General Council for Islamic Banks and Financial Institutions
المجلس العام للبنوك والمؤسسات المالية الإسلامية
CIBAFI

CIBAFI SPECIAL REPORT

GLOBAL ISLAMIC FUNDS: TRENDS, CHALLENGES, AND OPPORTUNITIES

2022

Published in 2022 by

General Council for Islamic Banks and Financial Institutions
Jeera III Tower, Office 51, Building No. 657, Road No. 2811, Block No. 428, Manama, Kingdom of Bahrain
P.O. Box No. 24456

Legal Deposit Number: 978-99901-26-20-4

ABOUT THE GENERAL COUNCIL FOR ISLAMIC BANKS AND FINANCIAL INSTITUTIONS (CIBAFI)

CIBAFI is an international organisation established in 2001 and headquartered in the Kingdom of Bahrain. CIBAFI is affiliated with the Organisation of Islamic Cooperation (OIC).

CIBAFI represents the Islamic financial services industry globally, defending and promoting its role, consolidating co-operation among its members, and with other institutions with similar interests and objectives.

With over 130 members from 34 jurisdictions, representing market players, international intergovernmental organisations, professional firms, and industry associations, CIBAFI is recognised as a key piece in the international architecture of Islamic finance.

In its mission to support the Islamic financial services industry by being the leading industry's voice in advocating regulatory, financial and economic policies that are in the broad interest of our members and that foster the development of the Islamic financial services industry and sound industry practice, CIBAFI is guided by its Strategic Objectives, which are, 1) Advocacy of Islamic Finance Values and Related Policies & Regulations; 2) Research and Innovation; and 3) Training and Professional Empowerment.

CONTENTS

ACRONYMS

AAOIFI	Accounting and Auditing Organisation for Islamic Financial Institutions
AI	Artificial Intelligence
AMMC	Moroccan Capital Market Authority
AuM	Assets Under Management
B2B	Business to Business
B2C	Business to Customer
BAM	Bank Al-Maghrib
BIMB	Bank Islam Malaysia Berhad
CEO	Chief Executive Officer
DLT	Distributed Ledger Technology
ESG	Environment, Social, and Governance
ETF	Exchange-Traded Fund
Fintech	Financial Technology
FSCA	Financial Sector Conduct Authority
GSIR	Global Sustainable Investment Review
ICIS	Islamic Collective Investment Schemes
ICM	Islamic Capital Market
IFI	Islamic Financial Institution
IFSB	Islamic Financial Services Board
IFSI	Islamic Financial Services Industry
IOSCO	The International Organization of Securities Commissions
IPO	Initial Public Offering
ISRA	International Shariah Research Academy for Islamic Finance
MRA	Mutual Recognition Agreements
MSCI	Morgan Stanley Capital International
PRI	Principles for Responsible Investment
REITs	Real Estate Investment Trusts
S&P	Standard and Poor's
SAC	Shariah Advisory Council
SDGs	Sustainable Development Goals
SRI	Socially Responsible Investment

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STATEMENT BY THE SECRETARY GENERAL

I am pleased to welcome you to CIBAFI's Global Islamic Funds Report, a special CIBAFI publication aiming to reflect on the recent developments of the global Islamic funds market and highlight key trends and opportunities that will be shaping its future. This special report comes in succession to our flagship publications, the Global Islamic Bankers' Survey (GIBS) and the Global Takaful Survey (GTS), with the view of shedding light on the growing prominence of the Islamic funds market, measuring its pulse and the vast opportunities it upholds.

The global Islamic funds market has been witnessing continuous growth over the past years, with its Assets under Management (AuM) growing by more than 300 percent since 2012. This has been fuelled by several factors, including changes in investment preferences and the increased interest in Shariah-compliant investments. With the growing market for Environmental, Social, and Governance (ESG) investing, Islamic funds possess a huge growth potential and are expected to play a prominent role in the Islamic Financial Services Industry (IFSI) in the coming years.

However, unlike other segments in the IFSI, research measuring the pulse of the Islamic funds market is sparse. This special report aims to fill that gap and to present a point of reference for the industry to understand the Islamic funds market, its current practices, and its key opportunities, as well as the main challenges that may impede its growth.

This report features results from a survey we conducted on Islamic funds management institutions and Islamic banks, capturing their perspectives and their level of involvement in the global Islamic funds market. The report offers insights on the type of Islamic funds and management services offered, the level of adoption of Fintech in the global Islamic funds market, the key concerns facing institutions in the market, among many other relevant factors.

We hope that this report will help to shed light on the current developments of the global Islamic funds market, thus paving the way for its growth by highlighting the main challenges that will need to be addressed and key opportunities that will need to be leveraged on. We also hope to follow this report with other reports looking at different segments of the IFSI.

Dr. Abdelilah Belatik
Secretary General

ACKNOWLEDGEMENTS

The Secretariat would like to convey its sincere thanks to its member and non-member banks and financial institutions who took part in the survey and provided their valuable inputs.

We also express our gratitude to the individuals who have contributed to making this report a success. We would like to appreciate the CIBAFI Secretariat, and Peter Casey, CIBAFI Consultant for their contributions and efforts in the different phases of this report's production.

We take this opportunity to express our sincere thanks to Ali Mamoun Ibrahim of Islamic Corporation for the Development of the Private Sector (ICD), Abdur-Rahman Syed of Jadwa Investment DIFC Limited, and Rehan Noor Pathan of SHUAA Capital for providing their valuable comments and suggestions to the report over the course of its preparation. We are also thankful to Refinitiv for sharing some data on the global Islamic funds market.

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مصرف الصفا SAFA BANK

CIBAFI would also like to express its appreciation to its Knowledge Partners, DDCAP Group™ and Bank Nizwa, its Supporting Partners, Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC), and Omdurman National Bank, and its Associate Partner, Safa Bank for their financial support.

We trust that the report will provide valuable insights to the Islamic bankers and Islamic funds managers around the globe in understanding the key trends, challenges, and opportunities in the global Islamic funds market. Together, using this knowledge, we will progress towards greater paths of success.

Dr. Abdelilah Belatik
Secretary General

EXECUTIVE SUMMARY

In the last decade, the global Islamic funds market showed a remarkable average annual growth of around 18 percent in Assets under Management (AuM). Despite the negative economic effects of the COVID-19 pandemic that decelerated the growth of AuM of Islamic funds from 35.1 percent in 2019 to 13.7 percent in 2020, the global Islamic funds market showed a positive recovery of 17.1 percent as of the third quarter of 2021. This exceptional growth, over the years, is a natural outcome of the growing demand for Shariah-compliant investments backed by an expanding range of Islamic funds available in various jurisdictions.

CIBAFI's report 'Global Islamic Funds: Trends, Challenges, and Opportunities' is unique in that it presents a unique perspective of Islamic financial institutions (IFIs) (here referring to both Islamic funds management institutions and Islamic banks) on the global Islamic funds market and their level of participation in it. Based on the CIBAFI survey, the report offers broad coverage and in-depth analysis of pertinent concerns, novel prospects, and challenges that IFIs foresee in the future development of the regional and global Islamic funds market. The findings of this report will help stakeholders in deepening their knowledge of the global Islamic funds market, understanding current developments, navigating through the main challenges in offering Islamic fund management products and services, and leveraging on pertinent ideas and innovations related to global trends.

> "Despite the negative economic effects of the COVID-19 pandemic, the global Islamic funds market showed strong growth of 17.1% as of third quarter of 2021."

The first section of the report provides an overview of Islamic funds which covers their structure and key features, investment options which address the diverse needs of investors, Shariah screening, and the participation of the Islamic banking sector in the global Islamic funds market.

The second section presents an overview of the global Islamic funds market. At present, the global market comprises 1,508 Islamic funds operated by 345 IFIs in 29 countries. With the average fund size growing in recent years, the total AuM of the global Islamic funds market has reached US $194.51 billion in September 2021 and is expected to grow further by the end of 2021. The top countries with Islamic funds domiciles, in 2021, are Malaysia (401 Islamic funds), Indonesia (209 Islamic funds), and Saudi Arabia (183 Islamic funds); however, when we look from an AuM perspective, the top three contributors are Saudi Arabia, Iran, and Malaysia, resulting in a total of 72.24 percent share (US $140.51 billion) of global Islamic funds market.

The third section of the report presents the findings of the CIBAFI survey. A total of 51 IFIs, from 23 countries in different regions, took part in the survey. The findings suggest that the top concerns of IFIs on the global Islamic funds market are Shariah non-compliance risk, lack of Environmental, Social, and Governance (ESG) investment or positive Shariah screening, absence of liquidity, lack of investor awareness and demand, and obstacles on receiving foreign investment. Respondents also share their insights on the challenges that can impact the future development of the global Islamic funds market; i.e., legal, and regulatory environment, adoption of financial technologies, absence of Shariah-compliant investment avenues, political and economic instability (in some regions), lack of standardization in Shariah-compliance and screening of Islamic funds, product innovation and development, and cross-border regulatory limits.

> The global Islamic funds market is comprised of 1508 Islamic funds operated by 345 Islamic financial institutions in 29 countries.

The fourth section of the report highlights the global trends and main opportunities for the sector. We found that the role of Socially Responsible Investment (SRI), ESG, and Fintech application in investment management are setting new trends and openings for the global Islamic funds market. Also, survey results suggest that the adoption of Fintech-based solutions in IFIs is on the rise; interestingly, the majority of the respondents already have infrastructure for Fintech-based solutions in their institutions, or are planning to implement them in the near future.

Moreover, investing in SRI/ESG asset classes is a relatively new avenue for the global Islamic funds market that possesses tremendous opportunities for growth. In the future, the Islamic SRI/ESG sector is expected to expand by virtue of the burgeoning demand from value-based investors, regulatory developments, multilateral development banks' support, and the growing recognition of Islamic SRI/ESG values by asset managers.

In the last section, the report identified some key challenges related to infrastructure development of the global Islamic funds market. These include Islamic funds' regulatory framework and adoption of regulatory standards, Shariah governance, lack of Shariah-compliant investments, scalability, and capital market development over the long term.

Overall, despite showing impressive growth over the years, the global Islamic funds market is relatively immature and much smaller in size compared to its counterpart. However, there exists tremendous growth potential that can be harnessed with a suitable ecosystem for Islamic funds. To that end, multiple efforts are required on the part of governments, regulators, policymakers, investors, Islamic banks, and Islamic funds management institutions.

The goal of this report is to provide a broadened perspective concerning current global trends, prospective opportunities, and possible challenges affecting the global Islamic funds market. Stakeholders will be able to gain insight into growth potential, as well as factors which will influence the future growth and development, through the lens of IFIs and the Islamic funds market.

1. Introduction

Investing in Islamic (Shariah-compliant) funds is not a recent phenomenon. The history of Islamic funds goes back to 1986, with the development of the first Islamic fund, Amana Income Fund, in the United States. The popularity of Islamic funds saw a boom in the early 21st century.

Today, Islamic financial institutions (IFIs) are offering various types of Islamic funds in many countries, both Muslim and non-Muslim alike. In the last decade, the global Islamic funds market showed a promising average growth of around 18 percent in Assets under Management (AuM), and this may rise as young Muslim populations and communities start saving for retirement and as their investment preferences expand. This growth is the result of several structural and behavioural changes in Muslim-majority countries, and the probability is that the global Islamic funds market will continue to strengthen.

Despite this undoubted progress, the global Islamic funds market is still very small relative to the conventional funds market, and there are only a handful of IFIs that have the scale to operate and compete at a global level. In terms of total AuM (2021), the global Islamic funds market by domicile is concentrated in three top jurisdictions; Saudi Arabia, Iran, and Malaysia, accounting for 72.24 percent share. The remaining 27.76 percent is distributed across 26 jurisdictions. Additionally, unlike the Islamic banking and Takaful (Islamic insurance) sectors, the global Islamic funds market is not extensively covered in the Islamic finance industry reports.

This situation prompted CIBAFI to provide a special report investigating and identifying the challenges and opportunities present in the global Islamic funds market. Recognising the importance of the topic and the need for a coordinated approach, CIBAFI conducted in-depth technical research based on (1) primary data: a comprehensive survey questionnaire engaging Islamic banks and Islamic funds management institutions operating in different regions of the world, and (2) secondary data: the historical database of the global Islamic funds market. The global Islamic funds market database is composed of 1,508 Islamic funds operated by 345 IFIs in 29 countries[1].

The objective of this report is to assist IFIs in deepening their knowledge of the global Islamic funds market, understanding current developments, and navigating through the main challenges in offering Islamic fund management products and services. Moreover, the report highlighted major concerns, novel opportunities, and prospective challenges that the IFIs foresee in the future development of the regional and global Islamic funds markets.

“72.24% of the global market share (in total AuM) is concentrated in three top jurisdictions: Saudi Arabia, Iran, and Malaysia.”

1. The database is sourced from CIBAFI and Refinitiv. In general, the data cover only funds available to the public and exclude some private funds. On the other hand, there could some minor double counting, for example where master-feeder fund structures exist, and both are included in totals. The data rely on Refinitiv’s classification of which funds can be considered to be Islamic.

1.1 A Comprehensive Survey

In keeping with the objectives of the report, CIBAFI developed a survey questionnaire to take IFIs' (i.e., Islamic funds management institutions and Islamic banks) perspectives on the global Islamic funds market and to understand their level of participation in it. The survey is designed to understand what types of Islamic fund investment and management services they are providing to customers or are interested in providing in the future. Moreover, the IFIs were asked about their market coverage in providing Islamic funds to investors, size of AuM, Shariah screening methodology, adoption of Fintech-based solutions, offering of Socially Responsible Investment (SRI) or Environment, Social and Governance (ESG) based Islamic funds, distribution methods, and the main concerns on the regional and global Islamic funds market.

The results of the survey are based on 51 responses from IFIs in 23 different countries. CIBAFI hopes that the results of the survey will provide IFIs with a comprehensive picture of the global Islamic funds market, its contemporary trends, challenges, and opportunities as well as insight into factors impacting the growth and development of the Islamic funds market in different jurisdictions.

