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Islamic Wealth Management Report 2024

CONTRIBUTORS

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Ahmed Ali Siddiqui has over 21 years of rich Islamic banking experience and has since been involved in pioneering work in the field of Islamic finance in Pakistan. His major areas of interest are Shari'a-compliant product development, Sovereign Sukuk & deal structuring, development of innovative solutions for retail, corporate & consumer banking, formulation of policy guidelines, Islamic banking training, Shari'a Audit, applicative research & Islamic financial advisory services.

He also holds the post of Senior Executive Vice President & Group Head, Shariah Compliance Department at Meezan Bank and is leading one of the largest research departments in the Islamic banking world with over 55 dedicated team members. He is also the Secretary for Shariah Supervisory Board at Meezan Bank Limited. Ahmed Ali Siddiqui is also part the Joint Financial Advisors team to the Government of Pakistan for Issuance of Local currency Sovereign Sukuk & Islamic financing transactions and has advised the government in structuring and issuance of Sukuk/Islamic transactions of over US$16.29 billion.

He has served and is also a member of several task forces at the Central Bank level related to Islamic banking products, Islamic banking regulations, governance framework, Accounting disclosures and Adoption of AAOIFI Shariah Standards. Ahmed Ali Siddiqui is also actively involved in Islamic banking training activities and has conducted various training sessions, corporate workshops & seminars on different Islamic Banking topics including Islamic Financial Products, Product Development & Structuring, Islamic Accounting Standards, Legal documentation and Liquidity Management Solutions etc both locally and abroad.

He is also a frequent speaker on Islamic banking at National Institute of Banking & Finance (State Bank of Pakistan), Export Promotion Bureau, LUMS & Center of Islamic Economics (CIE), Karachi and has conducted several specialised training sessions & workshops in UAE, Bahrain, Malaysia, Australia and UK. Ahmed Ali Siddiqui was named in the Islamica 500 for 2016 as among the 500 of the world's most prominent and influential personalities who have built up and pioneered the Islamic economy and the Halal industry.

Muhammad Usman Siddiqui, CFA

Muhammad Usman Siddiqui is a CFA charterholder and alumnus of IBA Karachi. He has over 8 years of experience in Islamic finance and is currently serving as Manager Retail, Consumer & Pool Management Unit in Shariah Compliance Department at Meezan Bank. Previously, he was associated with HBL as a Product Manager in Islamic Banking Department.

His areas of interest include Shariah structuring, product development, financial modelling and training.

CHAPTER 03

SHARI'A COMPLIANCE IN ISLAMIC WEALTH MANAGEMENT

Introduction

Wealth management shouldn't be taken as synonymous with Islamic financial management, as the latter may involve managing small sums of money in the form of savings for those who are not considered wealthy. Nevertheless, wealth management is an integral part of anyone who has acquired wealth through various means. Especially in this day and age, with uncertain economic conditions and skyrocketing inflation, it is of utmost importance that funds are properly allocated and managed, especially in line with the injunctions of Shari'a. At its very core, the concept of Islamic wealth management is based on striking a balance between the economic demands and spiritual aspirations of the individual. In this chapter, we will go through the various Shari'a compliance considerations to be adhered to in the wealth management process.

Stages of Wealth Management

The process of wealth management can be broadly categorised into the following stages:

1. **Wealth Creation:** This stage comprises building and creating wealth. This is often achieved by income through salaries, wages, businesses, investments etc.
2. **Wealth Accumulation:** This stage primarily comprises of accumulation of wealth through investment of unspent savings in appropriate avenues. For example, investing monthly savings in a bank account or a money market fund.
3. **Wealth Protection:** This stage pertains to protection of accumulated wealth. For example, availing life insurance, obtaining fire insurance on house etc.
4. **Wealth Distribution:** This stage refers to distribution of wealth to heirs, beneficiaries or public. This is done through inheritance, gift, waqf etc.
5. **Wealth Purification:** This stage pertains to purification of wealth which may be achieved through zakat and charity.

Umayyad Gold Dinars

First minted between AD 696-697, this piece is an early example of a purely Islamic coin, replacing pictorial depictions with Arabic inscriptions taken from the Holy Quran.

On April 4th, 2011, an Umayyad Dinar from the period 723 AD was sold for a whopping US$4.662 million.

Figure 3.1
Stages of Islamic Wealth Management

The initial stages of wealth management cater primarily to the financial needs of the individual whereas the latter stages branch into the spiritual needs and objectives.

