

CIBAFI BRIEFING

The Potential of Islamic Wealth Management for Islamic Banks: Key Market Trends, Challenges and Opportunities

CIBAFI is pleased to present its eighteenth "Briefing" on "The Potential of Islamic Wealth Management for Islamic Banks: Key Market Trends, Challenges and Opportunities". This briefing highlights the significance of Islamic wealth management from a Shariah perspective and its potential for the Islamic finance industry in general, with a specific focus on the Islamic banking sector. It provides an overview, key trends, and Islamic wealth management structure and practices in the industry. The briefing also examines the opportunities and challenges for Islamic banks and presents recommendations to capitalize on growth and expansion opportunities.

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1. Introduction

Wealth management is commonly described as a process of reviewing and making decisions about an individual's or family's wealth to achieve desired financial goals. This process involves integrated financial services, such as portfolio management and financial planning, tailored to the client's financial objectives, risk tolerance, and time horizon.

The primary task of the wealth manager¹ is to assist clients in achieving their desired financial goals. To achieve this, a range of products and services are employed targeting four key goals of wealth management: long-term investments and wealth accumulation, retirement planning and income, wealth and lifestyle protection, and wealth distribution.²

In the current dynamic and complex financial landscape, wealth management plays a vital role. The COVID-19 pandemic has brought about significant economic disruptions, market volatility, and heightened uncertainty, leading to various obstacles in wealth management. Globally, the focus has shifted to defensive strategies to protect against inflation, strengthen investment returns, and ensure financial security.³

2. Islamic wealth management

In the Islamic context, man is not the absolute owner of wealth, but is considered a trustee. It is his responsibility to manage this wealth guided by Quran and Sunnah.

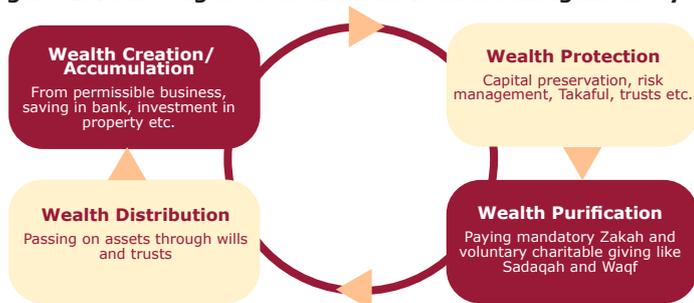
Islamic wealth management presents a comprehensive approach to financial management, considering an individual's spiritual, social, and economic well-being.

It emphasizes ethical and socially responsible investing, avoiding interest-based transactions, and ensuring that wealth benefits individuals and society as a whole. Islamic wealth management also requires transparency, accountability, and risk management of the portfolio, with all parties fully informed and consenting in contracts and transactions. Moreover, the wealth manager ensures investments are made in permissible industries and activities while avoiding forbidden activities according to Islamic principles.

2.1 Islamic wealth management cycle

The Islamic wealth management cycle offers a holistic framework for aligning wealth management with Shariah principles, Islamic values, and the pursuit of financial success and social responsibility. It comprises four stages that are wealth creation/accumulation, wealth protection, wealth purification and wealth distribution.⁴

Figure 1. Four Stages of the Islamic Wealth Management Cycle



Source: CIBAFI (2023) & Lhasasna (2017)

1. This includes the role of wealth management and/or advisory services.

2. (Mindel & Sleight, 2009)

3. (EY, 2023)

4. This framework of the Islamic wealth management cycle is a prominent academic view of understanding Islamic wealth management.

a. Wealth creation/accumulation

Islam encourages the pursuit of livelihood through trade and economic activities, emphasizing the responsibility of Muslims to earn their income and avoid dependency on others. In Islamic principles, wealth creation/accumulation is defined as the process of generating wealth through engaging in permissible business activities, investing in Shariah-compliant assets, pursuing lawful employment, and undertaking entrepreneurial endeavors that align with Shariah principles. As a result, any wealth acquired through impermissible means, such as gambling, speculation, or interest-based transactions, is strictly prohibited.⁵ Both Islamic and conventional wealth managers typically consider their clients' objectives, which may include accumulating sufficient funds for a child's education or their own retirement. However, an Islamic wealth manager must also give greater consideration to the means used to achieve these objectives, ensuring they remain in accordance with Shariah guidelines. This entails a more thorough evaluation of the ethical and religious acceptability of investment choices and business practices to uphold the values of Islamic finance.

b. Wealth protection

Wealth protection aims to safeguard from financial risks, uncertainties and unexpected life events, such as death, disability, or chronic illnesses. Islamic wealth managers employ various risk management strategies that adhere to Shariah principles. These strategies may involve making prudent choices and diversification of investments. Additionally, Islamic wealth managers may establish trusts, utilize Takaful contracts (Islamic insurance), engage in tax planning and management, and implement appropriate legal frameworks for comprehensive wealth protection.