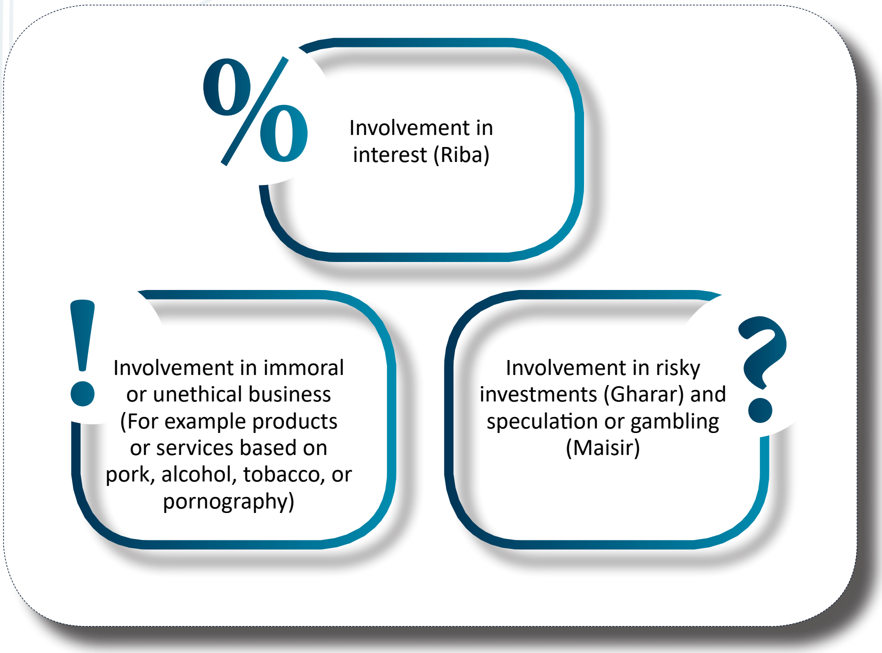
1.2 Survey Methodology

The CIBAFI Secretariat sent questionnaires to the CEO offices of CIBAFI's member and non-member Islamic banks as well as the Islamic funds management institutions, with the final responses received in September of 2021. All parts of the survey comprised both "closed" and "open-ended" questions. The open-ended questions allowed industry leaders to share their insights using more in-depth and detailed written responses.

The survey questionnaire is divided into two sections. Section A is designed for Islamic funds management institutions, whereas Section B is focused on Islamic banks. Each section includes both general and specific questions to gauge respondents' involvement in the global Islamic funds market.

2. Overview of Islamic Funds

Fundamentally, Islamic and conventional funds have similar key objectives – to preserve capital, spread risk, and achieve specific financial targets (often expressed as risk-adjusted returns). However, the distinction lies in the fact that Islamic funds have strict conformity with the precepts of Islamic law (Shariah) to avoid any elements that are prohibited by Islam. An Islamic fund must follow rigorous procedures to ensure its success and legitimacy. Though most Shariah scholars will allow purification from small amounts of unintentional Shariah non-compliant income , the investments of Islamic funds must not be associated with any of the following activities[2]:

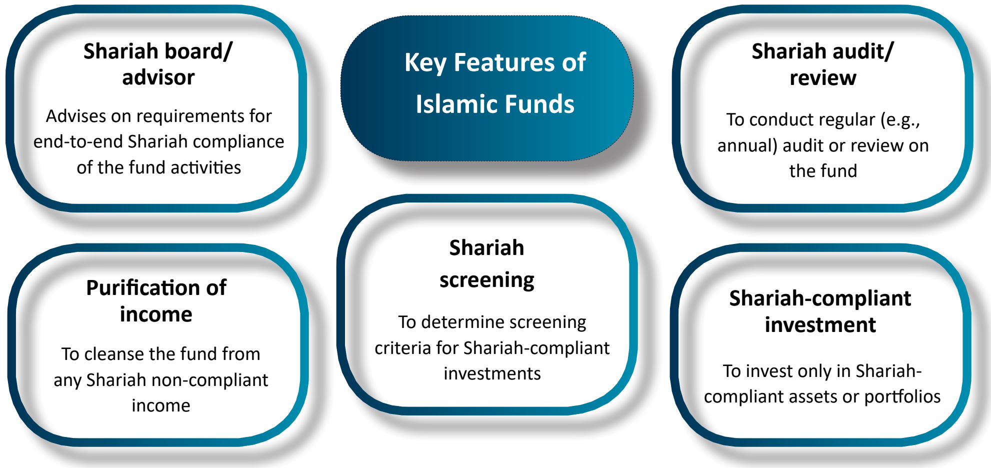


2. For example, investment in a real estate business where a small amount of rent comes from a conventional bank.

2.1 Key Features of Islamic Funds

Establishing an Islamic fund is not as simple as setting up a conventional fund. An Islamic fund must comply with the requirements of Islamic law in terms of its structure, operations, activities, and investments. Five key features distinguish the management of Islamic funds from conventional funds[3]:

Figure 1. Key Features of Islamic Funds



Source: CIBAFI and ISRA (2015)[4]

3. The details will differ from jurisdiction to jurisdiction and from fund to fund. In particular, a number of funds rely on screening criteria determined externally (e.g., by a regulator or an Islamic index provider) rather than determining their own.
4. Islamic capital markets: Principles and practices (2015). Kuala Lumpur: International Shariah Research Academy for Islamic Finance (ISRA).

2.2 Structure of a Fund

A typical definition of a fund, sometimes referred to as a collective investment scheme, would be along the lines of: "any arrangements with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property, or sums paid out of such profits or income". Subject to qualifications and exceptions, which vary from jurisdiction to jurisdiction, funds (or their managers) are generally subject to strict regulation, including the legal forms they may take and their governance arrangements[5].

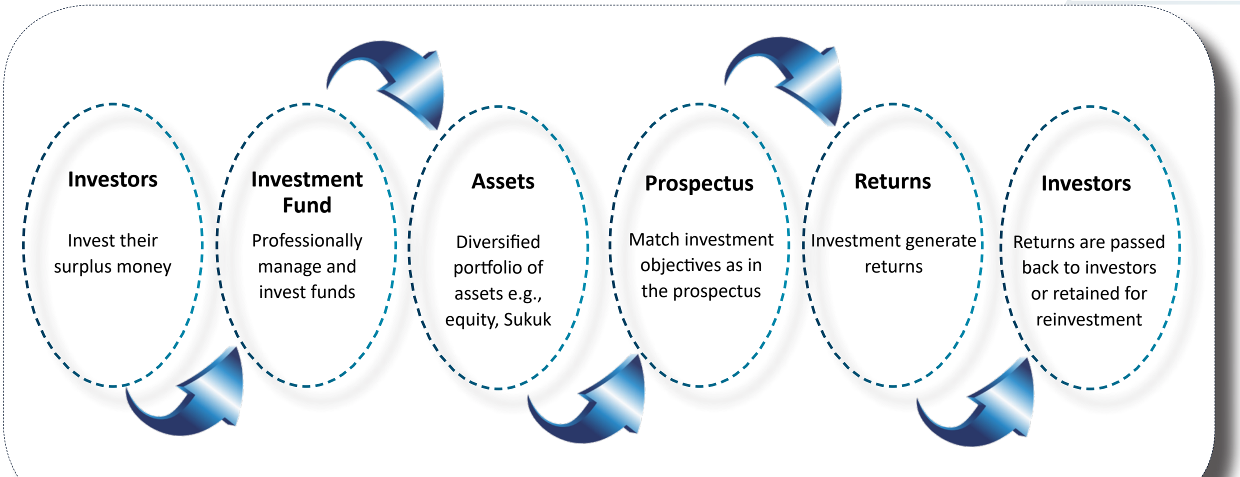
Generally, there are three types of funds: open-ended, closed-ended, and exchange-traded. An open-ended fund issues unlimited shares/units which investors can buy/sell directly from/to the fund or through authorized agents at a value based on the net asset value of the fund. "Open-ended" means that the number of investors and amount invested fluctuate as investor commitments are made and redeemed, and the fund can exist indefinitely for an undetermined period of time unless the fund is wound-up. Closed-ended funds issue limited shares/units through an initial public offering (IPO) which is then closed for new investments once the IPO is over. Closed-ended funds are generally associated with private equity and alternative investments and follow a "drawdown and distribution" model where the fund draws money from investors, makes investments, and after a period realizes those investments in one way or another; once the exit is achieved, the fund manager distributes to investors, and the money is typically not reinvested. Any investors wishing to exit the fund before its closing period will need to sell their shares at a market price.

The third type, the exchange-traded fund (ETF), is one where shares or units of funds are traded (typically in the public market), but which also has the possibility of issuing new units, allowing the ability to expand (and contract) in response to demand. An ETF is a kind of hybrid of the standard open- and closed-ended funds, and its market price is determined by the law of supply and demand – though arrangements often exist to keep the price close to one based on net asset value.

The flow diagram of the fund management process is illustrated in Figure 2.

5. Permissible legal forms vary, but may include such structures as trusts, open-ended investment companies, limited partnerships etc, depending on the legal tradition of the jurisdiction. There may be exemptions from regulation for some funds, especially those sold only to institutional investors, and special arrangements depending on the underlying assets (for example, valuation requirements for real estate held by a fund).

Figure 2. Fund Management Process Flow Diagram



Source: CIBAFI and ISRA (2015)

However, in practice, the process is typically more complex and other parties may be involved. For example, the fund manager may delegate some or all of the investment management to another entity; administration may also be delegated; there may very well be a regulatory requirement to appoint a custodian, which holds title to the assets on behalf of the investors; funds may well not be sold directly but through distributors – often banks.

The funds business is international, and different aspects of the process may take place in different countries. It is perfectly normal for a fund to be legally resident (domiciled) in Country A, with investments around the world, managed from Country B, and for the fund to be distributed in Countries C, D, and E.

2.3 Investment Options

The previous sections described some aspects of funds that are common to both conventional and Islamic funds. However, important differences emerge when one looks at investment options. Both conventional and Islamic funds can offer a wide range of investment types to meet the different needs of investors, though Islamic funds are subject to a Shariah compliance screening of the underlying investments. Shariah constraints also prevent Islamic funds from investing in derivatives, from most forms of leverage, and from selling short[6]. Islamic funds are therefore, in general, long-only, and Islamic hedge funds are effectively non-existent[7]. In terms of investment portfolios and the asset classes they invest in, Islamic funds can be classified into seven broad categories: money market funds, equity funds, Sukuk funds, commodity funds, mixed funds, alternative funds, and real estate funds[8].

6. Shariah scholars in some countries permit transaction structures that can mimic short selling, but these are not widely accepted.
7. There have been attempts to structure an Islamic hedge fund, but these also have not achieved wide acceptance.
8. Including Real Estate Investment Trusts (REITs).

2.4 Shariah Screening

As mentioned earlier, Islamic funds are subject to rigorous Shariah-screening to ensure that the fund is not investing in Shariah non-compliant activities. For equity investment, this would involve assessing both the underlying business activities and the fund's financial position to ensure that it is not likely to be either paying or receiving significant amounts of interest.

2.5 Islamic Funds and the Islamic Banking Industry

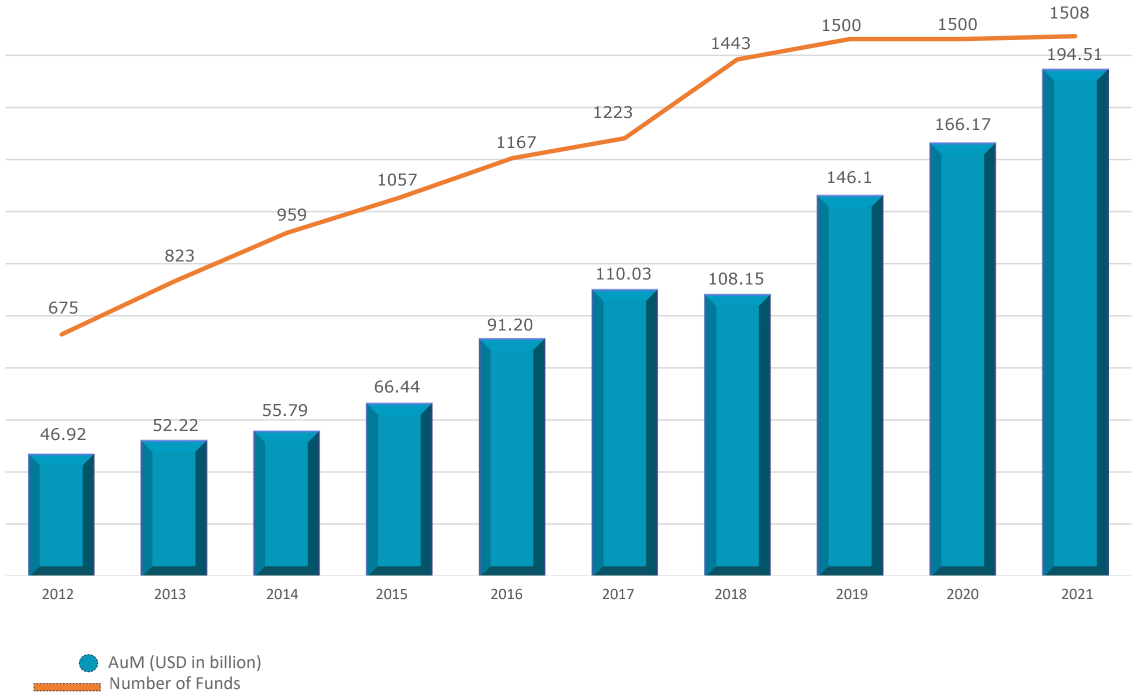
In general, few Islamic banks are directly involved in the Islamic funds market as fund managers. This tends to be the preserve of the larger Islamic banks. Al Rajhi Capital (a subsidiary of Al Rajhi Bank, Saudi Arabia), BIMB Investment (a subsidiary of Bank Islam Malaysia), and Al Meezan Asset Management (a subsidiary of Meezan Bank, Pakistan) are a few examples. They compete to some extent with specialist fund managers like Oasis Crescent, and also with large conventional fund managers such as Franklin Templeton, both of whom offer Islamic funds. Custody is also a service generally provided by very large banks – in this market, commonly the Islamic subsidiaries of major global banks.

However, Islamic banks very commonly act as distributors for funds managed by others. They provide investment avenues either directly or through a subsidiary to their clients (individuals and institutions). Depending on their clients' needs, these could well involve Islamic funds, possibly alongside other options to achieve short-to-medium and long-term capital appreciation, since Islamic funds offer obvious opportunities to hold a diverse underlying portfolio (e.g., equities, Sukuk, and money market instruments). In some cases, the bank may directly manage a portfolio of investments for their clients; in others, they may offer a platform allowing clients to build their own portfolios of funds. Some banks, for example, Abu Dhabi Islamic Bank (UAE), offer both possibilities.

3. The Global Islamic Funds Market

The global Islamic funds market is on a rise, a natural outcome of the growing demand for Shariah-compliant investments backed by an expanding range of Islamic funds available in various jurisdictions. During the period 2012-2021, the global Islamic funds market showed an average growth of around 18 percent in AuM. By the end of September 2021, the total AuM of Islamic funds grew by 17.1 percent and reached US $194.51 billion – up from US $166.17 billion in 2020.

