THE EMERGENCE OF ISLAMIC FINANCE
IN WEALTH MANAGEMENT
Abstract

With the emergence and subsequent growth of Islamic banking and finance, Islamic wealth management (IWM) is today no longer an unfamiliar concept. The global wealth management market is expected to grow at a compounded annual growth rate (CAGR) of 8.7 percent in 2021 to $1.26 trillion. In view of this, Islamic finance and Shariah-compliant products are an expanding segment globally, especially within the retail investment market. However, the development of IWM options is broadly speaking, still at a very early stage.

The trend towards embracing alternative investment options will continue; the key factors driving this growth include the rising population of both retirees and high net-worth individuals (HNWI) who require higher returns than what is possible in today’s low interest rate environments. More notably, the demand is expected to rise at a rate of 9.8 percent per year to 2025, when alternative assets under management (AUM) are predicted to total $17.2 trillion. With ethical and socially responsible funds broadening their appeal to investors, IWM options have also come into prominence in this area. As the first part of a series, this article aims to differentiate the conventional forms of wealth management and explore the potential of Islamic finance as an impactful wealth management solution.

Key Highlights

- Total value of global Islamic finance assets is expected to rise to $3.69tn by 2024
- 30% annual growth of Islamic funds value in 2019; total AUM was $140bn
- 127 Islamic funds were launched in 2019, including Shariah-compliant mutual funds, pension funds, insurance funds, and exchange-traded funds (ETFs)
- A 2019 Morgan Stanley survey found that 90% of people aged 24 to 39 would prefer to tailor their investments to align with their personal values
- There are over 300 Islamic equity funds managing assets valued at more than US$5bn
- US-based Wahed Invest launched the world’s first automated Islamic investment platform in 2017, allowing investors access to a Shariah-compliant portfolio and expanded into the UK market in 2018. We also expect to see a rise in Islamic finance robo-advisors
**Difference Between Conventional and Islamic Wealth Management**

There are five key components of IWM: wealth creation, wealth accumulation, wealth purification, wealth protection, and wealth distribution (as shown in Figure 1). Some of these components will help highlight the differences between conventional wealth management and IWM. The aim of any wealth management function is to provide a level of investment protection, generate and accumulate income, and to distribute wealth accordingly during life transitions and retirement.

**Figure 1. 5 Key Components of Islamic Wealth Management**

![Diagram of 5 key components of Islamic wealth management: Creation, Distribution, Accumulation, Protection, Purification](image)

**Objectives**

The objectives for wealth management (WM) in conventional finance includes providing individuals services that cover financial planning, investment advice, portfolio management, accounting/tax services, and other financial services including insurance.

While this is similar in the case of IWM, it also entails the requirement that a person’s wealth is managed in a manner that is in accordance with the norms of Islamic law derived from the Qur’an. Wealth must be created through income that is Shariah-compliant and can be further accumulated by utilizing various investment vehicles such as Islamic funds, sukuks (Shariah-compliant bonds) and Islamic equities.

**Purification**

A key difference in IWM is that it must also provide wealth purification and distribution. Wealth obtained through prohibited industries and activities, including gambling and entertainment, would automatically be disqualified. Moreover, investments in companies that have excessive interest-bearing debt and income will also be deemed non-Shariah-compliant. For Muslims, purifying their wealth involves providing a percentage of annual income (generated by Shariah-compliant investments) to zakat (obligatory charity).

Under the principles of Islamic finance, the fundamental principle to consider is that money is a means to promote social welfare without neglecting the competitive and sustainable advantage of its services. If it is earned, invested, and spent
in the right way, it brings barakah (blessings), not only to the individual but also to their family and society at large. Islamic finance can be seen to be more akin to socially responsible investing, as it seeks to provide sustainable development, enable economic prosperity, and eradicate poverty in the developing world. This is done through the use of waqf (endowments), the aforementioned zakat (obligatory charity), and sadaqah (voluntary charity) which facilitate the ultimate purification of an individual's wealth.

