Islamic Finance in US: Arrived, But Is It Growing?

9th Annual Symposium on Islamic Banking & Finance
Pasadena, California
March 30, 2002

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Presentation Over-View

• Interest in Islamic Products
  – Religious Sentiment & Prods/Perform?
• Islamic Mortgages
• Islamic Funds
• Expectations Not Met (Yet)!
• DJIM vs. FTSE Islamic
• Licensees & their Demands
• DJIMs vs. Conventional comparison
Islamic Investing has arrived, BUT is it Growing?

- Religious sentiment & Products/Performance
- Shariah Scholar (1987)
- Western Players (WMC, Citi, Permal)
- Islamic funds (100+)
- Global Index Providers (DJI & FTSE)
- Fund Rating (Lipper & Micropal)
- Conferences/Seminars
- Media Coverage

Where are We?

- Demographics & Psychographic
- Islamic Home Finance
- Islamic Vehicle/Equipment Financing
- Islamic Property Insurance
- Islamic Investing
- Islamic Charge Cards
Facts about US Muslims:

- 6-9 Million, but as low as 1.28 M
- Concentrated in 6-7 geographic pockets
- 60% College Grads (WSJ- 2/15/02)
- 50% make $50,000 (WSJ)
- ML opening: Indian/Minority Unit
  - ‘Explosive Growth in size & wealth’ FT (2/21)
  - ‘Minority clients may be key to success for financial firm over next 50 years’
- UK: Muslim millionaires “Hot New Sector”
  - 5,400 with $5B in liquid assets (FT Advisor-2/4)

Islamic Home Finance

- Most sought after Islamic product
  - Purchase and Refinance
- Community Based Initiatives:
  - MSI, Samad Group, BMI, Ameen Housing Corp., Toronto Housing Corp, LARIBA (American Finance House)
- Institutional:
  - UBK, HSBC, Capital Guidance, Freddie Mac, others to follow…
Islamic Home Finance (cont’d):

Constraints:
- Product- Musharaka, Murabaha, Ijara
  - Expensive (large down & short term)
- Application approval- no/bad credit
- Shariah Compliant issues
  - Deductibility
  - Property insurance
- Money- Demand is $B, and supply is $M
  - Securitization
- Staff- Supply/Interest, Training, etc.
- Qard hassan
- Customer Service & support

Islamic Mutual Funds/Portfolios

- Available since 1986 (Amana Income Fund)
  - Azzad, Allied, Islamia, Capital Guidance, BBH(?), others
  - About $64M in combined assets under management
- Fatwa of Sheiks Usmani, El-Naggar & Tug (1987)
- Wellington, Citibank, UBS, etc.
  - Mandate driven
  - Gulf based High Networths & Institutions
  - Internal benchmark
- Dow Jones Islamic Market Index (1999) & FTSE
  - DMI & TII Euro Small Cap Islamic Index
  - Resistance by some fund manager but not their clients
    - Regional weightings, concentration on sectors, turnover, back-testing data, etc.
Islamic Funds (Courtesy of Failaka.com)

- **Largest Islamic Funds**
  - Al-Ahli Global Trading (NCB) $503M
  - Alfanar/SEDCO (Permal) $171M
  - Al-Ahli Small Cap (NCB) $171M

- **Largest Islamic Managers**
  - Wellington Mgmt (Boston) $727M
  - Permal (New York) $336M
  - Deutsche Asset Mgmt (EU) $134M

- **Largest Islamic Sponsors**
  - NCB (Saudi Arabia) $935M
  - SEDCO (Saudi Arabia) $336M
  - Keppel Insurance (Singapore) $98M

Islamic Funds (Courtesy of Failaka.com)

- **Year**  **No. of Funds**  **Assets ($M)**
  - 1996  29  $800
  - 2000e  98  $5,000
  - 2002  100+  $3,300

- 34% decline (aum)!
- What Happened?
Islamic Funds (Courtesy of Failaka.com)

- Times Are Changing:

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Funds</th>
<th>Type of Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>23</td>
<td>8 GE &amp; 5CP/B</td>
</tr>
<tr>
<td>2002</td>
<td>11</td>
<td>1 GE &amp; 5CP/B</td>
</tr>
</tbody>
</table>

- What Does This Mean?