Figure 3. Growth in AuM and Number of Islamic Funds (2012-2021[9])



Source: CIBAFI and Refinitiv[10]

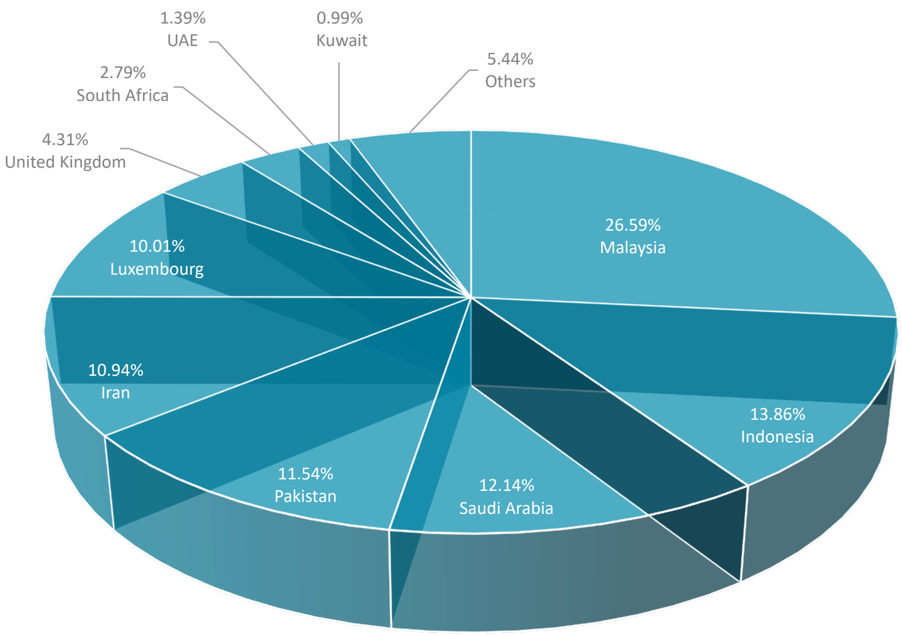
Despite the negative economic effects of the COVID-19 pandemic that slowed the growth of AuM of Islamic funds from 35.1 percent (y-o-y) in 2019 to 13.7 percent (y-o-y) in 2020, the global Islamic funds market showed a positive recovery of 17.1 percent as of the third quarter of 2021. It is expected that the total AuM of Islamic funds can further grow in the fourth quarter of 2021. On average, Islamic funds are smaller than their conventional counterparts; however, as the graph above implies, the average fund size has been growing in recent years.

In terms of the total number of Islamic funds, Malaysia, Indonesia, and Saudi Arabia are the leading domiciles. In 2021, with the market share of 26.59 percent (401 Islamic funds with AuM of US $43.50 billion), Malaysia retained its first position while Indonesia ranked second in top domicile countries with a share of 13.86 percent (209 Islamic funds with AuM of US $6.12 billion in 2021). Saudi Arabia stands in third position holding 12.14 percent (183 Islamic funds with AuM of US $53.36 billion) by number.

> Total assets of the global Islamic funds market are at US $194.51 billion, growing by more than 300% since 2012.

9. Data is updated until September 2021, however for some funds data is updated until June, July, or August 2021.
10. Source is based on CIBAFI database for years 2020 and 2021. Data for the years 2012-2019 are sourced from Refinitiv Eikon- Islamic finance development indicator (IFDI).

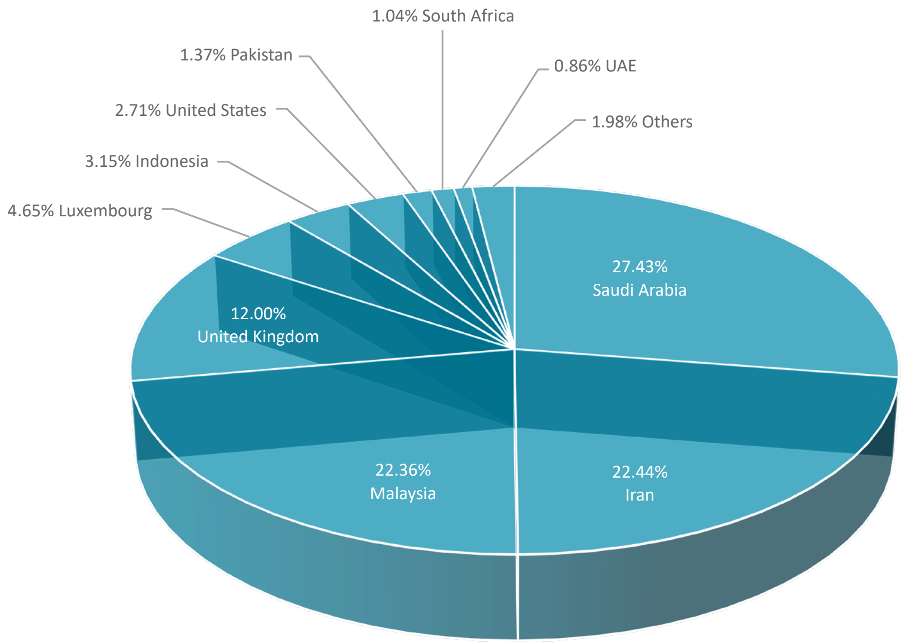
Figure 4. Top 10 Countries by Islamic Funds Domiciles by Number (2021)



Source: CIBAFI and Refinitiv

The picture is different when one looks at AuM, as Figure 5 illustrates. In these terms, the top three contributors are Saudi Arabia, Iran, and Malaysia, accounting in total for a 72.24 percent share (US $140.51 billion) of global Islamic funds. The difference reflects the differing average sizes of funds in the various market; for example, the large number of very small funds in Indonesia.

Figure 5. Top 10 Countries by Islamic Funds by AuM (2021[11])



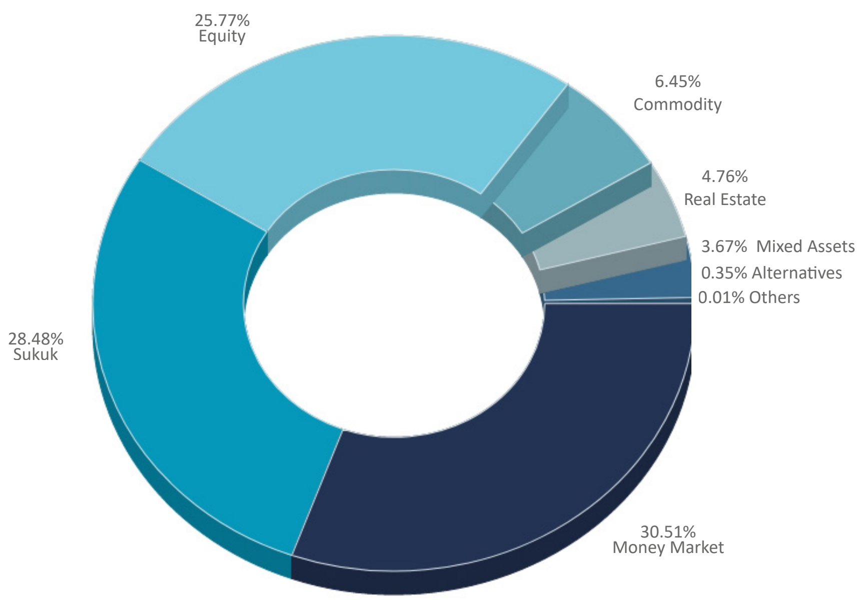
Source: CIBAFI and Refinitiv

A notable feature here is the prominence of some jurisdictions with limited Islamic finance industries but a strong presence in the conventional fund markets, such as Luxembourg and the United States. Moreover, there are still some OIC-Muslim majority countries – for example, Bangladesh, Iraq, Sudan, and Jordan – where the Islamic banking sector is well-established, but there are very few funds domiciled. In some cases, this points to an overall weakness in the funds market. For example, Jordan has few locally-domiciled funds of any kind, partly because of weaknesses in its funds' framework. On the other hand, Bangladesh has a substantial population of funds, though only a few claim Shariah-compliance. This suggests that different factors are at play. In addition, some countries are more open than others to the distribution of foreign-domiciled Islamic funds, which allow financial institutions to offer their clients a wide range of Shariah-compliant investments, often on a global basis.

On an international scale, the most prominent asset type is the money market, accounting for 30.51 percent of the global Islamic funds market in AuM. Sukuk funds represent 28.48 percent, while equity market funds are in third place with 25.77 percent[12].

11. The data on AuM is based on the Islamic funds domiciled in the respective country.
12. The Refinitiv classification scheme is different from some others, notably that used by Bloomberg. In addition, there are problems classifying some funds on which limited public information is available, and some issues of data overlap where some funds invest in others. The data should, therefore, be used with some caution.

Figure 6. Type of Islamic Funds by AuM (2021)



Source: CIBAFI and Refinitiv

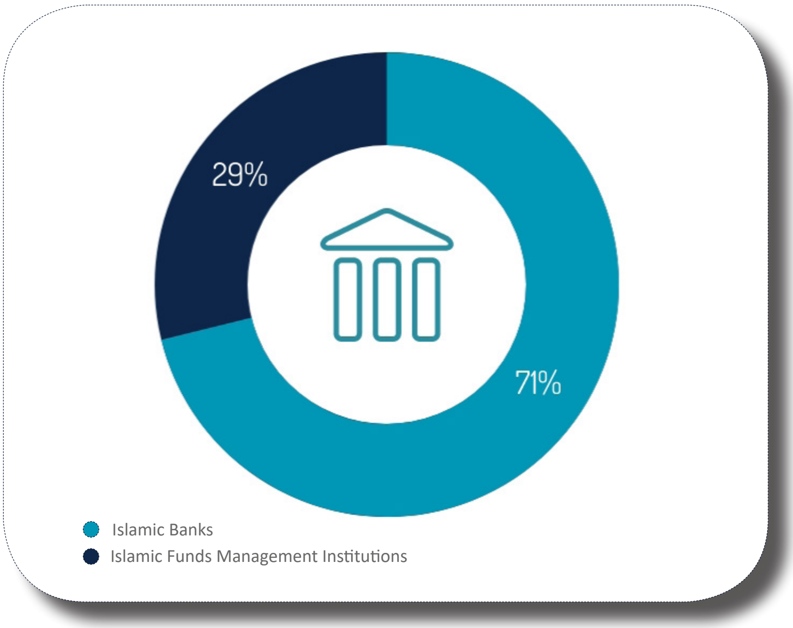
4. Global Islamic Funds Market Survey

The survey questionnaire was distributed to Islamic funds management institutions and Islamic banks from different regions of the world. In the survey, we asked a series of questions to IFIs regarding their operations, investment activities, and preferences in the global Islamic funds market. The questionnaire was divided into two sections: Section A includes questions that are designed for Islamic funds management institutions, while Section B focuses on the Islamic banking industry.

4.1 Key Findings of the Survey

A total of 51 responses were received from IFIs offering Islamic funds management services in 23 different countries in different regions of the world. The overall results show that 71 percent of the respondents to the survey were Islamic banks, whereas 29 percent were Islamic funds management institutions.

Figure 7. Category of Islamic Financial Institutions



At the regional level, the majority of responses (around 53 percent) are received from the GCC and Middle East ex-GCC regions. In terms of countries, the largest number of respondents are from Sudan, followed by Bahrain and Pakistan. The details of the respondents are presented in Table 1. Some major Islamic fund domiciles, such as Iran, Indonesia, the United Kingdom, and Luxembourg, are entirely unrepresented. On the other hand, some domiciles with minimal funds activity, such as Yemen and Sudan, provided significant responses. The results are therefore not statistically representative of the Islamic funds industry, but do give an indication of the diversity of issues faced in different jurisdictions.

Table 1. Respondents by Regions and Countries

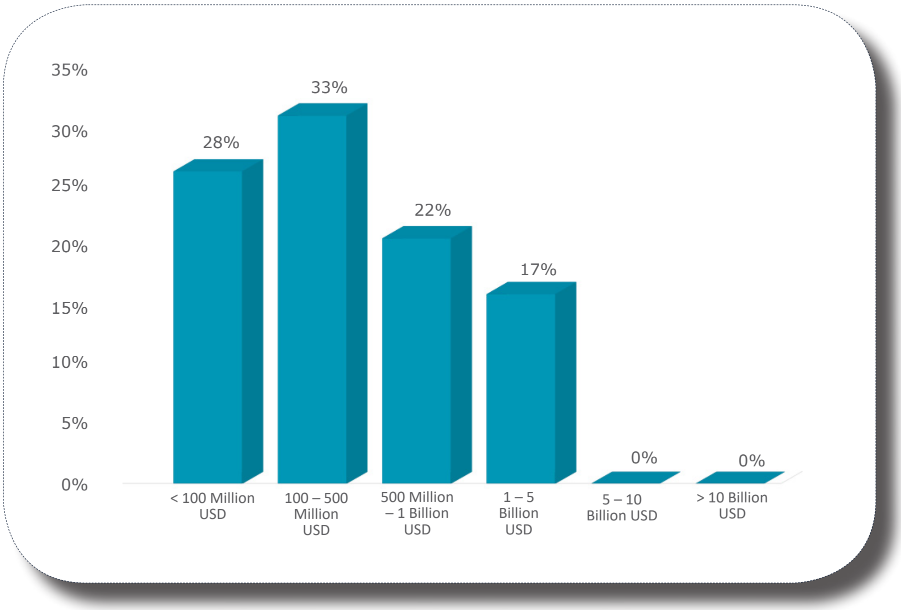
Group	Region	Countries from which Islamic financial institutions responded	Number of responded
Group 1	GCC	Bahrain, Kuwait, Oman, Saudi Arabia, UAE	14
Group 2	Middle East ex-GCC	Egypt, Iraq, Jordan, Lebanon, Palestine, Syria, Yemen	13
Group 3	Southeast Asia	Malaysia	2
Group 4	West, Central, and South Asia	Bangladesh, Pakistan	7
Group 5	North Africa	Algeria, Libya, Sudan	9
Group 6	Sub-Saharan Africa	Somalia, South Africa	2
Group 7	Europe & Others	Canada, Germany, Turkey	4
Total number of countries and financial institutions		**23 Countries**	**51**

4.1.1 Responses of Islamic Funds Management Institutions

In the first section of the survey, we asked several questions which are specific to Islamic funds management institutions. The objective of these questions is to know about their operations, investment activities, and preferences in the global Islamic funds market, as well as to identify any specificities that are associated with Islamic funds management institutions.