Furthermore, maintaining a balanced financial approach, where expenditures are in harmony with income. Avoiding extravagance and unnecessary spending is encouraged, while giving priority to the needs of both the family and the wider community. Moderation, balance, and fairness are the guiding principles that should govern expenditures, ensuring that individuals spend within their means and avoid accumulating excessive debt or financial obligations that could lead to financial stress and instability.

c. Wealth purification

Wealth purification involves the act of setting aside a portion of one's income or assets for charitable purposes, with the aim of purifying the remaining wealth. The primary method of wealth purification in Islam is through Zakah, which requires Muslims to give a specific percentage of their wealth, typically 2.5%⁶, to support the poor and needy in society. By giving Zakah, individuals not only purify their wealth but also earn blessings from Allah (swt) while contributing to social justice and equality. Islamic wealth managers play a crucial role in assisting clients in calculating and fulfilling their Zakah obligations, ensuring compliance with Islamic principles.

In addition to Zakah, there are other forms of voluntary charitable giving in Islam, such as Sadaqah and Waqf, which also contribute to the purification of wealth. Waqf involves donating assets or property for charitable purposes⁷, such as building schools or hospitals, leaving a lasting impact on society. Sadaqah, on

5. (Ahmed, 2020)

6. Percentage payable, as a religious obligation, of the wealth one possesses above the Nisab, which is equal to 87.48 grams of gold and 612.36 grams of silver. However, there are different rates depending on the asset type, for example, agriculture produce and livestock.

7. Waqf can also be used for non-charitable purposes, such as family Waqf (providing for the family).

the other hand, can be offered at any time and in any amount, providing support to a wide range of recipients, including the poor, the sick, the elderly, orphans, and the homeless, among others.

d. Wealth distribution

Wealth distribution involves meticulous planning to ensure that accumulated wealth is managed and distributed according to one's wishes with minimal hassle. The primary focus is on achieving fair and equitable sharing of wealth among family members and beneficiaries in accordance with Shariah principles and inheritance laws. The role of the wealth manager is to ensure that Islamic injunctions regarding one's properties and financial obligations are meticulously carried out. This includes addressing outstanding debts, meeting dependents' expenses, and fulfilling Zakah payments.

Moreover, the Islamic wealth manager takes measures to minimize unnecessary legal costs and protracted legal proceedings, while also aiming to reduce the burden of taxes. By doing so, the wealth manager strives to minimize financial hardship to the family and mitigate the risk of conflicts and animosity arising among family members during the wealth distribution process.

3. Islamic Wealth Management Industry and Islamic Banking Sector

Although the Islamic financial services industry (IFSI) has shown significant growth over the past two decades, Islamic wealth management remains a niche segment and is still in its nascent stages of development. There is indeed no reliable data on the size of the Islamic wealth management industry, but it is certainly small in comparison with the multi-trillion-dollar conventional global wealth market of US\$ 137 trillion (2021)⁸. By way of indicative size, in 2022 the global Sukuk issuance was US\$ 193.9 billion⁹ while the global bond market issuance registered a massive US\$ 6.4 trillion¹⁰.

To put it into perspective, the Sukuk market is but a speck of sand on a beach in comparison, and it is highly probable that the Islamic wealth management industry is significantly smaller when considering its assets under management (AUM). Nevertheless, Islamic wealth creation is witnessing expansion among affluent individuals and families in Muslim-majority countries. This trend is driven by the increasing interest in Shariah-compliant investment options, the demand for ethical and socially responsible investment vehicles, and the growing population of high net-worth individuals (HNWI) and ultra-high net-worth individuals (UHNWI)¹¹, especially in the Middle East, Africa and Asia regions¹², which has resulted in a boost to the market. Moreover, in certain jurisdictions, such as the GCC countries, the slow expansion of the lower-end market of the wealth management sector is commonly attributed to the traditional involvement of the State in protecting citizens from hardship including healthcare, education and retirement provisions.