Protection
Due to the uncertainties that an individual may face in life, conventional wealth management protects the wealth of the person using different forms of insurance, including life insurance, to cover any loss. By contrast, IWM must comply with Shariah law by avoiding gharar (uncertainty), and accordingly forbids the use of insurance as the contract is a form of maisir (speculation/gambling) which will contain riba (usury), which in turn means it is considered haram (prohibited).

As Muslims cannot use insurance as a tool within their wealth protection planning, they instead use a takaful contract – a type of risk-sharing model where money is pooled between members to support each other if they suffer as a result of any adverse circumstances. This form of risk management is a co-operative system, since the risk is shared between the group and they have a mutual responsibility towards one another. In contrast, conventional insurance follows a risk-transfer model and may invest in sectors which are not Shariah-compliant.

Distribution
In conventional WM, the laws governing the distribution of wealth and inheritance upon the death of an individual differ from country to country. In the UK, for instance, if someone has made a will, they have 100% freedom to transfer their estate to whoever they wish, including family and friends. If there is no will, then their wealth is subject to rigid intestacy rules where nothing could be left for the family.

For Muslims, wealth and assets are transferred through wasiat (will writing), hibah (gift) and waqf (endowments). Under Shariah law, when a person has written a will, they only have testamentary freedom on a third of their wealth. The other two-thirds of the individual’s estate must go to primary heirs – which include spouses, children, and parents – for which the distribution is fixed as per the Qur’an.

Islamic Wealth Management Products
Navigating the current landscape of wealth management and the products available, there have traditionally been limited options for Muslims that align with both their religious beliefs and their need for a good return on investment. As highlighted in Figure 2, there is now a case for a variety of investment options to be considered halal (permissible) when looking to invest. These options are all still subject to a level of Shariah-compliance – for example, precious metals like gold can be invested into if they are physically held and not through gold futures and options. Funds and mutual funds cannot utilise derivatives or equities that are non-compliant. In addition, financing investment options such as property is also subject to Shariah-compliant loans. Going forward, the demand for Islamic finance products will continue to grow as coming generations are increasingly amenable to more ethical forms of investing that also consider environmental and social impact, which as mentioned is an underlying principle of Shariah law.

As the IWM industry looks to positive prospects of growth for both client investors and service providers, there are some key considerations that must be taken into account when designing and selling compliant products and services. The rising demand among investors for sophisticated IWM products will bring about challenges and opportunities for service providers:

- Permissibility of the products due to varying Shariah interpretations
- Pricing the product competitively relative to conventional investment options
- Profitability/returns for the products should also be attractive for Islamic wealth clients
Figure 2. Comparison of Investment Options

Conventional Investment Options
- Conventional Bonds
- Conventional Savings Accounts
- Derivatives
- Forex
- Futures & Forwards
- Options & Binary Options
- Swaps

Islamic Investment Options
- Cryptocurrencies
- Exchange Traded Funds (ETF)
- Funds & Mutual Funds
- Precious Metals
- Property
- Stocks & Shares
- Venture Capital Investing

1 Subject to financial & business screening from a Shariah law perspective

Conclusion
Globally, IWM is expected to see continued sustained growth due to rising demand for Shariah-compliant investments. Underpinned by a paradigm shift in individuals’ desire to embrace alternative options and capitalize on sustainable investing, the fundamentals of Islamic finance have become attractive to both growing and increasingly affluent Muslim populations and ethically minded consumers.

The rise of IWM has been developing incrementally in the Islamic finance industry for quite some time, particularly in Muslim-majority countries in East Asia, notably Malaysia and Indonesia. In addition, the oil-rich states of the Middle East are diversifying away from standard products in response to the impact of low oil prices. This trend is expected to accelerate following the COVID-19 pandemic.

Moreover, proponents of IWM – from the providers to the regulators – are gearing up to offer a greater array of Shariah-compliant wealth management products and options to a client base that is generating private wealth at a remarkable rate.

In the next part of the series, we will explore the challenges faced by Islamic finance in the wealth management space, its future potential, and the changing consumer behaviors towards ESG and value-based investing.
REFERENCES


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