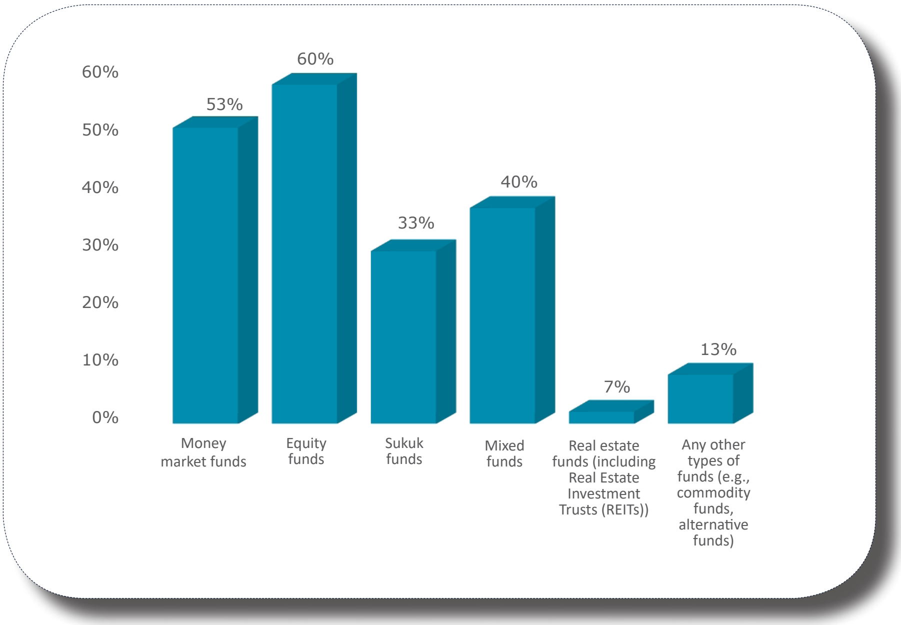
The findings show that more than half of the respondents (61 percent) are small-size institutions with an Islamic AuM of US $500 million or less. The remaining 39 percent of the institutions are medium-size with AuM ranging from US $500 million to US $5 billion. It is notable that none of the respondents falls under the category of large size institutions with AuM of more than US $5 billion. While we know that on average the Islamic funds are relatively small, in terms of AuM, compared with their conventional counterparts, we also know from the CIBAFI and Refinitiv database that very large funds do exist. The data therefore, imply that the responses of those Islamic funds are not included in the survey.

Figure 8. Size of Total Islamic Assets Under Management



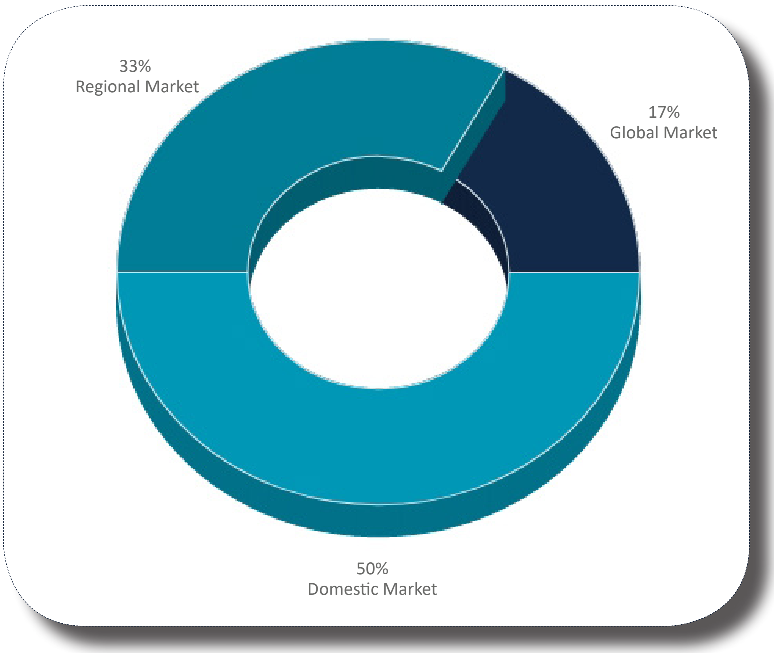
When asked what types of Islamic funds the institution manages, the survey results showed that 60 percent of the respondents are managing equity funds. Similarly, around 53 percent of the respondents are managing money market funds followed by mixed funds with 40 percent. Sukuk funds are in the fourth position with 33 percent of respondents managing them.

Figure 9. Type of Islamic Funds Managed by the Islamic Funds Management Institutions



When asked the question on market coverage or reach of their institutions in providing Islamic funds to investors (i.e., the range over which institutions' funds are distributed, whether directly by them or by others), the results show that half of the institutions (50 percent) are targeting the domestic market. Some institutions (33 percent) have greater market coverage and provide Islamic funds to investors on a global scale, whereas only 17 percent of the respondents are serving regional markets; e.g., the GCC region or Southeast Asia region.

Figure 10. Market Coverage/Reach of Institution in Providing Islamic Funds to Investors



Special Classes of Islamic Funds

In an open-ended question, the Islamic funds management institutions were asked about any special classes of Islamic funds (e.g., funds limited to institutional investors, ETF structures, private funds, etc.) that they are offering to their investors.

Some of the responses overlapped with the categories already considered. In particular, a number of respondents drew attention to the commodities funds, especially physical gold and silver funds, that they operate. However, several respondents mentioned that they did indeed operate ETFs, funds aimed at institutional investors, and also private funds (i.e., funds not generally open for subscription). One institution mentioned that it operates a fund specifically for banks and, interestingly, another institution mentioned a voluntary pension scheme. As already indicated in a footnote, private funds will not show up in the statistics available to us, confirming our instinct that the total Islamic funds industry is larger than those statistics suggest.

Shariah Screening Methodology

In another open-ended question, we asked Islamic funds management institutions to share their Shariah screening methodology or process to ensure Shariah compliance with underlying investments. Some chose to comment only on the process, while others gave a fairly full description of the underlying methodology. These differ somewhat, depending in some cases on local regulatory requirements.

One Islamic funds management institution provided a comprehensive response stating that "For domestic Shariah-compliant listed equities, reference is made to the list of Shariah-compliant securities issued by the Shariah Advisory Council (SAC) on a half-yearly basis. For domestic unlisted Shariah-compliant equities, the Shariah Adviser applies the two-tier quantitative approach based on the business activity and financial ratio benchmarks in determining the Shariah status of the equities. The contribution of Shariah non-compliant activities to the group revenue or group profit before taxation of the company will be computed and compared against the relevant business activity benchmarks as follows:

(i) The 5 percent benchmark applies to the following businesses/activities:

- Conventional banking
- Liquor and liquor-related activities
- Dividends from Shariah non-compliant investments, Shariah non-compliant entertainments
- Gambling
- Conventional insurance
- Pork and pork-related activities
- Interest income from conventional accounts and instruments (including interest income awarded arising from a court judgment or arbitrator)
- Non-halal food and beverages
- Tobacco and tobacco-related activities; and any other activities deemed non-compliant according to Shariah.

For the above-mentioned business activities, the contribution of Shariah non-compliant business activities to the group revenue or group profit before taxation of the company must be less than 5 percent. The interest income and dividends from Shariah non-compliant investments will be compared against the group revenue. However, if the main activity of the company is holding investments, the dividends from Shariah non-compliant investments will be compared against the group revenue and group profit before taxation.

(ii) The 20 percent benchmark which applies to the following business activities:

- Share trading
- Stockbroking business
- Rental received from Shariah- non-compliant activities
- Other activities were deemed- non-compliant according to Shariah.

For the above-mentioned business activities, the contribution of Shariah non-compliant business activities to the group revenue or group profit before taxation of the company must be less than 20 percent. For the financial ratio benchmark, the Shariah advisor will determine if the financial ratios (i.e., debt over total assets and cash over total assets ratio is less than 33 percent) of the equities, comply with the financial ratio benchmarks. For cash over total assets, cash only includes cash placed in conventional accounts and instruments, whereas cash placed in Islamic accounts and instruments is excluded from the calculation. For debt over total assets, debt only includes interest-bearing debt, whereas Islamic financing or Sukuk is excluded from the calculation. In addition to the above two-tier quantitative criteria, the Shariah Advisor also takes into account the qualitative aspect which involves public perception or image of the company's activities from the perspective of Islamic teaching".

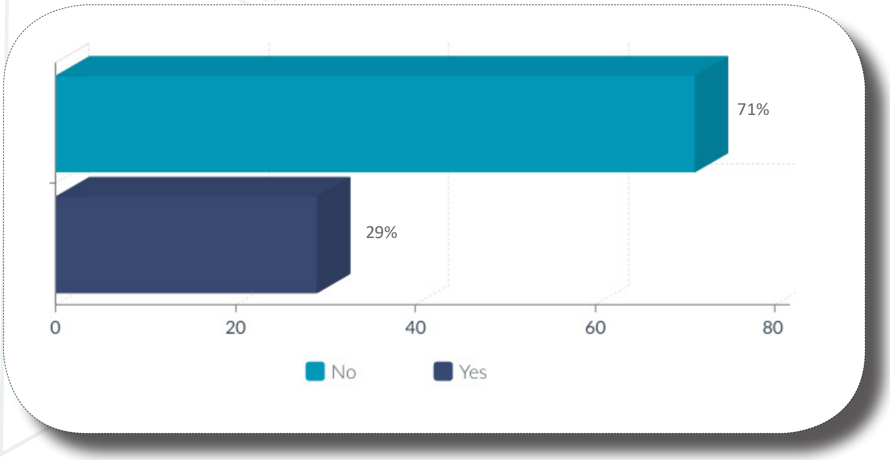
Other respondents quoted methodologies which, while conceptually similar, used different figures, such as for allowable debt as a percentage of total assets. One referred specifically to the AAOIFI standard, while others based themselves on the indices used by providers such as S&P and MSCI. Where indices were used, there was sometimes provision for ad hoc reference to a Shariah board where the firm was considering an investment not included in the index.

The detailed responses focused on the screening of equities; we did not obtain useful information on the screens used by money market funds, real estate funds, etc.

Sustainable Islamic Funds

In the survey, we also asked respondents to share if their institutions are offering SRI or ESG criteria. Interestingly, the majority of the respondents (71 percent) are not providing sustainable Islamic funds services to their investors while only 29 percent said they are offering such services.

Figure 11. Islamic Funds Management Institutions' Involvement in Sustainable Islamic Funds



Further, we asked an open-ended question to know more about the types of sustainable Islamic funds being offered, as well as the future plans of institutions that are currently not offering sustainable Islamic funds.

It is encouraging to see that many Islamic funds management institutions are well aware of the global funds market trends and are integrating sustainable and responsible practices in the selection and management of their investments. A respondent from the Europe & Others region shared that, "All of our funds are Shariah-compliant and [we] integrate responsible investment and ESG criteria in the selection and management of our investments. We are a signatory of the Principles of Responsible Investment (PRI) which is the world's leading proponent of responsible investment. This allows us to demonstrate our commitment to responsible investment, and places us at the heart of a global community seeking to build a more sustainable financial system".

From Sub-Saharan Africa, an institution stated that, "We are leaders in ESG investing and actively integrate ESG screening and engagement best practices in our Shariah investment strategies".

Moreover, some institutions are developing or planning to offer sustainable Islamic funds services to their investors. A respondent from Southeast Asia stated that "We are in the midst of developing a retail domestic ESG Equity Fund for investors". From Europe & Others region, a respondent wrote: "Currently, we do not have any sustainable Islamic funds. However, the company has plans to offer its customers Islamic products based on ESG criteria in near future as soon as completing feasibility study regarding such instruments".

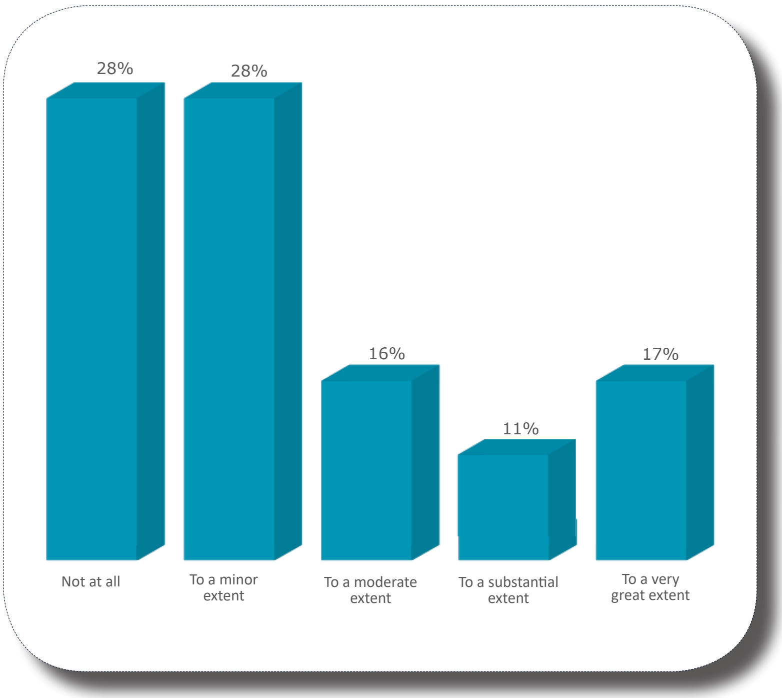
Nonetheless, some Islamic funds management institutions do not see an urgent need to offer sustainable Islamic funds services to their investors. Two respondents from the West, Central, and South Asia region mentioned that "At the moment, there are no such plans under consideration to offer sustainable Islamic funds". A similar response was recorded from an institution in the GCC region stating that "There is no current plan to introduce sustainable Islamic funds". This is, perhaps, owing to a lack of awareness and demand among the investors or the absence of regulatory support to promote sustainable and responsible investments in the respective jurisdictions.

Some funds were operating in areas with particular ESG considerations. For example, one firm specialising in commodity funds specifically referenced its measures to deal with some of the ESG issues around the gold industry. Another respondent referenced its investments in support of Islamic foundations (Awqaf) and their charitable activities.

Investors' Demand for Sustainable Islamic Funds

To further know about the investors' demand for sustainable Islamic funds, we asked Islamic funds management institutions the question, "Does your institution perceive investor demand for Islamic funds based on SRI/ESG criteria?" The responses are shown in Figure 12.

Figure 12. Investors' Demand for Sustainable Islamic Funds

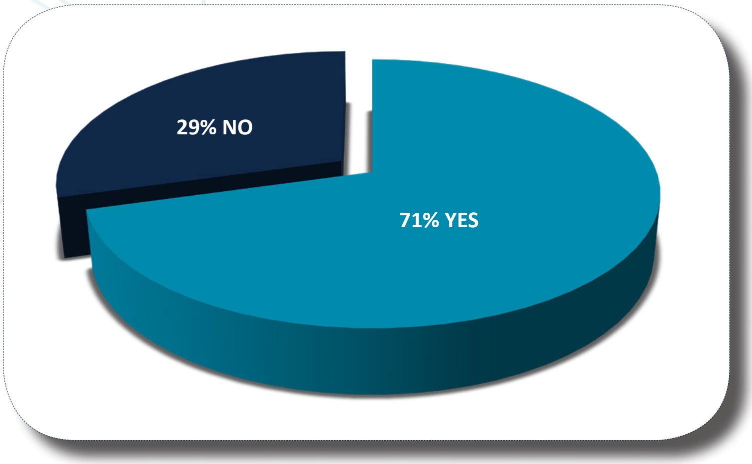


Perhaps unsurprisingly, the results showed that the majority of respondents (56 percent) perceive investor demand for Islamic funds based on SRI/ESG criteria either 'not at all' or 'to a minor extent'. The findings are consistent with the responses of the institutions in the previous open-ended question, where respondents from the West, Central, and South Asia and GCC regions shared that they do not have plans under consideration to offer sustainable Islamic funds.

Adoption of Fintech-based Solutions

We asked respondents for their adoption of Fintech-based solutions in providing Islamic funds management services. It is encouraging to see that the majority of the respondents (71 percent) have exposure to Fintech-based solutions in their institutions, while only 29 percent stated otherwise.