As in conventional finance, there are two major segments of wealth management. One delivers financial planning and advice, with investment decisions ultimately for the client. The other

involves discretionary management of the money that the client has placed with the institution. In some, but not all, jurisdictions, there is a significant industry that is mainly or entirely advisory. Industry structures vary from jurisdiction to jurisdiction as, to some extent, do the preferred modes of investment. In particular, family Takaful plays a much greater role in some jurisdictions than in others; this would also be true of conventional life insurance.

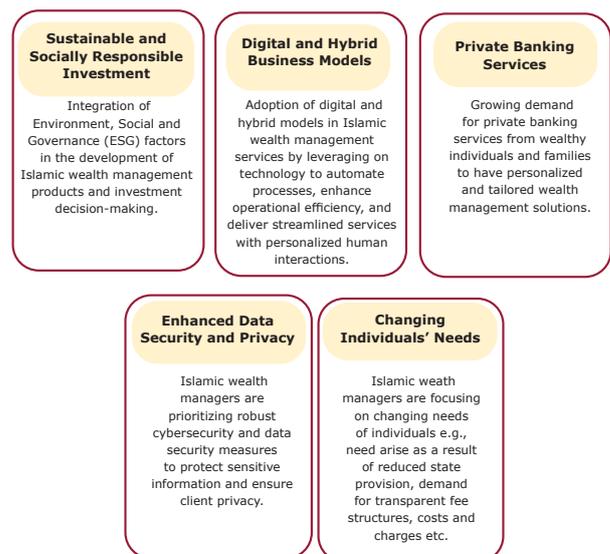
The Islamic banking sector, being a major element of the IFSI, is offering a range of wealth management products and services, including Islamic unit trusts, Takaful, tax and Zakah planning, estate and retirement planning, debt management etc., all of which are structured in accordance with Shariah principles.

Islamic private banking services are also gaining popularity for providing clients with personalized investment advice and tailored solutions based on their specific financial goals and risk appetite. Leading banks in core Islamic finance markets such as Southeast Asia, the Gulf Cooperation Council (GCC), and the broader Middle East and North Africa (MENA) region have thus begun to tap into the Islamic private banking segment.

3.1 Current market trends

In recent years, the Islamic wealth management industry has undergone significant transformation. Key factors driving this transformation include a rising interest in Shariah-compliant investment options, thematic investment needs, the adoption of digital and hybrid business models, Islamic private banking services, data security and privacy, and a growing focus on environmental and social considerations. As a result, wealth managers are redefining their daily business approaches to navigate these trends and changes effectively. Figure 2 presents the key market trends in the global Islamic wealth management industry.

Figure 2. Key Market Trends



Source: CIBAFI (2023), Alpen Capital (2021) and CAPCO (2021)

8. (Bain & Company, 2022)

9. (Refinitiv, 2023)

10. (Dealogic, 2023)

11. HNWI with wealth of US\$ 1-30 million and UHNWI US\$ 30 million and above.

12. Growth of HNWI and UHNWI: 879,000 individuals with wealth of US\$ 3.42 trillion in Middle East (2.8% growth 2021-22); 195,000 individuals with wealth of US\$ 1.86 trillion in Africa (4.3% growth 2021-22); and 7,054,000 individuals with wealth of US\$ 24.65 trillion in Asia (2.0% growth 2021-22), Capgemini Research Institute (2023).

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3.2 Islamic Banks as key players

The Islamic wealth management industry is primarily driven by the core Islamic finance markets, namely GCC and Southeast Asia. These markets hold prominence due to the substantial presence of Islamic banks (both retail and private banks) that serve as major providers of Islamic wealth management products and services. Moreover, these regions are home to a high number of Islamic banks with large customer bases and asset sizes, which contributes significantly to their leadership in the global Islamic wealth management industry.¹³

a. Gulf Cooperation Council (GCC)

In the realm of the global Islamic wealth management industry, the GCC market stands out in terms of its size and diversity¹⁴. It holds the largest share, amounting to US\$ 1.324 trillion (2022)¹⁵, which represents 57.6% of the total assets in the global Islamic banking industry. The region is home to a total of 78 Islamic banks, including full-fledged banks, Islamic windows and Islamic private banks. Many of these banks are offering a wide array of Islamic wealth management products and services tailored to individuals and families. Among the GCC countries, Bahrain leads with the highest number of 28 Islamic banks, followed by the UAE with 23 banks, and Saudi Arabia with 12 banks¹⁶.

b. Southeast Asia

Southeast Asia is the second largest market with Islamic banking assets value of US\$ 318.8 billion in 2022, constituting a global market share of 13.7%^{17,18}. The region comprises two systemically important jurisdictions: Malaysia and Brunei. Additionally, the share of Islamic banking in Indonesia, although not considered domestically systemically important, still contributes significantly to the overall value of Islamic bank assets in the Southeast Asian region.