15 Largest Funds
- 1 has $25,000 mini
- 3 with up-front load
  - 1 has >2% Load
- 1 has >2% fees
- $108 M ave size

15 Smallest Funds
- 3 have $25,000 mini
- 9 with up-front load
  - 6 have >5%
- 6 have >2% Fees
- $4.4 M ave size
MMA Survey (2001):
Faith & Wall Street Intersect

- 8/10 religious/spiritual investors
- Women (63%) more likely than men (49%)
- Ages 25-44 (55%)
- African Americans & Family with minors (57%)
- 80% never heard of religious funds
- 60% are will try now/future
- Sin industries
  - Alcohol, Tobacco, Gambling, Abortion its products
- Identify as Protestant, Catholic, Fundamental Christian
- Where are the Muslims?
- What are the implications?

Islamic Mutual Funds/Portfolios

- Conditions Ripe for Growth in US:
  - Population, Shariah, Awareness, Managers, Islamic Index, etc.
- But What Happened?
  - Distribution channels (assets, duration, niche-play)
  - No-Load (no incentive for brokers)
  - Marketing (road shows, seminars, etc.) & Call centers
  - No Peer Review (No Morningstar --> Failaka.com)
  - Shariah issues (standards) Amana vs. Allied/Azzad
    - VC (or PE) is preferred route of investing
  - Reliance on Imams (not trained)
  - Risk averse (Volatility) & No Islamic MM or CDs
  - Lack of interest (ahead of its time)
  - Performance to conventional market
Muslim Country Situation

- 56 Muslim countries
- 30 have stock exchanges
- 16 allow direct FPI (ex. Not Saudi Market)

Situation in OIC countries:
- GCC/MENA not investable map
- Capital Flight ($800B from GCC)
- Currency, Inflation, & Political risks
- Regulatory environment & Corruption
  - Illiquid, Free float (ADR alternatives)
  - Malaysia & Indonesia in DJGI
- Lack of opportunities

What Can Be Done?

- Overcome Ignorance, Inertia and Inaction
- Education & awareness --> Avoid fraud
  - Conferences, Websites, Marketing mats, papers, etc.
- Educate the Imams and Boards of Mosques
- Approach your institution for Islamic products
  - They do not want to lose business
- Approach western financial institutions
  - Dow Jones Index example
- Approach institutions offering Islamic products
  - Demand based play
  - Cap protection, Islamic MM, Index linked CD, Islamic ETF, VC fund
Or Be Marginalized!

• Or keep hearing;
  – $150B+
  – Growing at 15%
  – 1.2B customers (Really?)

DJIM vs. FTSE Global Islamic Index
Interim Tolerance Parameters

• DJIM- 2/9/99
• DJI's Shari'ah Board (5)
• Shks. Usmani, Abu-Ghuddah, Yaquby, Elgari, DeLorenzo
  – D/MC <33%
  – C + IBS/MC <33%
  – AR/Assets <45%
• DJI Calculates/Maintains
• 1640 stocks, 34 countries, $9 Trillion
• Quarterly review
• 30 Islamic Indexes
• Nearly 30 licensees

• FTSE 11/99
• TII Shari'ah Board (4)
• Shks. Al-Yaseen, Faidhulla, Al-Madhpur, Al-Sharif
  – D/A <33.33%
  – Purify all impermissible income
• FTSE Calculates/Maintains
• 944 stocks
• Semi-annual review
• 5 Islamic Indexes
Top 10 DJIM Holdings

