

Revolutionary financing

The alignment of Shariah and sustainable investing

THERE are about 1.8 billion Muslims globally or a quarter of the world population. Despite this number, Muslims have been underserved by the asset management industry with limited innovation in product offerings and low growth in assets. As of June 2019, only US\$3 billion was invested globally in Shariah global equity funds. Furthermore, most funds have struggled to achieve scale in 2017 and 69 per cent of funds had assets under management of less than US\$25 million.

This can be contrasted with the rapid growth of assets invested along sustainability lines. There is now over US\$133 billion invested in this sector's funds. This is quadruple the amount invested in 2011.

Incorporation of sustainability considerations is both complementary in philosophy to Shariah investing and has the potential to improve investment outcomes. Two important points merit deeper consideration:

THERE IS CONSISTENCY BETWEEN SHARIAH AND SUSTAINABLE PRINCIPLES

Shariah portfolios are more sustainable than traditional equity portfolios, even though this is partly by chance rather than by design.

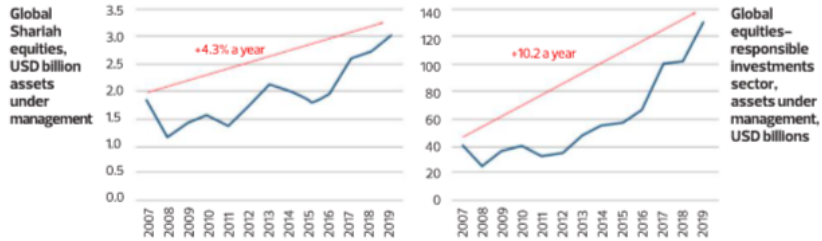
Just recently, Maybank Islamic Berhad collaborated with global investment manager, Schroders for a joint research report on the alignment of Shariah and Sustainable Investing. The findings of the report advocate that investors who embrace Shariah principles when investing, should also be open to the ideas of sustainable investing.

The research shows that the incorporation of sustainability considerations is both complementary in philosophy to Shariah investing, and has the potential to improve investment outcomes.

CONSISTENCY IN PRINCIPLES

There are many variants of sustainable investing but the common underlying principle is to incorporate how a company interacts with society and its environment in the investment decision-making process. It can involve excluding companies involved in certain sectors or it can more generally take account of Economic, Social and Governance (ESG) factors when assessing the potential risks and rewards of an investment.

Figure 1: The Shariah universe is small and growing slowly, the popularity of sustainable investing has soared



Source: Broadridge, as at July 2019

Shariah investing has traditionally focussed on excluding companies which do not comply with Shariah principles, such as earning revenues from prohibited activities (e.g. alcohol, gambling, adult entertainment and non-Shariah compliance finance). The prohibition of interest, or Riba, under Shariah law also means that companies which exceed prescribed limits on the portfolio of debt or cash are not permitted. Environmental impact is not normally a consideration.

However, the teachings of Islam have a much broader reach. The Islamic view holds that all natural and depletable resources are blessings from Allah (swt) and they are to be managed in trust in order to ensure the rights of this and future generations are preserved. Therefore, Shariah investing widens the focus beyond financial returns to include the overall well-being and welfare of individuals and society at large as well as environmental preservation.

The two main areas of difference between Shariah and sustainable approaches to investing concern the prohibition of (receiving or paying) interest and the exclusion of the traditional finance sector. The first of these can be considered consistent with conventional (non-Shariah) views on sustainability, although the latter has no equivalent. Where Shariah compliance is essential, Shariah principles must take precedence. Shariah-specific products are required.

CURRENT OFFERINGS FORCE A COMPROMISE

Muslim investors are currently faced with a

choice between two competing options:

- Invest in a Shariah-compliant fund that pays no formal heed to environmental considerations.
- Invest in a traditional sustainable fund which is not Shariah-compliant.

Neither is satisfactory. Furthermore, 66 percent of Asian respondents to the Schroders 2019 Global Investor Study said they would always consider sustainability factors when selecting an investment product, higher than the 57 percent globally who agreed with this statement. In other words, there is strong demand for investment products which take account of.

A CALL TO ACTION

The traditional exclusionary focus of the Shariah investment industry is ripe for disruption. It resulted from the industry attempting to replicate what already existed in the traditional investment industry, in a Shariah-compliant way. Moreover, Muslims should not be forced to compromise between their religious beliefs and their desire to invest in a sustainable manner, especially given that the underlying principles are so closely aligned. The Shariah industry has languished but there is no reason why, if it bridges this divide, it cannot grow substantially and better serve the Muslim community.

This is a summary version of a longer paper on the alignment of Shariah and sustainable investing. The full paper can be accessed at <http://schroderstalkingpoint.com>