The Southeast Asian region boasts a total of 235 Islamic banks¹⁹, with Indonesia taking the lead with 204 Islamic banks²⁰, followed by Malaysia with 17 banks, Singapore with 6 banks, Thailand with 4 banks, Brunei with 3 banks, and the Philippines with 1 Islamic bank.²¹ These Islamic banks are offering a wide array of Islamic wealth management products and services tailored to their clients.

Singapore, in particular, has been identified as a promising growth area for Islamic wealth management within the Islamic finance industry. This presents an opportunity for expanding distribution among investors in Asia and the Middle East, as investors from the GCC seek new markets. Banks from Malaysia and the GCC are actively exploring the expansion of their operations in Singapore and aiming for the growth of their Islamic finance offerings.

3.3 Product and Service Offerings

Islamic banks are offering a range of wealth management products and services that are Shariah-compliant and cater to the specific needs and risk appetite of their clients. However, the range of Islamic wealth management products and services varies

between Islamic banks and jurisdictions. Some of the key Islamic wealth management products and services offered by Islamic banks are presented in Figure 3. These products and services are categorized within the ambit of the Islamic wealth management cycle.

Figure 3. Examples of Islamic Wealth Management Products and Services in Islamic Banks²²



Source: CIBAFI

3.3.1 Structures and practices in Islamic wealth management

Islamic banks implement diverse structures and practices that may vary across jurisdictions. However, there are fundamental commonalities in the structures and practices of Islamic banks, aimed at upholding Shariah compliance and catering to clients' wealth growth and management needs. Recognizing that individuals have unique approaches to wealth management, Islamic banks and other financial institutions strive to provide tailored financial solutions that align seamlessly with their client's lifestyles and business endeavours. This ensures that clients receive services that not only meet their specific requirements but also adhere to Shariah principles. Generally, an Islamic wealth management structure involves the following process:

- The process begins with a thorough assessment of the client's financial goals, risk appetite, and investment preferences. Islamic wealth managers work closely with clients to understand their unique needs and develop a comprehensive wealth management strategy.
- Islamic wealth managers engage in comprehensive financial planning to assist clients in achieving their long-term financial goals. This involves assessing the client's current financial situation, analysing cash flow, budgeting, and identifying areas for improvement.
- Assisting clients in developing a comprehensive financial plan that addresses all their financial and non-financial needs within the scope of engagement.
- Assisting clients in developing wills and estate plans that align with Islamic principles. This involves helping clients outline their wishes for the distribution of assets after their passing in a manner that complies with Shariah guidelines.

13. It is important to note that some UHNWIs in the GCC region have a lot of their wealth managed through institutions - some of them Islamic - based outside the region. However, the evolving regulatory developments across the GCC nations, Malaysia and Indonesia have led to investments flowing back onshore across the world of wealth management.

14. Due to the absence of reliable data on wealth management specifically, the Islamic banking sector is used as a proxy for the likely geographical concentration of that industry.

15. (CIBAFI, 2023) and (IFSB, 2022)

16. Data is collected from Central Banks of GCC countries (Bahrain, UAE, Saudi Arabia, Qatar, Oman, and Kuwait, 2023).

17. (CIBAFI, 2023) and (IFSB, 2022)

18. Refer to footnote 14.

19. Islamic banks include full-fledged, Islamic windows/units, rural Shariah banks (Indonesia) and specialized Islamic private banks (2023).

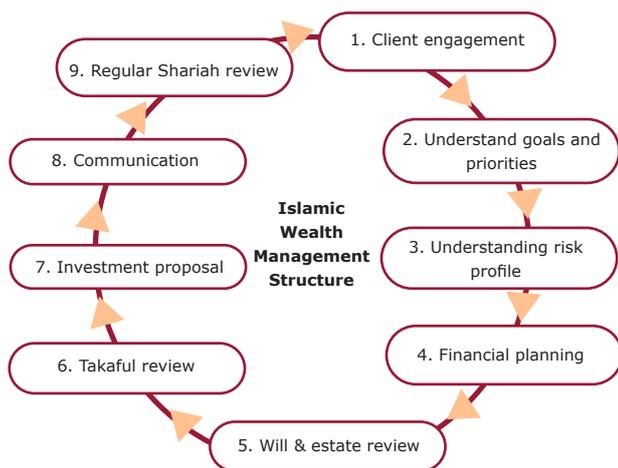
20. This includes 3 types of banks: Sharia Commercial Banks (13), Sharia Business Units (20) and Sharia Rural Banks (171).

