

Institutional investors and Sharia

Institutional investors in predominantly Islamic regions such as Malaysia and the Middle East play a significant role in nurturing the sharia-compliant investment industry. Comprehensive data is scarce in this nascent marketplace, but anecdotal evidence and occasional public reports indicate that sovereign funds, pension funds, wealthy families and Muslim institutions in these regions have been actively investing into sharia-compliant investment firms and service providers, as well as sharia products.

About 95% of assets in Malaysia's MyETF-DJIM25 are owned by institutional investors, estimates Zainal Izlan Zainal Abidin, CEO of i-VCAP Management, which launched Malaysia's first Islamic ETF in January 2008.

Most are Malaysian institutions, but Izlan thinks more global institutions will subscribe to MyETF in the next couple of years as confidence returns to the equity markets and as global investors seek increasing exposure to emerging markets.

"Investors in the Middle East traditionally invested into real estate, but they are beginning to diversify into equity markets as good returns from direct property investment are becoming harder to find. With this trend, Islamic ETFs and funds will become more appealing to them, as they present an easy way to access sharia-compliant equities, including those in Malaysia," Izlan says. i-VCAP also has a fund restricted to qualified institutional investors and high-net worth individuals.

An Islamic fund management firm based in Kuala Lumpur, i-VCAP has several indirect institutional shareholders. The firm's direct shareholder is ValueCAP, which is owned by Malaysia's US\$25 billion sovereign fund Khazanah Nasional; the government employees' pension fund Kumpulan Wang Amanah Pencen (KWAP); and fund manager Permodalan Nasional Berhad (PNB).

Institutions like Khazanah, KWAP and the RM348 billion Employee Provident Fund (EPF) are not Islamic organizations as such, and their investment strategy and asset allocation may not explicitly plan for sharia investments. But they inadvertently own sharia-compliant assets.

EPF's 25.71% allocation to equities exposes the fund to more than 100 companies listed on Bursa Malaysia; about 88% of Bursa's companies are sharia-compliant. For example, EPF owns 82.23% of RHB Capital Group, which includes RHB Islamic Bank.

In 2008, EPF increased investments into Islamic bonds to RM31.49 billion, which is 29% of the loans and bonds allocation. In the preceding year, the fund invested RM27.77 billion into sukuk, which was 28.5% of allocation to bonds.

KWAP has a strategic asset allocation of 27% to domestic equities and 40% to domestic loans and money markets. Considering the domestic



Zainal Izlan Zainal Abidin

market's complexion, there is an exposure to sharia-compliant assets, even if unintended.

In recent years, Khazanah has made a steady stream of investments into Islamic firms. Malaysia is one of the world's largest sharia investment markets, and Khazanah appears to play a role in keeping this lead, as a provider of capital. With US\$87 billion in sharia assets, Malaysia ranks third behind Iran with US\$293 billion and Saudi Arabia with US\$128 billion.

In 2009, Khazanah invested US\$150 million into Fajr Capital for a 25% stake. Other sovereign investors in this Dubai-based Islamic investment firm include Brunei Investment Agency and Abu Dhabi Investment Council. Fajr invests primarily into companies offering Islamic financial services, and is led by CEO Iqbal Khan, who was the founding CEO of HSBC Amanah.

In 2008, Khazanah took at 10% equity stake in Jadwa Investment for US\$76 million. Jadwa is a sharia-compliant investment firm based in Saudi Arabia. The firm provides investment banking, corporate finance, brokerage and asset management services.

Khazanah also has a joint venture with Dubai Group and Singapore-based Asia Capital Reinsurance to establish ACR Retakaful Holdings. The reinsurance company will channel conventional insurance risks from industries such as infrastructure, energy and marine into sharia-compliant takaful structures.

Another Malaysian institution investing in sharia-compliant assets is Lembaga Tabung Haji, the Muslim pilgrims' fund. Established in 1969, it is the world's first Islamic fund. The RM23 billion fund has a diverse portfolio, including a property subsidiary TH Properties.

In late 2009, TH Properties' CEO Datuk Ismeel Ismail reportedly said his firm had made RM2.3 billion worth of investments into Malaysian and

Saudi Arabian real estate, and Tabung Haji wants to expand its property portfolio with London and European assets.

Tabung Haji also has a 9% share of Malaysia's Bank Islam, a sharia-compliant bank. In October 2009, speculation ran rife that the bank's Dubai shareholder would divest its 40% stake. It was widely believed that Tabung Haji would assume this stake. Tabung Haji declined an interview request from IPA.

Even in markets where Muslims are not in the majority, niche institutional investors require sharia-compliant services and products. These include the Islamic Religious Council of Singapore (MUIS), which administers real estate donated to the community for philanthropic purposes. This form of giving is called waqf. MUIS has a subsidiary, Warees Investments, to manage its real estate investments and income disbursement to beneficiaries.

Sharia investment professionals think that non-Muslims will find sharia investments attractive from the risk perspective. Sharia prohibits high leverage and extreme uncertainty and volatility, for example. David Vicary Abdullah, global leader of Deloitte's Islamic finance group, remarks that "the majority of growth in Islamic finance is from non-Muslims and non-Islamic institutions. This was in part spurred by the economic crisis. People needed liquidity. It exists in the Gulf Cooperation Council countries and the Islamic finance sector remained relatively untouched by the crisis."

Vicary Abdullah has been speaking to non-Islamic institutions worldwide about sharia-compliant investing. "Large pension funds and family offices in developed economies are beginning to look at sharia products such as Islamic mutual funds, project finance, funds of funds, real estate funds, aircraft finance, country-specific and industry-specific funds and sukuk," he says.

But few conventional investors are au fait with the sharia proposition currently. David Smart, global head of sovereign and supranational funds at Franklin Templeton, thinks that few non-Muslim institutional investors will find sharia products attractive, unless they demonstrate superior returns. Scott Kalb, chief investment officer at Korea Investment Corporation, says he is unfamiliar with sharia investments.

International Financial Services London (IFSL) estimates that sharia-compliant assets total about US\$951 billion at the end of 2008, which is 25% greater than in 2007. In the mid 1990s, the sharia-compliant marketplace was only US\$150 billion. Currently, the sharia market is dominated by Islamic commercial banks, which account for 74% of assets, investment banks 10%, sukuk 10%, funds 5% and takaful 1%, according to IFSL.