<table>
<thead>
<tr>
<th>April 2001</th>
<th>August 2001</th>
<th>Jan. 2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Cisco Systems</td>
<td>Microsoft</td>
<td>Microsoft</td>
</tr>
<tr>
<td>• Intel</td>
<td>Exxon Mobil</td>
<td>Exxon Mobil</td>
</tr>
<tr>
<td>• Exxon Mobil</td>
<td>Pfizer</td>
<td>Pfizer</td>
</tr>
<tr>
<td>• Pfizer</td>
<td>Intel</td>
<td>Intel</td>
</tr>
<tr>
<td>• IBM</td>
<td>BP Amoco</td>
<td>IBM</td>
</tr>
<tr>
<td>• BP Amoco</td>
<td>Glaxo SmithKline</td>
<td>Johnson &amp; Johnson</td>
</tr>
<tr>
<td>• Vodafone Group</td>
<td>Johnson &amp; Johnson</td>
<td>BP PLC</td>
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<tr>
<td>• GlaxoSmithKline</td>
<td>Merck</td>
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<td>• Merck</td>
<td>SBC Communication</td>
<td>Glaxo SmithKline</td>
</tr>
<tr>
<td>• Microsoft</td>
<td>Cisco Systems</td>
<td>Cisco Systems</td>
</tr>
</tbody>
</table>

Sample DJIM Licensees

• Permal/SEDCO (US/Saudi)
• Abu Dhabi Islamic Bank (UAE)
• Allied Asset Advisors (USA)
• Azzad Asset Management (USA)
• Brown Brothers Harriman (USA)
• Oasis Asset Management (South Africa)
• Rockefeller Group (USA)
• SAMBA (Saudi-American Bank)
• UBS (Switzerland)
• HSBC (UK)
• Al-Tawfeek (Saudi Arabia)
Sample Licensees

- Deutsche Asset Management (Germany)
- iHilal.com (UAE)
- Bank Al-Jazira (Saudi Arabia)
- Dexia
- JP Morgan Chase (USA)
- Al Bank Al Saudi Al Fransi (Saudi Arabia)
- Schroders (UK)
- Allied Irish Bank (UK)
- StrategicNova Funds (Canada)
- Albert Asset Management
- Capital Partnership

Demands of Licensee Fund Managers

- DJIM Universe in Format
- Performance Monthly Files:
  - Country breakdown
  - Global sector breakdown
  - Regional/Country sector breakdown:
    - Americas
    - N. America
    - Europe
    - UK
    - Japan
## DJIMs & Counter-Part Indexes

<table>
<thead>
<tr>
<th>Index</th>
<th>Change</th>
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<tbody>
<tr>
<td>DJIM</td>
<td>-18</td>
</tr>
<tr>
<td>MSCI</td>
<td>-17</td>
</tr>
<tr>
<td>JAP</td>
<td>-30</td>
</tr>
<tr>
<td>N 225</td>
<td>-23</td>
</tr>
<tr>
<td>UK</td>
<td>-15</td>
</tr>
<tr>
<td>FT 100</td>
<td>-16</td>
</tr>
<tr>
<td>US</td>
<td>-16</td>
</tr>
<tr>
<td>S&amp;P</td>
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</tr>
<tr>
<td>ENE</td>
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<tr>
<td>D ENE</td>
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<tr>
<td>EM</td>
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<tr>
<td>D HCR</td>
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<tr>
<td>US L,M,S</td>
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<tr>
<td>EU L,M,S</td>
<td></td>
</tr>
<tr>
<td>Euro L,M,S</td>
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</tr>
</tbody>
</table>

**Indices:**
- **US**
- **Tech**
- **Can**
- **A/P**
- **MSCI**
- **QQQ**
- **TSE**
- **D A/P**
- **JAP**
- **ENE**
- **TLS**
- **HCR**
- **DW x US**
- **N 225**
- **D ENE**
- **EAFE**

**Changes:**
- **-18**
- **-17**
- **-30**
- **-23**
- **-16**
- **-13**
- **-9**
- **-4**
- **+5**
- **-30**
- **-24**
- **EAFE**

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**Dow Jones Indexes**

*The markets' measure.*