Shari'a Compliance in Wealth Management

Since wealth management is a continuous exercise, it is every Muslim's duty to ensure that it is undertaken in line with the guidance of Shari'a principles. Below are some of the key areas to focus on during the wealth management cycle:

1. Source of Funds

The foremost consideration for Islamic wealth management is that the source of funds should be from halal avenues. As mentioned in below hadith, one of the first questions to be asked on the day of judgement will be regarding the generation of wealth.

"The son of Adam will not pass away from Allah until he is asked about five things: how he lived his life, and how he utilised his youth, with what means did he earn his wealth, how did he spend his wealth, and what did he do with his knowledge." (Tirmidhi)

The importance of halal income can also be ascertained from the fact that once companion Sa'ad Ibn Abi Waqqas asked the Messenger of Allah:

"O Allah's Messenger pray for me to Allah that He makes me the one whose prayers are accepted." Upon this, the Holy Prophet (PBUH) commented, "O Sa'ad, make your food halal and your prayers will be accepted." (Al-Mujam Awsat, 6: 311)

Chap 03: Shari'a Compliance in IWM

In this backdrop, it should be ensured that one's livelihood is not created from Shari'a non-compliant avenues (especially salaries from conventional banks dealing in interest-based activities, conventional insurance firms, tobacco firms, gambling businesses etc.) as this is the foundational step for entire wealth management mechanism. In case of any doubt or confusion, individuals should seek guidance from Shari'a scholars regarding their source of income rather than relying on word of mouth or their own interpretation of Islam. It should be ensured that one's livelihood is not created from Shari'a non-compliant avenues (especially salaries from conventional banks dealing in interest-based activities, conventional insurance firms, tobacco firms, gambling businesses etc.) as this is the foundational step for entire wealth management mechanism.

This is a tricky aspect of due diligence in Islamic wealth management, as in most jurisdictions – Islamic and otherwise – there is no differentiation between halal income/wealth and lawfully earned income and acquired wealth. Income or wealth acquired through legal means is important and whether this is halal or haram isn't a consideration in the due diligence processes adopted by financial institutions, including Islamic banks and financial institutions. The latter have an emphasis on halal and haram when dealing with the institutions (in some cases) but they ignore this aspect when dealing with their customers of the liabilities side, i.e., investors in the investment accounts.

2. Investment of Funds

Another important aspect that is severely ignored is the Shari'a compliance status of investments. Unfortunately, perhaps due to lack of awareness, individuals often keep their funds invested in interest-based instruments like conventional bonds (coupon-bearing / zero-coupon bonds), interest-bearing saving accounts or term deposits from conventional banks. It is of dire need to realise the consequences of such acts as the Holy Quran prohibits riba in strict and categorical terms:

"O you who believe, Fear Allah and give up what remains of your demand for Interest, if you are indeed a believer. If you do not, then you are warned of the declaration of war from Allah and His Messenger;". (Al Quran, 2:278)

An argument that is often presented in defence of such investments is the lack of alternative Shari'a-compliant instruments. However, this is not the case as the Islamic banking industry has globally increased to an assets size of US$4 trillion having a presence in 76 countries with availability of a wide range of instruments including but not limited to checking accounts, investment certificates, sukuk, Shari'a-compliant mutual funds, Islamic REITs etc. Hence, individuals should ensure that their wealth is invested in halal and riba-free modes having a sound Shari'a governance and review mechanism. It is advised that thorough research is always conducted about the investee organisation regarding its Shari'a Advisor/Shari'a Board, availability of Shari'a Certificate on its products and level of Shari'a compliance in the organisation.

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3. Shari'a Screening for Investment in Shares

For guidance of individuals, it is suggested to invest in shares listed on credible Shari'a-compliant indices (like KMI 30, KMI All Index in Pakistan). Some global Islamic indices include Dow Jones Islamic Market Index, MSCI World Islamic Index, FTSE Global Equity Shariah Index Series, and Kuala Lumpur Shariah Index (KLSI).

Box 3.1

For trading and investment in equity (shares), it should be ensured that the underlying organisation adheres to various Shari'a compliance filters and criteria. To cater for this, various bodies have issued Shari'a screening criteria that gauge non-compliance of subject scripts. For instance, the KSE Meezan Index (KMI) criteria which was formulated by joint efforts of PSX and Meezan Bank is as follows:

- Business of company: Core business to be halal and in line with dictates of Shari'a
- Interest-bearing debt to total assets: Should be less than 37 per cent
- Non-compliant investments to total assets: Should be less than 33 per cent
- Non-compliant income to total revenue: Should be less than 5 per cent
- Illiquid assets to total assets: Should be at least 25 per cent
- Net liquid assets to share price: Market price per share should be greater than net liquid assets per share

4. Importance of Budgeting

It is essential for all individuals to budget appropriately and keep track of their financial matters. This entails listing down the various Shari'a-compliant sources of funds, expenses to be incurred, zakat and charities to be distributed and allocating a limit to avoid overspending and excessive consumption beyond means.