Figure 13. Adoption of Fintech-based Solutions



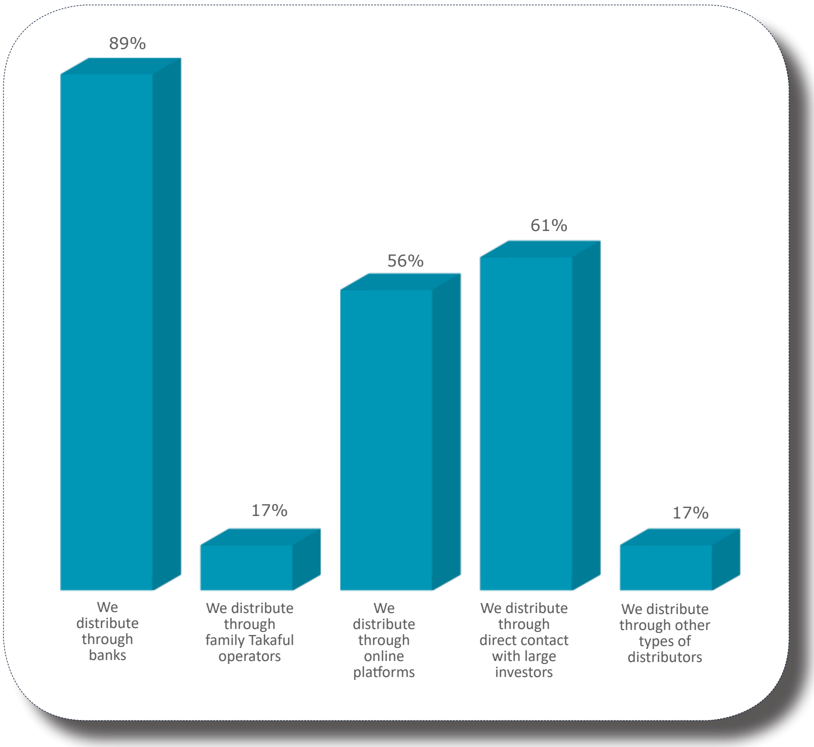
However, when we asked respondents to share what kind of Fintech-based solutions their institutions have adopted and about the Fintech adoption plans of institutions that have yet to have exposure to Fintech-based solutions, it was clear that institutions are adopting both mobile applications and web-based solutions to enhance efficiency at both the institutional level and in customer services; e.g., investment selection and portfolio management, market intelligence, financial analysis, and advisory services. A small number of respondents mentioned more advanced approaches such as artificial intelligence or distributed ledger technology. One referred to a fully-automated equity selection process driven by a machine learning algorithm, while another referred to its robo-advisory platform developed with a local Fintech company.

> "Findings show that Islamic funds management institutions are aware of the global market trends and are integrating sustainability and adopting Fintech-based solutions in their operations."

Islamic Funds Distribution Methods

Generally, Islamic funds management institutions adopt different methods and strategies to distribute Islamic funds to their investors. Some institutions have their own distribution channels while some rely on other mediums; for example, banks, online platforms, Takaful operators, etc. In the survey, we asked respondents to share what distribution methods they have adopted. The responses are shown in Figure 14.

Figure 14. Distribution Methods Adopted by the Respondents



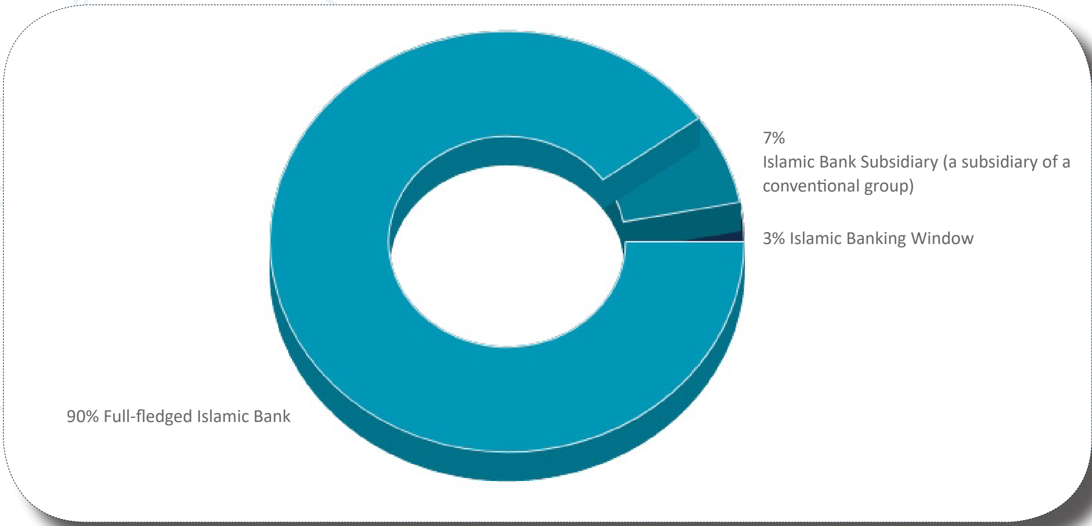
The prominence of bank distribution is noticeable, especially in comparison with "other types of distributors". This implies that non-bank wealth managers and financial advisors (which would have fallen into the "other" class) are not a major feature of most of the markets in which Islamic funds are sold. The direct contact with large investors may well be associated with the institutional investor funds referred to earlier, or to private funds typically run for a small number of large investors.

4.1.2 Responses of Islamic Banks

In the second section of the survey, we asked Islamic banks questions designed to inform about the role and level of participation of Islamic banks in the global Islamic funds market, as well as to identify any specificities that are associated with them. The following section provides us with a more comprehensive picture of Islamic banks and their involvement, operations, investment activities, and preferences in the global Islamic funds market (other than as fund managers; where Islamic banks were also fund managers, their responses in that role were captured in the previous section).

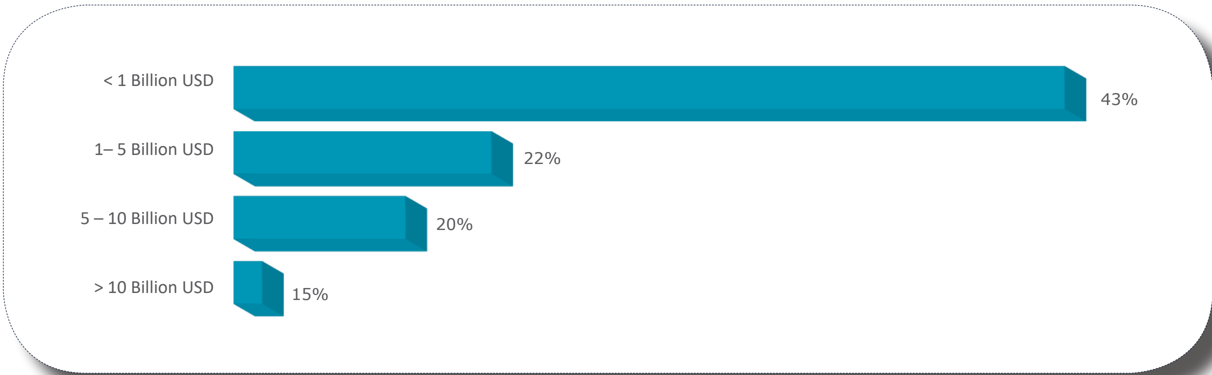
We asked Islamic banks to identify in which category of the Islamic banking operations their institution falls. The findings of the survey show that a clear majority of respondents (90 percent) are categorized under full-fledged Islamic banks followed by Islamic bank subsidiaries (7 percent), whiles only 3 percent of the respondents are Islamic banking windows.

Figure 15. Categorisation of Islamic Banks



The results on the question about the size of the total Islamic assets show that a significant number of respondents (43 percent) are managing Islamic assets totaling less than US $1 billion. Meanwhile, less than a quarter of respondents (22 percent) said their assets are between US $1 to 5 billion. Around 20 percent of the respondents are managing Islamic assets between US $5 to 10 billion. The remaining 15 percent of respondents are managing Islamic assets over US $10 billion. We were thus seeing a high proportion of smaller banks, which would be more likely to distribute funds managed by others than to operate their own funds.

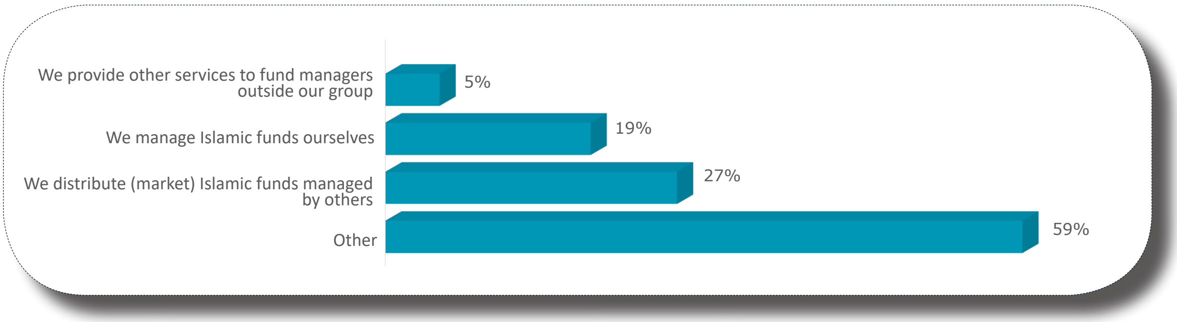
Figure 16. Size of Total Islamic Assets



Involvement of Islamic Banks in Islamic Funds Market

To further parse Islamic banks' involvement in the global Islamic funds market, we asked respondents to share their relevant activities and services offered to their investors and other fund managers. The responses are shown in Figure 17.

Figure 17. Involvement of Islamic Banks in the Islamic Funds Market



The size of the 'Other' category was surprising. However, more than half of the respondents (59 percent) chose 'Other' option and described their activities and services. In this regard, some banks describe that they are offering Islamic funds managed by other banks and some other banks are providing services like issue management, under writing, and portfolio management. However, several respondents appeared to use this category to indicate that they are currently not engaged in the Islamic funds market.

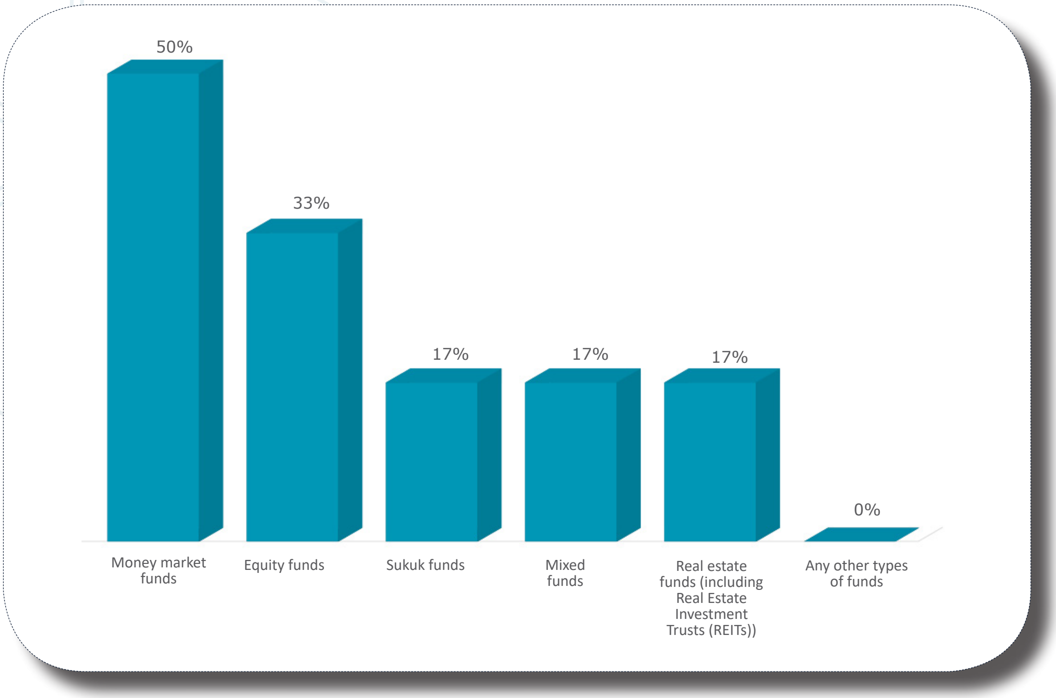
Type of Islamic Funds

When asked the question, "What type of Islamic funds does your institution offer to clients for investment?" the survey results show (Figure 18) that half of the respondents (50 percent) said they are offering money market funds to their investors, while 33 percent of Islamic banks offer equity funds. Islamic banks are also offering mixed funds, Sukuk funds, and real estate funds with a percentage of 17. However, none of the respondents chose 'any other types of funds (e.g., commodity funds, alternative funds, and private funds)' as offered funds to their investors.

> "Islamic banks have a greater emphasis on offering money market funds and equity funds to investors."

These findings are somewhat different from the results of Islamic funds management institutions, which had a greater emphasis on equity funds and money market funds. They are also at variance with what the statistics tell us about the proportions of AuM in different fund types across the industry as a whole. This may imply that some types of funds are distributed largely by other (non-bank) routes, or it may be an artefact of the sample.

Figure 18. Type of Islamic Funds Offered to Investors



Special Classes of Islamic Funds

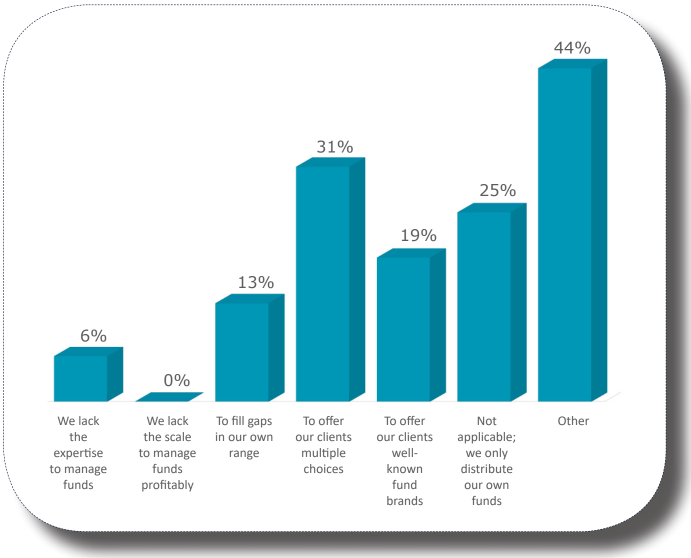
In the vein of the open-ended question to Islamic funds management institutions, the Islamic banks were asked about any special classes of Islamic funds, such as funds limited to institutional investors, ETF structures, private funds, etc., that they are offering to their investors.

Interestingly, most of the respondents (from different regions) said that they do not offer any special classes of Islamic funds. This tends to support the hypothesis that some types of funds are distributed primarily by non-bank routes.

