

# Shari'ah Compliant Funds: The Pace of Asset Growth May Finally Begin to Quicken

While the past 15 years have seen tremendous interest and growth in the field of Islamic finance, a close examination specifically on the Islamic funds sector reveals that growth fund has been nothing if not gradual. In 1994, there were a scant nine Shari'ah-compliant funds in the GCC; the number is now approaching 400 (Source: [www.failaka.com](http://www.failaka.com)). Over the years, the number of funds has grown and eventually trickled across the globe, though always in a very measured way. While many funds prospered, especially those in Saudi Arabia and Kuwait and those with large retail distribution capabilities, others have experienced more than their fair share of frustration, and a number of funds have tried and failed.

The main complaint by managers has traditionally been the same: problems with distribution — the other challenges of creating an Islamic-compliant fund have largely been figured out. The work of Dow Jones on their popular “screens and ratios” and the many variations thereof have gained near universal acceptance, and securities conforming to these guidelines are generally found in sufficient quantities to allow for the creation of viable funds. In fact, for many years there has been wide consensus that you can structure a Shari'ah-compliant fund on nearly all of the major world bourses. By way of example, it is claimed that approximately 90% of shares on the KLSE in Malaysia are Shari'ah-compliant and therefore eligible investments for a Shari'ah fund; and not long ago, the DFM in Dubai became the world's first Shari'ah-compliant stock exchange. In short, the knowledge and experience is there, but very often the monies do not follow...or follow quickly enough. This may be changing.

The cause for optimism is two-fold: the rise of Takaful, or Islamic insurance and the first sign of government support.

For many industry observers, the least developed, and therefore the area with the most potential within Islamic finance is Takaful. By comparison, Islamic funds are in many ways a mature product in the field, with a history stretching back in the 1960s and 1970s (although the major push came in the 1990s). However, Takaful has one key similarity, in that its potential market is comprised of both retail and institutional clients that span the globe. While the past five years have seen Islamic private equity, investment banking and most especially Sukuk making headlines, it is quite possible that the next five years may belong to the expanding number of Takaful houses that are springing up across the globe.

The point about Takaful is simply that, just like conventional insurance companies, Takaful companies should become large buyers of funds for their excess premiums. The catch is that of course an Islamic Takaful company should not be investing in conventional funds, but rather in one of the relatively few Shari'ah-compliant funds. Although they will likely have a markedly low risk/reward profile, their growth could provide an additional area of support for eager fund managers.

The second encouraging factor is the involvement of governments. It is fair to say that, thus far, assets in Islamic funds have grown organically, primarily through the greater awareness and acceptance of retail investors. While many of these investors, especially early investors, may have been high net worth investors, Islamic funds have been primarily supported by grass root individual investors. This is particularly so in the major markets of Saudi Arabia and Malaysia. While the growth has been steady, total assets in Shari'ah-compliant equity and balanced funds (listed shares) stand at a mere \$19 billion. While it may be an unfair comparison, it is illustrative that the total for socially responsible fund assets stands at roughly 49bn (\$76 bn) from a universe of nearly 500 funds.\*

Given this state of affairs, and with the GCC especially flush in recent years, many have questioned why the regional governments have not been major investors. Surely they have their reasons, but recently the FT reported that the Dubai government would be committing \$250m into an Islamic-compliant hedge fund product, a subset of the Islamic funds industry that has found it especially difficult to attract investment. Might this be the tip of the iceberg? With most GCC governments solidly behind the industry in terms of establishing regulatory regimes and supporting development initiatives, and with oil now in its sixth year of a bull market, perhaps actual investment is the next step. If we are indeed in the midst of Goldman Sachs' “super spike” in oil prices, with \$200 per barrel the next stop, just think of what would happen if even a percentage of this sovereign wealth was diverted into this gradualist industry. It could grow tenfold overnight. \* <http://www.responsible-investor.com>

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