5. Wealth Protection through Islamic Insurance

Wealth protection entails safeguarding and preserving the generated wealth through various financial products like insurance (general and life). However, conventional insurance products involve elements of riba (the prohibited interest), gharar (contractual uncertainty) and qimar (gambling) making the underlying contract Shari'a non-compliant. It must be ensured through proper due diligence that only Shari'a compliant insurance products (takaful) are opted and offered by an organisation with a Shar'ia advisor/Shari'a board in place to oversee and ensure compliance with Shari'a principles. Moreover, individuals often invest in funds claiming to guarantee 100 per cent profit and principal during the investment tenure which is against the concept of partnership in Islamic finance. Principal and profit cannot be guaranteed in partnership-based modes like musharaka and mudaraba. In fact, Islamic finance is based on the concept of risk sharing as opposed to risk transfer. Hence, it is of utmost importance to review such investee funds and their Shari'a compliance status before investment.

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6. Distribution through Zakat

Zakat is one of the five pillars of faith in Islam and every eligible Muslim must partake in it. It is a means of purifying income as the owner distributes a portion of wealth in society to the needy, helping in the circulation of wealth and simultaneously removing the greed and selfishness associated with it.

"[True] righteousness is [in] one who believes in God, the Last Day, the Angels, the Book, the Prophets and gives of their wealth, in spite of love for it, to relatives, orphans, the needy, the traveler, those who ask [for help], and for freeing slaves; [and who] establishes Prayer and practices regular charity". (Al Quran, 2:177)

However, despite the magnitude of funds involved, Shari'a compliance of such funds is sometimes unattended. It must be ensured by the individuals when donating zakat to a charitable organisation or NGO that they adhere to below checks:

1. Proper segregation of zakat funds from other charity funds
2. Investment of zakat funds in Shari'a-compliant avenues.
3. Usage of zakat funds in line with Shari'a principles
4. Supervision of activities under Shari'a advisor/Shari'a board

It is often seen that many reputed organisations do not have a proper Shari'a compliance mechanism in place; rendering their entire zakat activity in question. As individuals, it must be emphasised and ensured that all funds to be distributed as zakat are provided to organisations having a sound Shari'a compliance mechanism in place.

7. Income Purification through Charity

Like zakat, donations to charity must also be subject to Shari'a compliance checks. In case of donations to charitable organisations or NGOs below areas should be properly evaluated:

1. Proper segregation of charity funds from zakat funds
2. Investment of charity funds in Shari'a-compliant avenues
3. Supervision of activities under Shari'a advisor/Shari'a board

Choosing a Wealth Management Product

Some of the key considerations for individuals while investing and choosing financial products are:

1. Shari'a Compliance of Product

Oftentimes, people are not aware if the opted financial product is halal and in line with Shari'a guidelines. Hence, it is reiterated that we, as Muslims, should always obtain complete clarity regarding the underlying product structure and its Shari'a compliance before investing.

2. Suitability of Product (risk-reward profile)

It is observed that people often end up opting for an investment product that is not in line with

