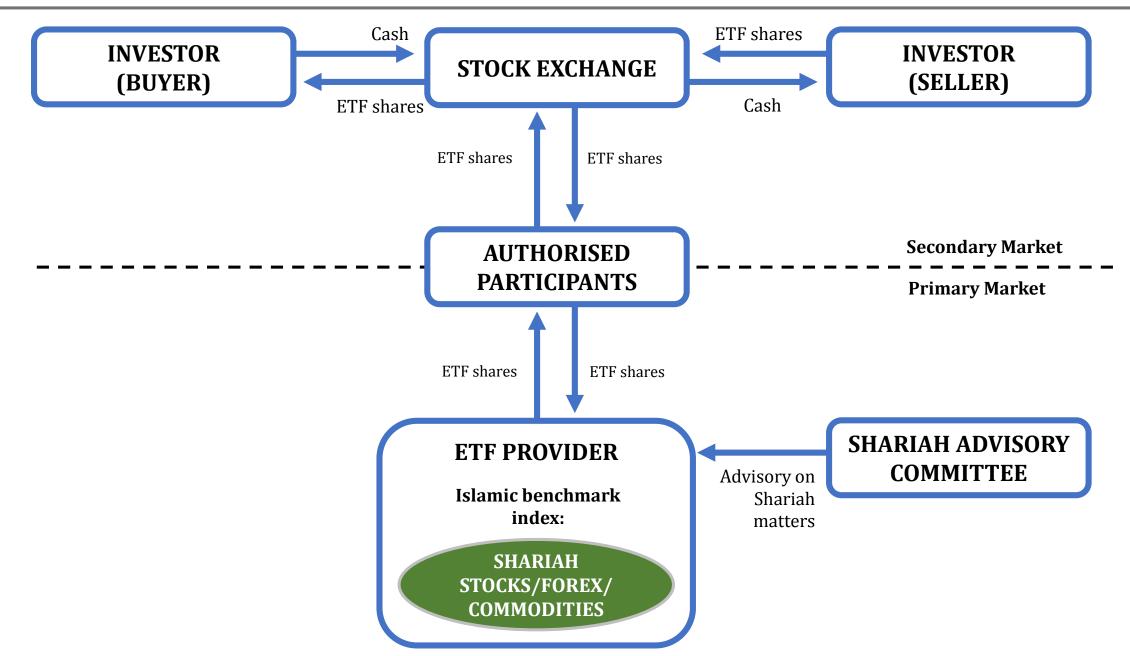




### **Basic structure of an Islamic ETF**







### **Example of an investment process**





#### **GLOBAL AND REGIONAL FACTORS**

Interest rates, stock market outlook, economic growth, regional economy, liquidity flow



#### **CURRENCY OUTLOOK AND COUNTRY ASSESSMENT**

GDP growth, inflation, trade balance, interest rate outlook



#### GLOBAL FIXED-INCOME MARKET ASSESSMENT

Supply and demand, performance of government securities, market sentiment on yields



#### MATURITY STRUCTURE AND SECTOR ALLOCATION



#### **SELECTION OF SECURITIES**



- Qualitative analysis
- Quantitative analysis

#### **SECURITIES ANALYSIS**

- Structure of the fund
- Terms and conditions
- Valuation analysis

#### **SELL DISCIPLINE**

- Change in economics or sector outlook
- Deteriorating credit conditions & Mis-pricing

# Top-Down

**Bottom-Up** 

# **Key challenges**





1 Regulatory framework

- Lack of regulation & transparency
- Inadequate disclosure

Talent & Technology

- Lack of talented human capital
- Adaptation of Fintech

3 Scalability

 Achieving a minimum level of scale efficiency is a challenge.

Investible Assets

 Lack of investment opportunities and Shariah-compliant financial assets

Reclassification of Securities

 Shariah-compliant portfolio might become non-compliant with time





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