Distribution of Islamic Funds

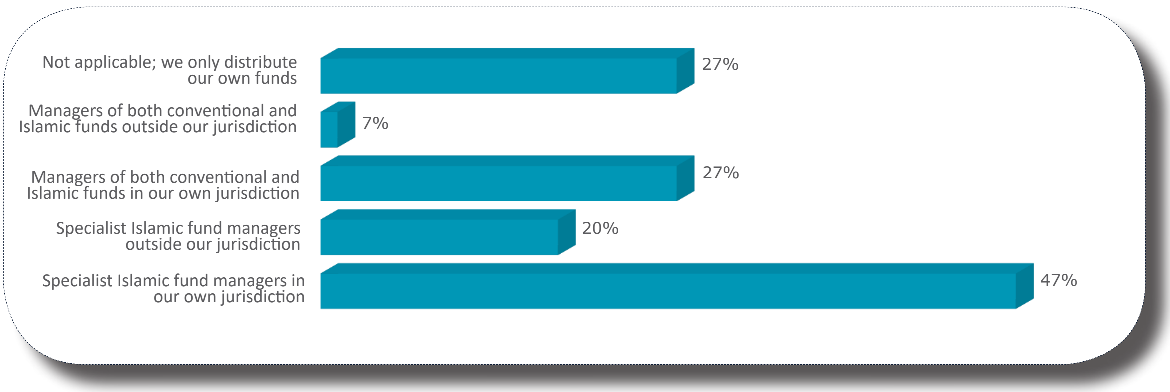
In the survey, we asked Islamic banks to share the main reasons for the distribution of the Islamic funds managed by other institutions. Multiple choices were possible. While 25 percent of the respondents said that they distribute only their own fund brands, around 31 percent of the respondents stated they are distributing Islamic funds managed by other institutions in order to offer their clients multiple choices of investments, and 19 percent of respondents conveyed a wish to offer their clients well-known Islamic fund brands. The least-claimed reasons for distributing other institutions' Islamic funds were related to capability issues; i.e., 'lack of expertise to manage funds' and the 'lack the scale to manage funds profitably'. However, a good number of respondents (44 percent) chose 'Other'. As before, some appear to have used this to indicate that they are not participating in the Islamic funds market at all. However, some banks referred to local regulatory constraints under which they are legally not permitted to manage funds, either because this is not permitted in local regulations or because they do not have a licence to do so.

Figure 19. Reasons for Distributing Islamic Funds Managed by Other Institutions



We next asked respondent banks about the source of the Islamic funds that they distribute. The findings show that the main source of Islamic funds distributed by Islamic banks is from the specialist Islamic fund managers in their own jurisdiction (47 percent). The second most prominent sources of Islamic funds for Islamic banks are the managers of both conventional and Islamic funds in their own jurisdiction (27 percent). Of the remaining respondents, 20 percent indicated that they distribute Islamic funds managed by specialist fund managers outside their jurisdiction, whereas only 7 percent of the respondents said they are sourcing Islamic funds from managers of both conventional and Islamic funds outside their own jurisdiction. The dominance of local fund managers may reflect the fact that respondent banks are mostly small and probably focus on their own jurisdiction. Some are also in countries where currency controls may limit the ability of investors to invest abroad.

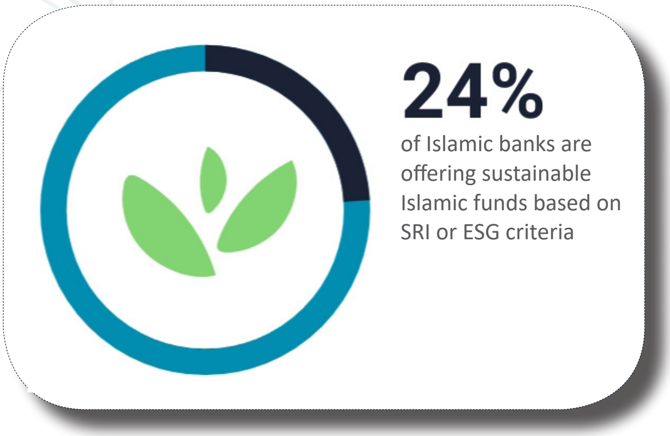
Figure 1.20 Sources of Islamic Funds Distributed by Islamic Banks



Sustainable Islamic Funds

Following up on Section 1, we asked Islamic banks to share if their institutions are offering sustainable Islamic funds based on SRI or ESG criteria. The findings shown in Figure 1.21 are similar to those from Islamic funds management institutions; the majority (76 percent) of the Islamic banks said they do not provide sustainable Islamic funds services to their investors; only 24 percent are providing such services.

Figure 21. Islamic Banks' Exposure to Sustainable Islamic Funds



Further, in an open-ended question, we asked Islamic banks about the types of sustainable Islamic funds they offer, or their future plans if they are currently not offering sustainable Islamic funds.

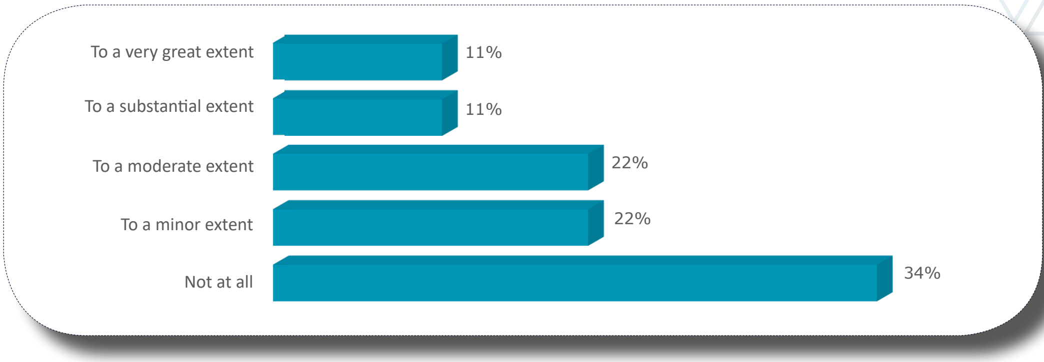
In general, most of the respondents are currently not offering sustainable Islamic funds to their investors; however, it is encouraging to see that many Islamic banks are planning to offer such funds in the future. A bank from the GCC region commented: "The Bank is opportunistically exploring rolling out offerings that are aligned with SRI and ESG mandates". Another bank from the same region stated that "We have an intention to offer sustainable Islamic funds in the future, including green Sukuk". A bank from the Southeast Asia region said, "Yes, we aim to offer our first sustainable Islamic fund by end of 2021, and are currently also sourcing more solutions for the future".

> "The bank is opportunistically exploring rolling out offerings that are aligned with SRI and ESG mandates."
>
> - a bank in GCC stated.

Investors' Demand for Sustainable Islamic Funds

We also asked Islamic banks to share to what extent they are receiving investor demand for Islamic funds based on SRI/ESG criteria. The response from Islamic banks, shown below, is not much different from what we have received from Islamic funds management institutions.

Figure 22. Customers' Demand for Sustainable Islamic Funds



Shariah-compliance of Islamic Funds

When Islamic banks were asked how they ensure Shariah-compliance of funds which are distributed by them but managed by other institutions, we found that all respondents have comprehensive Shariah screening methods in place. These most commonly rely on the review of each fund by the bank's Shariah advisors. In some instances, however, there was a local requirement for any fund distributed locally to be approved by a national Shariah body. In some instances, both systems operated in parallel, and funds were reviewed both by the national body and by the bank's own Shariah advisors.

Perceived Problems with the Supply of Islamic Funds for Distribution

We also asked Islamic banks to highlight any problems they are facing with the supply of Islamic funds for distribution including both market and regulatory problems. The responses show that, in general, Islamic banks do not see any challenges in terms of the supply of Islamic funds and regulatory problems. Some, however, are facing issues of cost and a limited range of funds available. In this regard, one bank commented, "Generally, we do not foresee a supply problem of Islamic funds for distribution, but as the market matures, there will be a need for more thematic and sectoral funds in the Islamic space. As a bank, we continue to have more discussions with asset management companies to encourage more launches of global, thematic and sectoral solutions in the Islamic space". Another bank from a different region related their self-reliant approach: "The space for Shariah-compliant products remains a small fraction of the overall market. Finding suitable offerings at reasonable cost remains to be the key challenge facing Islamic banks. Therefore, we resorted to creating our own offerings rather than using pre-existing offering to serve our clients". A bank from a third region voiced concerns: "Islamic funds are new in terms of offering and dissemination, and they need experts and specialists to help manage them in a professional manner in order to achieve the desired goals and be of benefit to the clients in accordance with what achieves the common interests of all parties".

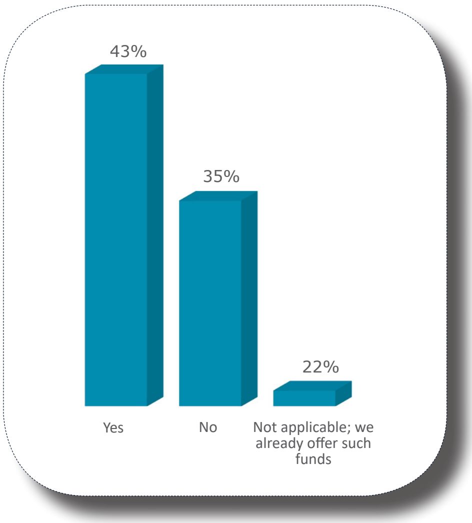
> "The space for Shariah-compliant products remains a small fraction of the overall market, therefore, finding suitable offerings at reasonable cost remains to be the key challenge facing Islamic banks."
>
> - a bank in GCC stated.

Some banks did, however, identify issues specific to their jurisdiction; for example, the lack of an appropriate legislative environment and a scarcity of investment opportunities.

Plans to Offer Islamic Funds

We asked those banks which were currently not offering Islamic funds to clients whether they had plans to provide them in the future. There are some problems with the responses, since the number saying that they already offer Islamic funds was smaller than for previous questions. However, Figure 23 shows an encouraging picture of the plans Islamic banks envision for offering Islamic funds to their investors.

Figure 23. Plans of Islamic Banks to Offer Islamic Funds



Perceived Problems in Offering Services to Fund Managers

In regard to Islamic banks' services (e.g., custody, management of investments, etc.) to funds managers outside their group, we asked respondents to share if they are facing any problems in the process. These problems can be related to markets or regulations in the respective jurisdiction. Most of the respondents said that this question is not relevant, since they do not offer services to fund managers outside their group. This is, perhaps, not surprising as it is consistent with the findings of an earlier question, where only 5 percent of respondent banks said they are providing such services (see Figure 17). It does, however, imply that most banks have no current desire to provide such services.

4.1.3 Key Concerns and Future Development of the Global Islamic Funds Market

To identify the primary concerns of IFIs and the challenges in the future development of the global Islamic funds market, we asked some open-ended questions to both Islamic funds management institutions and Islamic banks.

When reviewing respondents' answers to the question, "What are the main concerns of your institution with respect to the global Islamic funds industry?", we found that Shariah non-compliance risk, lack of ESG or positive Shariah screening, absence of liquidity, lack of investor awareness and demand, and obstacles on receiving foreign investment are the major concerns cited by both Islamic funds management institutions and Islamic banks.

Some institutions expressed concern regarding the future growth of Islamic funds in the conventional banking environment. One Islamic funds management institution commented the following: "We are not seeing enough adoption of ESG or positive Shariah screening practices in Islamic funds. On the Sukuk side, there is still too much friction between conventional regulation (in non-Islamic countries) and Islamic structures - which is limiting the development and growth of the industry". Another respondent mentioned concerns about the long-term: "The main concern regarding the global Islamic funds industry is lack of liquidity. An effective portfolio management strategy may not be achieved in the absence of liquid markets due to limited diversification. Therefore, the long-term and sustainable growth of Islamic financial markets depends largely on well-developed and deep secondary markets".

> "The main concern for the global Islamic funds industry is lack of liquidity."
>
> - an Islamic funds management institution in Europe stated.

Other institutions discussed Shariah compliance restrictions and how they may affect Islamic funds on the world stage. One bank noted, "Our main concern is that many of the global funds are not Shariah-compliant. Therefore, in many cases, a local fund cannot simply feed into a global fund, but a strategy needs to be replicated locally to mirror such a global strategy. Currently, in the market, there are not many fund houses that are doing such replication of global strategy for Shariah-compliant funds". Another bank said that "Islamic funds have relatively lower Assets Under Management (AuM) in relation to the conventional space and that may be an issue for allocators of significant capital to invest in these products without becoming anchor investors. This may be a source of a lack of flexibility in times of stress and/or rebalancing". Another bank relayed investment concerns: "The most important concern is the obstacles that some countries place on receiving foreign investments. Also, the limited investments that comply with Shariah controls, compared to the conventional ones, which reduces the degree of diversification of investment portfolios and making them more affected by downward economic effects and the high turnover rates of Islamic investment portfolios".

There are some puzzling features of these comments in relation to individual investments, since there are many equities across the world (including Muslim-minority countries) which pass Shariah screening. It is possible, however, that some of the comments may have been made in the context of other fund types – for example, money market funds or Sukuk funds, where the same would not be true. However, one interesting theme emerging is that Shariah limitations do impact diversification by excluding some sectors; this means different investment strategies will be necessary, thus requiring the resources to develop and execute those strategies. There is also not an available shortcut used in some developing fund markets by creating a feeder fund which simply invests in a master fund (often a major global fund) based elsewhere, because there are limited global funds that are also Shariah-compliant.

> “We are not seeing enough adoption of ESG or positive Shariah screening practices in Islamic funds.”
>
> - an Islamic funds management institution in Sub Saharan Africa stated.

Specific Concerns in Respect to Jurisdiction

We also asked respondents to share if they have any specific concerns related to jurisdictions in which they operate, in which their funds are distributed, or where they hope to do business in the future.

A number of jurisdiction-specific points were made, some concerned with geopolitical issues such as sanctions or restrictions on inward or outward foreign investment. Other points were concerned with the relative immaturity of the Islamic funds industry or Islamic finance in the jurisdiction more generally. Concerns articulated included: “(1) The limited availability of Shariah-compliant investment avenues as compared to conventional investment avenues in the domestic markets, (2) the lack of investor awareness and accessibility to investors in non-urban centres, and (3) absence of any single regulatory body to regulate the Islamic funds industry”. Another fund manager remarked, “There is lack of historical performance record of Islamic funds. This is important since investors preferred established and reputable fund houses. Also, investors are preferring low fee investment platforms, e.g., online platform charging zero initial service charge and lower management fee”. Another Islamic funds management institution voiced apprehension about discrepancies: “Shariah scholars [in their jurisdiction] still have different views about Shariah compliance which undermines the creation of a consistent regulatory framework and corporate governance principles in the country. This causes confusion for retail investors considering their lack of financial literacy. There should be national Shariah boards for creating unified standards for the Islamic funds industry”.

It appeared that all those who responded addressed the question in terms of the jurisdiction where they primarily operate; none seemed to be commenting on jurisdictions into which they operate or distribute cross-border, or in which they would like to operate in the future.