لَيْسَ الْبِرَّ اَنْ تُوَلُّوْا وُجُوْهَكُمْ قِبَلَ الْمَشْرِقِ وَ الْمَغْرِبِ وَلٰكِنَّ الْبِرَّ مَنْ اٰمَنَ بِاللّٰهِ
وَالْيَوْمِ الْاٰخِرِ وَالْمَلٰٓئِكَةِ وَالْكِتٰبِ وَالنَّبِيّٖنَ ۚ وَاٰتَى الْمَالَ عَلٰى حُبِّهٖ ذَوِى الْقُرْبٰى
وَالْيَتٰمٰى وَالْمَسٰكِيْنَ وَابْنَ السَّبِيْلِ ۙ وَالسَّآئِلِيْنَ وَفِى الرِّقَابِ ۚ وَاَقَامَ الصَّلٰوةَ وَاٰتَى
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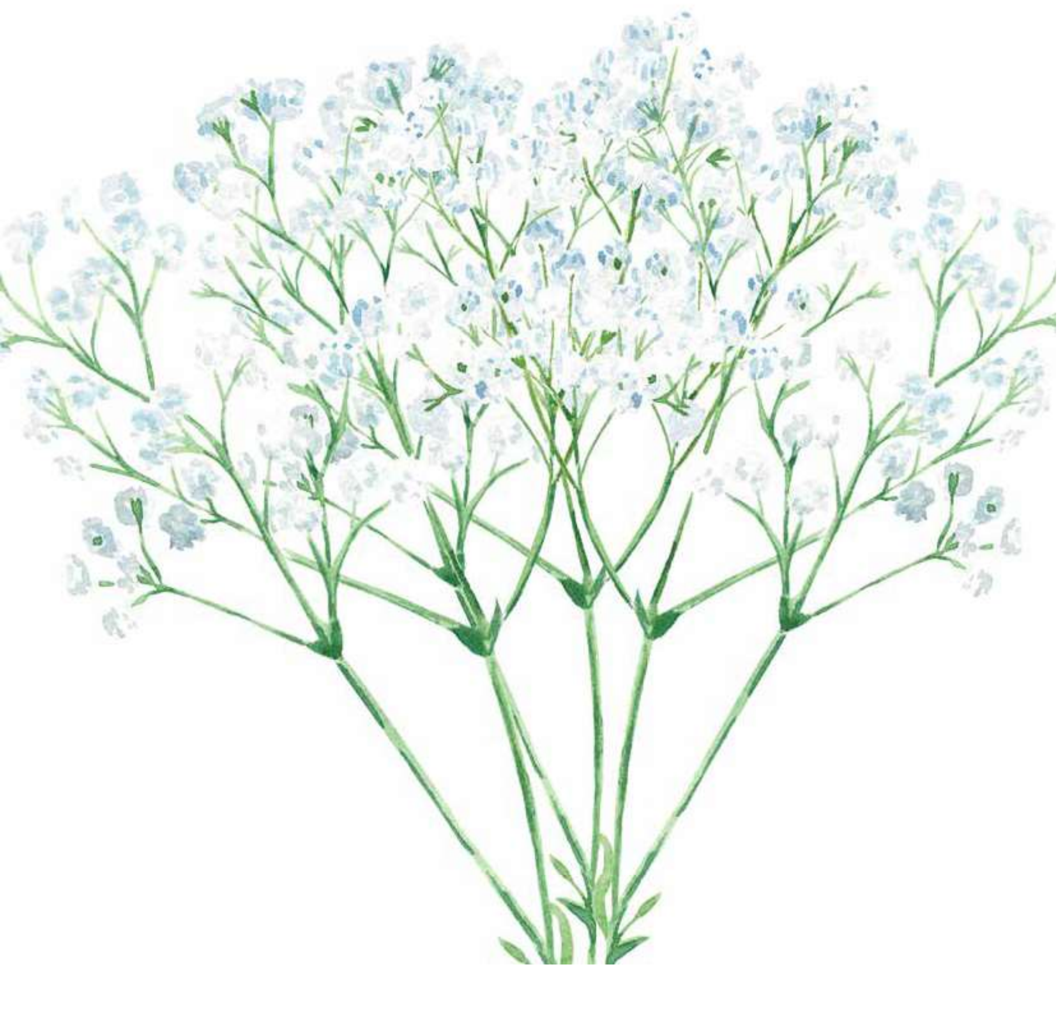
الْبَاْسِ ؕ اُولٰٓئِكَ الَّذِيْنَ صَدَقُوْا ؕ وَاُولٰٓئِكَ هُمُ الْمُتَّقُوْنَ ـ البقرة : ١٧٧



their risk and return profile due to either lack of understanding or mis-selling by sales teams of the respective institution. Therefore, it is strongly advised to understand if the product aligns with the needs of the investor.

3. Hidden Costs, Commissions and Charges

When opting for a product, it is always recommended to understand the entirety of its features, including the various charges, costs and commissions associated with it.

Many times, products accompany hidden costs, charges and commissions resulting in lower yield and unnecessary deductions for the customer. The fees and charges can be broadly categorised in three types:

a. **Upfront deductions:** These are charged right at the onset (like front-end load, sales commission, bid-ask spread) resulting in lower cash value and longer payback period.

b. **Periodic fees:** These are charged over a period and may include management fee, takaful fee, maintenance or service fee

c. **Fees at maturity:** These are generally charged upon maturity or early encashment like backend load, premature encashment fee etc. Often these result in large deductions for the customer at the end of investment.