21. Data is collected from Central Banks and financial authorities of Southeast Asian countries (Indonesia, Malaysia, Brunei, Singapore, Thailand, and the Philippines) (2023).

22. Islamic wealth management products and services differ across countries. For instance, in some countries Zakah and Waqf fall under the jurisdiction of government institutions.

- Islamic wealth managers guide clients in selecting Takaful products that provide coverage for various aspects such as life, health, property, and business. By incorporating Takaful into the Islamic wealth management process, individuals and businesses can safeguard their assets while adhering to the principles of fairness and solidarity as outlined in Islamic finance.
- Islamic wealth managers construct a customized investment portfolio for the client, considering their risk profile, investment horizon, and financial objectives. Investment portfolios may include Islamic investment funds, Sukuk (Islamic equivalents to bonds), Islamic equity funds, real estate investment trusts (REITs), and other structured products that align with Islamic principles.
- Islamic wealth managers provide regular updates and report to clients regarding the performance of their investments and the overall management of their wealth.
- Shariah scholars conduct Regular Shariah reviews to ensure that the investment products and services offered are compliant with Shariah principles.

Figure 4. Islamic Wealth Management Structure and Practices



Source: CIBAFI

4. Industry Challenges and Opportunities

The Islamic wealth management sector, like other facets of the Islamic finance industry, encounters a multitude of challenges and opportunities as it strives for expansion and advancement. The following points elucidate some noteworthy challenges and opportunities:

4.1 Regulatory and compliance issues

Islamic wealth management faces several regulatory and compliance challenges, especially in regions lacking of specific regulations governing Islamic finance. The absence of clear and consistent regulatory guidelines for Islamic banking and the Islamic capital market can create ambiguity and uncertainty for both providers and clients seeking to grow their wealth through Islamic wealth management.

Moreover, in some regions, the universe of Islamic alternative investments is limited, and the lack of a facilitative regulatory environment restricts Islamic wealth managers' ability to diversify client portfolios.

4.2 Technological advancements

The advancement of technology has presented both opportunities and challenges for the Islamic wealth management industry. On the one hand, technologies and innovations, such as artificial intelligence (AI), big data analytics, cloud computing and blockchain, offer new ways to improve efficiency, automation, cost reduction, and customer experience. These technologies have allowed IFIs to expand investment options, reach a wider audience and offer tailored solutions.

On the other hand, technology integration also presents several challenges that need to be addressed. For example, the adoption of new technologies often requires navigating complex regulatory and compliance frameworks, demanding firms to ensure adherence to industry regulations, laws, and ethical standards. Moreover, increased reliance on technology and the storage of sensitive client data, pose an elevated risk of data security and privacy breaches for IFIs. Additionally, technology integration requires significant investments in infrastructure and training, which can be a challenge for smaller Islamic wealth management firms.

4.3 Sustainability and ESG practices

Sustainability and Environmental, Social, and Governance (ESG) practices present a significant opportunity for the Islamic wealth management industry to harness and expand. With increasing awareness and demand for responsible investing, integrating sustainability and ESG considerations into investment strategies can attract a broader range of clients and investors. The industry's focus on ethical and socially responsible investments, positions it well to take advantage of this trend. By incorporating ESG factors, Islamic wealth management firms can align their offerings with the values and preferences of socially conscious individuals and institutions, enhancing their competitive edge and long-term growth prospects.

Moreover, embracing sustainability not only contributes to positive environmental and social outcomes but also helps manage risk and enhance overall portfolio performance. There is, however, a need for greater awareness and education among Islamic finance practitioners about the importance of sustainability and ESG considerations.

4.4 Opportunities for growth and expansion

The Islamic wealth management industry is poised for significant growth and expansion, driven by various opportunities that lie ahead. One such opportunity is the increasing demand for ethical and socially responsible investment options. As more individuals seek investment vehicles aligned with their values and principles, Islamic wealth management offers a compelling solution with its emphasis on Shariah-compliant investments and ethical practices. Additionally, there is a vast revenue growth opportunity in affluent segments and the low-end market, which Islamic wealth managers can tap into profitably.