Future Development of Global Islamic Funds Market

In the survey, we asked IFIs to share their insights on the challenges that can impact the future development of the global Islamic funds market. The responses, received from Islamic banks and funds management institutions, revealed that the main challenges are perceived to be related to the legal and regulatory environment, adoption of financial technologies, unavailability of Shariah-compliant investment avenues, lack of awareness on Islamic funds, political and economic instability (in some regions), lack of standardization in Shariah-compliance and screening of Islamic funds, product innovation and development, and cross-border regulatory limits.

In this regard, an Islamic funds management institution said that “The main challenges are the lack of an appropriate legislative environment, scarcity of Shariah-compliant investment opportunities and the difficulty of diversifying the assets of investment funds as a result of the repercussions of COVID-19 pandemic”. Another respondent reported, “Financial innovation and product development are critical to the success of the global Islamic funds industry as it helps to introduce new Shariah-compliant products that enhance liquidity, risk management, and portfolio diversification". It appeared from the context that this comment was particularly concerned with money market funds and liquidity management for IFIs. Another institution believes that "The growth of financial assets and instruments that are based on financial technologies and alternative investments compared to traditional investments, as well as the changing laws governing financial markets" are the challenges that influence the future growth of Islamic funds market.

Islamic banks echoed similar concerns regarding the availability of diverse Islamic funds services, as well as regulatory roadblocks. One said that "Among the most important challenges are (1) availability and standardization of regulatory matters imposed by supervisory and regulatory authorities in relation to legal controls, (2) availability and standardization of Shariah matters related to the extent of compliance of funds with Shariah provisions, ensuring its application to guarantee legitimacy and credibility, and (3) developing green investment funds to mobilize financing for the sustainable development goals (SDGs) by providing innovative structures, ratings, and governing frameworks". Another expressed concerns regarding: "The volatility in the markets, cross-border regulatory limits and limited standardization ensuring efficient management of funds and generating returns which can bring investment comparable to the conventional funds. Also, lack of Shariah-compliant securities impacts the development of global Islamic funds". Yet another said that, "The challenge we foresee is in the product breadth of Islamic funds. As the market matures and investors get more sophisticated, there will be more demand for more innovation in the Islamic funds industry so that the product breadth and variety will match that of the conventional funds; i.e., thematic, alternative, sectoral space".

The overall impression gained from the comments is that most respondents' worries were focused on the jurisdictions in which they primarily operated, rather than their position in the global market. This was exacerbated by the absence of survey responses from some of the larger global managers and distributors. However, some global issues did emerge. One is that the relatively small scale of the Islamic funds market makes it difficult to match the product breadth and variety of conventional funds economically, especially since the requirement of Shariah compliance closes off some of the shortcuts to doing so. Divergence in Shariah standards also limits the ability to develop globally.

Steps for Amelioration of the Global Islamic Funds Market

Next, we asked the IFIs to share their opinion on the possible steps that national and international bodies best might take to enable the global Islamic funds market to flourish. The key measures suggested, for national and international bodies, can be categorized as: raising awareness of how Islamic funds operate, human capital development, strengthening regulatory and legislative frameworks, improving regulatory oversight to enhance investor confidence, promoting research and innovation, encouraging and incentivising banks to participate in the Islamic funds market, and promoting sustainable and responsible Islamic funds based on SRI and ESG criteria. The responses were, however, quite divergent; it was not obvious what would be the most appropriate body to take action in each case.

5. Global Trends and Main Opportunities for the Sector

In the past, Islamic funds were mainly focused on traditional asset classes, however, recent trends emerging on the global horizon are affecting the Islamic funds market. Similar to conventional fund management, the role of SRI/ESG and the application of Fintech in investment management are setting new trends and opening innovative opportunities for the global Islamic funds market.

These trends are also reflected in the findings of the survey, where both Islamic funds management institutions and Islamic banks shared their experiences in offering Islamic funds based on SRI/ESG criteria, investors' demand, and their future plans in this regard. Similarly, it is found that the adoption of Fintech-based solutions in the Islamic funds management institutions is on the rise, with the majority of institutions already having exposure to Fintech-based solutions in their institutions, or plans to implement them in near future. For most, however, these Fintech approaches are at the relatively basic level of distributing funds over online platforms and relating updates to investors electronically.

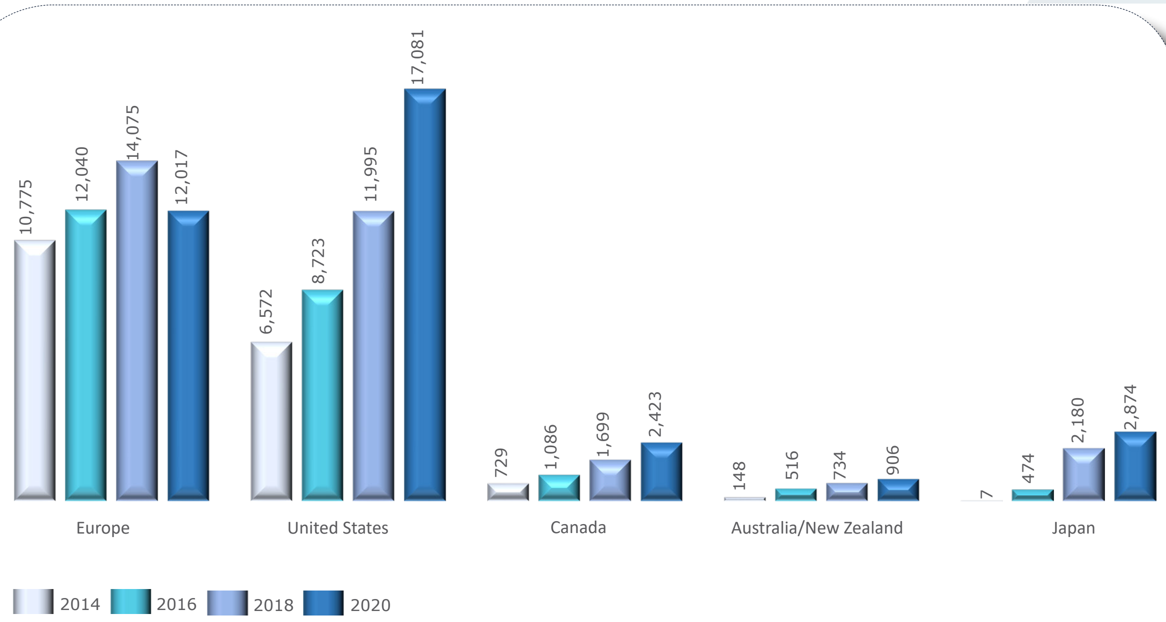
5.1 Sustainable/Socially Responsible/ESG Investments

Sustainable investing, SRI, and ESG investment are overlapping, but slightly different, approaches to investments not driven purely by investment risk and return. ESG is an investment approach that integrates environmental, social, and governance factors in portfolio selection and management. "Sustainable" investing generally gives more weight to environmental factors as articulated through the UN Sustainable Development Goals. Socially Responsible Investment is very close to this but tends to put a little more weight on social areas such as health, education, and housing. However, there are as yet no generally-accepted standards, and the terms are often used almost interchangeably. Today, Sustainable/SRI/ESG is increasingly accessible to investors with various investment options available through a broadening array of investment vehicles and across asset classes.

In the last decade, global sustainable investment assets have shown impressive growth. According to the Global Sustainable Investment Review (GSIR)[13], the global sustainable investment assets[14] increased by about 15 percent from US $30.7 trillion in 2018 to US $35.3 trillion at the beginning of 2020. The report finds that the United States and Europe are leading the world with the highest share[15] where sustainable investing represents around 82 percent of professionally managed assets. However, in terms of where assets are domiciled globally, the United States has the highest proportion with around 48 percent of the global sustainable investing assets.

13. Produced by a group of private-sector bodies, and taking an inclusive view of what qualifies as sustainable.
14. Data includes the sustainable investment assets from major markets of Europe, Africa, the US, Japan, Canada, Australia and New Zealand.
15. The proportion of sustainable investing compared to total managed assets.

Figure 24. Growth of Global Sustainable Investing Assets, 2014-2020 (USD in billions)



Source: GSIR (2021)

Fundamentally, there is a natural alignment between principles of Islamic finance and SRI, ESG, or impact investing; both have similar objectives to create a financial system that is more sustainable for the society, economy, and the environment. Given the growth of global SRI funds, there exist vast opportunities to establish Islamic SRI funds around the world. In this regard, some early signs of Islamic SRI sector development can be seen, such as in Malaysia. In 2014, the Securities Commission of Malaysia, with the collaborative efforts of industry players, created a conducive environment for the Islamic SRI sector with the introduction of the framework for SRI Sukuk, which outlines the eligible projects to be classified under SRI.

> "Globally, the United States has the highest proportion of domiciled assets, with around 48% of the global sustainable investing assets."

Islamic SRI funds e.g., Public e-Islamic Sustainable Millennial Fund (Public Mutual, Malaysia) and SC Global Sustainable Equities Fund (SEDCO Capital, Luxembourg) are investing in Shariah-compliant stocks of companies that incorporate SRI considerations in their business practices, while BIMB ESG Sukuk Fund (BIMB, Malaysia) invests in Sukuk, but also taking account of the ESG performance of the originators.

Investing in SRI/ESG asset classes is, nevertheless, a relatively new and promising avenue for the global Islamic funds market. In the future, the Islamic SRI/ESG sector is expected to expand by virtue of the increased demand from value-based investors, regulatory developments, multilateral development banks (e.g., Islamic Development Bank) support, and the growing recognition of Islamic SRI/ESG values by asset managers.

5.2 Fintech-driven and Innovative Funds

Fintech has revolutionized the global financial industry. It embraces everything from high-speed algorithmic trading in financial markets to the delivery of small-scale payment services through smartphones. Fintech breaks down physical barriers in access to financial products and services and facilitates greater financial inclusion.

The global funds market is of course no exception when it comes to the Fintech revolution; technology is expected to transform the entire industry. Fund management institutions are using Fintech to augment the funds market through cost reduction, expanding online services, and widening the customer base. Some are finding that the use of Artificial Intelligence (AI) deep learning in investment management for deeper market insights, combined with big data, can offer risk analytics and action for the future to maximize risk-adjusted returns and reduce downside risks. Moreover, AI can also be utilized in the difficult task of measuring ESG scores of companies as a core requirement for SRI funds, or in other aspects of investment selection. These can be seen as attempts by active fund managers to use technology to erode the cost advantages otherwise enjoyed by passive trackers. Another example is of robo-advisers which enhance the efficiency of investment advisory services, including fund selection. Regulatory technology employs information technology to enhance regulatory processes, e.g., regulatory reporting, risk management, identity management & control, compliance, and transaction monitoring, that enable funds managers to meet regulatory requirements more efficiently. Again, the large-scale record-keeping functions of custodians may prove appropriate to distributed ledger technology (DLT).

However, owing to the relatively small size of Islamic funds, the larger (conventional) players may be in a better position to benefit from technical advances. This is likely to be a particular issue for fund managers; while distributors are often substantial banks or wealth managers, with the capability, if they wish, to invest in robo-advice or online fund distribution platforms, the managers of small funds are unlikely to deploy comparable resources. Some services can be effectively bought in from specialist providers, but this does imply the existence of a substantial funds industry infrastructure.

5.3 Money Market and Liquidity Management

A high proportion of Islamic funds are money market funds. These may invest in short-tenor traded instruments, notably Sukuk, but may also invest through such means as placements with Islamic banks, trade finance, etc. Islamic money market funds play an important part in the Islamic finance ecosystem, not only for personal investments but as ways in which Islamic banks can manage their own liquidity.

Liquidity management for Islamic banks has been an issue for some years, especially in jurisdictions that are not major issuers of Sukuk, since one obvious outlet for short-term liquidity – interest-bearing bonds – is not available to them. This issue has been exacerbated by the more demanding liquidity regimes imposed following the global financial crisis, notably the Basel

Committee's Liquidity Coverage Ratio and Net Stable Funding Ratio and their IFSB counterparts. The availability of institutional investor money market funds can help to alleviate liquidity management problems, and opportunities in this area are likely to increase as demanding liquidity requirements are put in place in further jurisdictions.

> "Islamic money market funds play an important part in Islamic finance, not only for personal investments but as ways in which Islamic banks can manage their own liquidity."

Regulators will, however, need to be conscious of the risk that liquidity issues are simply transferred from banks to funds; when the system comes under stress, fund withdrawals exceed the ability of fund managers to liquidate their own investments.

6. Key Challenges Facing the Market

Each country's issues with developing their Islamic funds on the global stage will vary depending on both the market size and whether its development is mature, developing, or in its infancy. The state of the conventional funds market is also a factor; the obstacles involved in creating an Islamic funds market where there is already a strong conventional one is different from those where the overall funds industry is weak. Those considering the development of the industry also need to be clear on their aims. Making Islamic funds available to meet the needs of domestic Shariah-conscious investors could be achieved by allowing foreign funds to be marketed in the jurisdiction, or by allowing domestic feeder funds to be established. Increasing investment in the local Islamic Capital Market (ICM) requires domestically focused funds and investor education; in some jurisdictions, this may require a fundamental change in the way individuals save (e.g., for retirement). Becoming an international centre requires yet deeper infrastructure, capable of supporting investment both domestically and internationally; many countries aspire to this, but experience in the conventional sector suggests that relatively few will succeed.

In addition, while money market funds can be an important part of the Islamic finance ecosystem, they pose obstacles of their own, as discussed above.

The key challenges related to infrastructure development of the sector are as follows:

6.1 Islamic Funds' Regulatory Framework and IFSB-21

An adequate regulatory framework is a key requisite for an efficient, well-performing, and regulated Islamic funds market. Although the regulatory environment is improving, several jurisdictions are under-regulated or, in some cases such as Saudi Arabia and Malaysia, the existing regulations are weak in comparison to the developed Islamic funds[17]. This situation can potentially expose both the industry and the investors to unnecessary risks; for instance, industry-wide reputational risk and the Shariah non-compliance risk. These risks may arise if Islamic funds face financial difficulties, including liquidity pressures, or are alleged not to be complying with Islamic principles.

17. Islamic Funds Market, COMCEC (2018).

In this regard, Islamic Financial Services Board (IFSB) issued Core Principles (IFSB-21) for the ICM segment. IFSB-21 offers a comprehensive framework that creates greater harmonization of regulations and practices in the ICM. IFSB-21 also provides a basis for regulatory authorities to set standards on eligibility, governance, organization, operational conduct and disclosure requirements for Islamic collective investment schemes (ICIS) i.e., Islamic funds. Because this standard is based on the Core Principles of IOSCO, a jurisdiction with a developed regulatory regime for conventional funds will find it much easier to adopt than one without such a regime.