It is necessary to always ask the institution for an actual example of an investment with all included costs, charges and deductions to get a complete picture. More often than not, upon complete disclosure of all costs and charges, the product is no longer feasible for the individual.

4. Investment Horizon

Another important aspect is the tenure of investment compared with the breakeven or payback period. For instance, an investor is looking for a short-term product of approximately one year, whereas the product has a higher breakeven or payback period of around two years.

This scenario is very common, especially in bancassurance products (life insurance policies sold through bank counters) where the payback period is long term but the customer is often not aware of the same and expects breakeven on a shorter tenure.

5. Liquidity

Liquidity is also a critical consideration for investors when making investment decisions. Some investments offer high liquidity (real-time or same day) like income or money market mutual funds whereas assets like gold or real estate are relatively less liquid.

Investors should properly consider the liquidity costs as per their needs before opting for the respective investment. Having a significant quantity of funds locked up in illiquid assets may not be ideal for an investor with liquidity needs.

Conclusion:

Keeping in view the above factors, individuals should always assess their investment requirements and properly evaluate the nature of assets and their underlying features before proceeding ahead. The onus also falls on the sales team of the investee organisation to analyse the customer profile and pitch products in line with their suitability, tenure and liquidity needs after complete disclosure.

Case Study: Meezan Kafalah

Meezan Kafalah is a unique and one-of-a-kind proposition for individuals offered by Meezan Bank providing both income generation and wealth protection features. The product provides a regular stream of income (based on the concept of mudaraba) along with life takaful coverage, making it an ideal proposition for medium to long-term savers looking for enhanced protection.

Underlying Shari'a Mode

a. **Mudaraba:** Customer (as rab-ul-maal) invests its funds with the Bank (as mudarib). Funds are allocated to a deposit pool, which is invested strictly in Islamic modes of finance. The Bank calculates the profit of pool every month and the net income of the pool is distributed between the Bank (mudarib) and the customer (rab-ul-maal) on the basis of predetermined profit sharing ratio and weightages.

b. **Wakala:** The customer appoints Meezan Bank as his/her wakeel (agent) to obtain takaful cover whereby the Bank may collect takaful contribution i.e. takaful expense amount from the customer, arrange takaful and charge wakala fee for facilitating takaful coverage.

Industry Norm: High Commissions and Delayed Break-evens

Due to the widespread distribution network of banks, insurance companies enter into an alliance with them to market their life insurance products. This is commonly referred to as bancassurance where insurance products are sold from bank counters on behalf of insurance companies through an agency agreement.

Although this alliance may result in a win-win situation for both parties, it often ends up with a longer break-even period for customers due to the heavy commissions involved. For perspective, during the initial years, a significant portion of customer contributions or premiums (going as high as 40 per cent) are allocated as bank's commission and hence, not invested resulting in longer breakeven periods sometimes stretching beyond three years. This can often lead to reputational and service issues for banks as customers are generally unaware of such arrangements, especially in cases of premature encashments.

Features of Meezan Kafala

- **100 per cent allocation from day one:** Unlike insurance products offered by banks through the bancassurance model, all customer installments in Kafala are 100 per cent invested in mudaraba from day one. This is extremely beneficial for customers with cash values in a much better shape as compared to the industry.
- **Affordability:** Investment plans for Kafala start as low as PKR 2000/- per month.
- **Tenure:** Plans available from 3 years to 15 years.
- **Flexible payment options:** Monthly, Quarterly, Annual, Lumpsum

- **Breakeven period:** Unlike the industry norm where breakeven periods generally start after two or three years, Meezan Kafalah offers positive cash value from the very first month.
- **No upfront deduction or hidden charges like** Bid Offer Spread, Management fee, service fee
- **Takaful cost charged at actual:** Being an agent of customer, Meezan Bank procures takaful coverage at a very nominal cost, charged at actual to the customer.
- **Flexible exit option:** Easy exit at any time during investment tenure. A five per cent wakala fee to be charged upon premature encashment. May be waived as per bank's discretion after three years of investment.
- **Leading takaful coverage:** Upto PKR15 million with 100 per cent additional claim on death

Features of Kafala

As opposed to the traditional life insurance products at offer, Meezan Kafalah offers a unique proposition, providing the income benefits of a regular savings plan with no hidden or upfront costs, an earlier break-even period, an easy exit option and enhanced protection through an economical takaful coverage.

The product can be considered a decent fit for middle to senior-aged customers looking for a combination of savings and protection.