The growing global Muslim population offers a sizable market for Islamic wealth management, favouring industry growth. Islamic banks can harness this by leveraging their diverse customer base. The increasing adoption of Islamic finance by non-Muslims also presents a significant growth opportunity for the industry.

Furthermore, new customer segments are emerging as a result of demographic shifts and the global expansion of wealth. An estimated 250 million Generation Y and Generation Z customers (born between 1981 and 2012) will have an annual income of over US\$100,000 by 2030. The Asia-Pacific and Americas will lead

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this wealth expansion, with 90 million and 110 million individuals, respectively.²³ This offers an enormous growth potential for the industry. Additionally, the integration of technology, e.g., AI, big data and robo-advisors in Islamic wealth management can boost efficiency, accessibility, and customer experience. This can help position the industry as a global player, catering to diverse investor preferences.

5. Conclusion and Recommendations

Given the Islamic wealth management industry is in its nascent stage, it has witnessed notable progress, driven by increasing interest in Shariah-compliant investment options, demand for ethical investment vehicles, and the growing population of affluent individuals in Muslim-majority countries. Many Islamic banks are offering a range of Shariah-compliant wealth management products and services, including private banking services tailored to the specific needs of clients. Nonetheless, others are not fully capitalizing on the opportunities for growth and expansion presented by the industry. These banks, from non-core Islamic finance markets, have an opportunity to tap into the potential benefits of offering comprehensive Islamic wealth management solutions to their valued customers.

To realize its full potential, the Islamic banking sector must address various challenges and leverage available opportunities and growth potential in the Islamic wealth management industry. It is thus recommended that Islamic banks should:

- Develop more innovative Shariah-compliant wealth management products and services that cater to the needs of different customer segments e.g., Generation Y and Generation Z customers and the low-end market.
- Invest in research and development to stay abreast of industry trends and emerging technologies.
- Develop partnerships with leading technology providers and fintech companies to enhance the efficiency and effectiveness of Islamic wealth management operations.
- Emphasize the importance of sustainability and ESG practices in Islamic wealth management and integrate them into product development and service offerings.
- Engage with Islamic finance stakeholders to promote the growth of the industry.

It is also recommended that Regulatory and Supervisory Authorities (RSAs) should:

- Develop clear and comprehensive regulatory frameworks that provide guidance on Shariah compliance and consumer protection for Islamic wealth management products and services.
- Promote the adoption of best practices in sustainability and ESG practices by Islamic financial institutions through regulatory incentives and guidance.
- Encourage innovation in Islamic wealth management through the provision of regulatory sandboxes and support for fintech startups.
- Encourage the development of professional certification programmes to train human capital and promote talent in the area of Islamic wealth management.

About CIBAFI

CIBAFI is an international non-profit organisation founded in 2001 by the Islamic Development Bank (IsDB) and a number of leading Islamic financial institutions. CIBAFI is affiliated with the Organisation of Islamic Cooperation (OIC). With over 130 members from more than 30 jurisdictions from all around the world, CIBAFI is recognised as a key piece in the international architecture of Islamic finance. Its mission is to support the Islamic financial services industry's growth by providing specific activities and initiatives that leverage current opportunities while preserving the value proposition of Islamic finance. CIBAFI is guided by its Strategic Objectives, which are 1) Advocacy of Islamic Finance Values and Related Policies & Regulations; 2) Sustainability and Innovation Integration; 3) Industry Research and Analysis; and 4) Professional Development.

Contact Information:

General Council for Islamic Banks and Financial Institutions (CIBAFI) Jeera 3 Tower, Office 71, Building No. 657, Road No. 2811, Block No. 428 Manama, Kingdom of Bahrain. P.O. Box No. 24456

Email: cibafi@cibafi.org
Telephone No.: +973 1735 7300
Fax No.: +973 1732 4902
www.cibafi.org

Acknowledgements

CIBAFI would like to offer its sincere thanks to the individuals who have contributed to making the publication a success. We would like to appreciate the CIBAFI Secretariat members and Mr. Peter Casey, CIBAFI Consultant. We also thank Prof. Dr. Ahcene Lahsasna, Salihin Shariah Advisory Services for his valuable comments during the development of the briefing. We trust that this publication will offer valuable insights to Islamic bankers around the globe on the Islamic wealth management industry and the key considerations for both banks and regulatory and supervisory authorities to capitalize on growth and expansion opportunities.

References

For more information about the references, please access the following link:

[References of CIBAFI's 18th Briefing](#)