Under the guiding principles for Islamic funds, IFSB-21 stressed on providing information to investors that is clear, accurate, sufficient, and timely. Moreover, the regulatory system should provide for rules governing the legal form and structure of Islamic funds and the segregation and protection of investors assets. The Islamic funds should make sufficient disclosures about their Shariah governance and Shariah-compliance, operational matters, and disclosures on the special types of Islamic fund need to reflect their specific structures, operational considerations, and risks. It is, therefore, important for the regulators and supervisors in different jurisdictions to adopt IFSB-21 for further development of the Islamic funds markets. The disclosure requirements on ICIS are dealt with in greater detail in IFSB-19[18].

> "IFSB-21 offers a comprehensive framework that provides a basis for regulatory authorities to set standards on eligibility, governance, organization, operational conduct and disclosure requirements for Islamic collective investment schemes"

6.2 Shariah Governance

One particular and important aspect of IFSB-21 is Shariah governance. Islamic funds need governance arrangements that will provide assurance about the underlying investments, about associated issues such as purification of non-compliant income or dealing with investments that become non-compliant[19], and about operational arrangements. In some jurisdictions, Shariah governance arrangements originally designed for Islamic banking may not translate well to the funds market.

6.3 Availability of Shariah-compliant Investments

Any Islamic fund needs a pool of Shariah-compliant investments available to it. Whereas any equity market is likely to include many shares that are compliant, at least as regards the underlying business, funds will typically also need investments like Sukuk and Islamic deposits or other money market instruments. Without these, a local Islamic funds market will struggle to flourish, though of course, it may be possible to establish Islamic funds investing mainly in foreign or international instruments.

18. Whereas IFSB-21 focuses on funds which invest in tradable securities, IFSB-19 also includes disclosure requirements for some other types of funds, such as real estate funds.
19. For example, where an enterprise merges with one conducting forbidden activities, or takes substantial conventional (interest-based) financing.

6.4 Scalability

Scalability is another challenge faced by the Islamic funds markets in jurisdictions where the ICM is in its early stage of development. Since the ICM is a niche market with possibly limited assets available to it, it is challenging for many Islamic fund management institutions to achieve a minimum level of scale efficiency at a time when fund charges are taking increased prominence in investment decisions. They will also need to keep abreast of competitors by staying updated on recent developments in Fintech; e.g., for investment management and record-keeping. In some jurisdictions, the funds ecosystem may allow managers to alleviate the problems of scale by (effectively) outsourcing, but this will not be an option everywhere.

6.5 Market Development

Whereas the previous recommendations apply entirely or mainly to Islamic funds, in some markets the overall funds industry may need development. This will especially be the case if the policy objective is to support investment in the local capital market. While the development of this kind may require the introduction of a modern regulatory regime, changes in savings patterns may also be needed. For example, in some jurisdictions people tend to rely on the government to support them in retirement or adversity; in others personal savings may be more important, perhaps intermediated by insurance/Takaful or pension schemes. This creates greater opportunities for investment funds, as the funds market offers a valid perspective in the social provisions debate. Where individuals are encouraged to save in this way, the Islamic funds market should also advocate for Shariah-compliant options to be offered.

7. Conclusion and Policy Recommendations

Despite showing consistent growth over the years, the global Islamic funds market, when compared to its counterpart, is relatively immature and much smaller in size. With the exception of a few core developed markets, most of the jurisdictions offering Islamic funds are either in their developing or infancy stage of development. Sometimes this also reflects a weak conventional funds market. However, there exists tremendous growth potential that can be harnessed with a suitable ecosystem for the Islamic funds market. To that end, multiple efforts are required on the part of governments, regulators, policymakers, investors, Islamic banks, and Islamic funds management institutions.

The most pressing need, as already explained, is to identify the main policy objectives. These will critically affect decisions on which parts of the fund's ecosystem need to be encouraged in the jurisdiction and where quick wins can be achieved. In particular, if the aim is to create a supply of Islamic funds for a local Muslim minority, it will be quicker to do this by permitting the distribution of foreign funds (whether directly or via feeders) than to build a full domestic ecosystem.

Therefore, to develop a conducive ecosystem for the global Islamic funds market, it is recommended that the governments and regulators should:

- Demonstrate political will and build cohesive collaboration among the key stakeholders.
- Define the policy objectives, both short and longer-term, and their relationship to the development of other aspects of Islamic finance in the jurisdiction.
- Remove regulatory obstacles to the funds business including, in some jurisdictions, tax disadvantages for funds, capital controls limiting the ability to invest elsewhere, and unduly cumbersome regulatory approval procedures.
- Develop essential building blocks to establish ICM (in underdeveloped markets) and support ICM activities (in relatively developed Islamic funds markets) and implement IFSB-21 guidelines for greater harmonization of regulations and practices in the ICM.
- Improve the supply of Shariah-compliant investments, in particular by encouraging domestic Sukuk issuance and an Islamic money market.
- Create a market demand for Islamic funds by encouraging funds as a vehicle for personal savings and through Shariah-compliant investments or ethical investing for government and corporate pension schemes.
- Develop a conducive environment for cross-border Islamic funds through mutual recognition agreements (MRA) between jurisdictions, e.g., MRA between Security Commission Malaysia and with Dubai Financial Services Authority.
- Train human capital and increase market awareness through awareness campaigns, promotional activities, seminars, and forums for public education.
- Develop a framework with strong guidance and principles for investor protection within ICM.

Islamic banks and Islamic funds management institutions, both individually and collectively, should:

- Encourage and participate in the policy development process described above.
- For banks and other wealth managers, ensure that Islamic funds are among the options offered to their clients.
- Take advantage of existing cross-border investment infrastructure to attract international investors, particularly for SRI funds.
- Adopt industry best practices in risk management, transparency, and disclosure on Shariah-compliance of investment funds, Shariah governance, and other operational matters.
- Adopt Fintech solutions, e.g., AI and DLT, to enhance the operational efficiency of Islamic funds.
- Educate stakeholders and create awareness among investors and employees on Islamic funds and highlight their socio-economic benefits.
- In more advanced jurisdictions particularly, deepen the Islamic funds market through a wider range of funds including, in particular, SRI funds and innovative funds (e.g., Waqf-featured funds, venture capital funds).

Global Islamic Funds Market by Domicile

Figure 1. AuM by Country, 2021 (USD in millions)

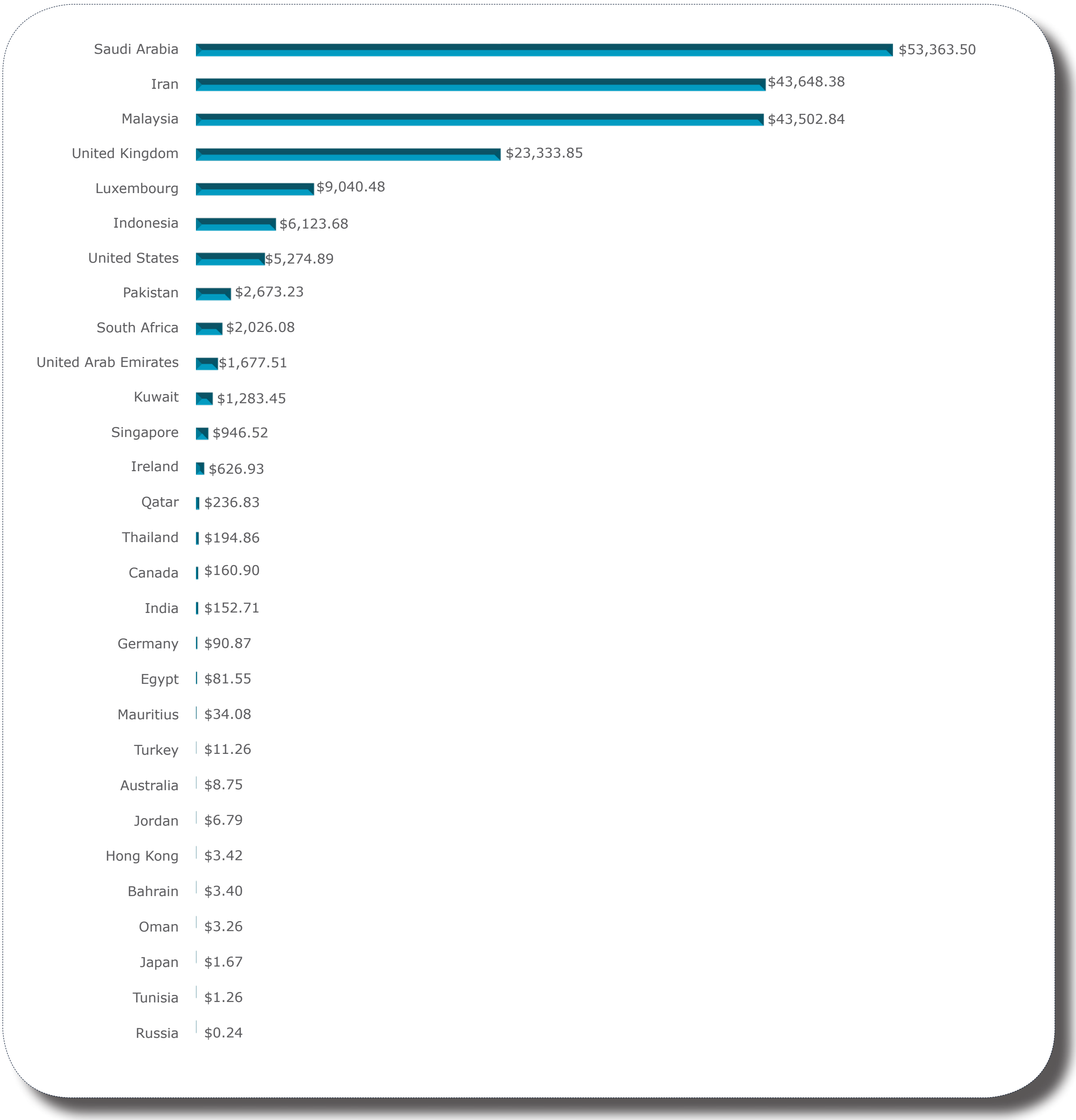


Figure 2. Top 10 Islamic Funds Domiciles by Number of Funds (2021)

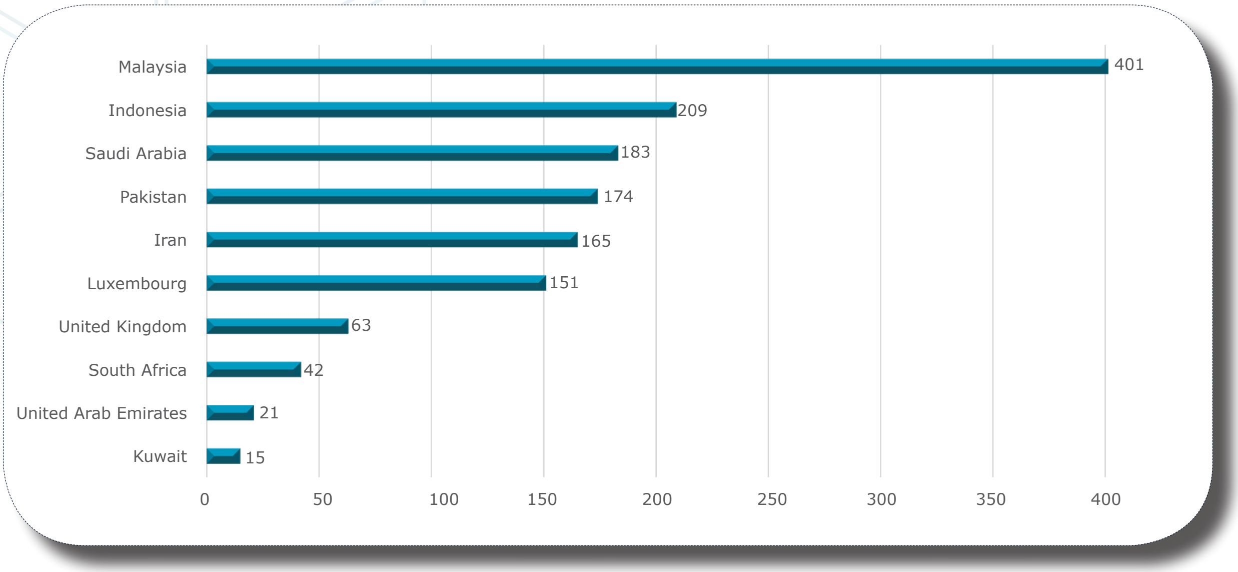
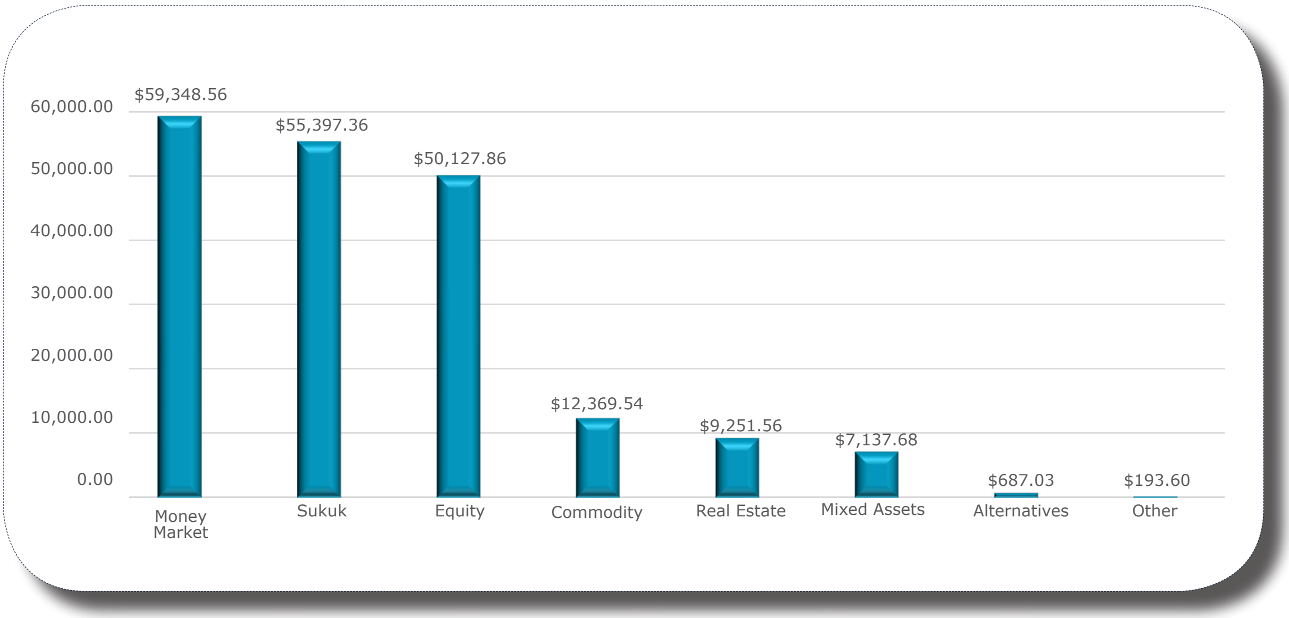


Figure 3. Type of Islamic Funds by AuM, 2021 (USD in millions)



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