Islamic Fund Management

By: Prof. Rodney Wilson.

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This is an important paper and a significant contribution to the field of Islamic finance. The academic writings on this subject (especially in English) are quite rare. Therefore, this paper is a welcomed addition to the literature.

The paper is, basically, a survey of Islamic Investment Funds, especially those managed out of the U.K and other European banking entities. His emphasis is on Islamic equity funds, where he begins by an exposition on the difference between equity investment and two nominate Shari'ah contracts, Musharakah and Mudarabah. Musharakah and Mudarabah are the basic partnership contracts in Shari'ah.

Managing and structuring Islamic equity funds take up a considerable part of the paper where both equity and trade funds are covered, while the question of Shari'ah compliance is about two pages (P.6,7). However, the bulk of the paper focuses on evaluating a number of existing Islamic Investment Funds, both equity and trade. Being the largest market for Islamic Funds, Saudi Arabia draws about 10 pages, where Funds and distributors are examined. The historical review (PP 22-24) is very useful and in fact quite novel.

No doubt that a major effort was exerted by the writer, with valuable insights on the subject, especially the practical side of Islamic Investment Funds. I believe we are lucky to have scholars like Prof. Wilson, benefiting us with their knowledge and expertise on the subject.

Nevertheless, being among a very small group so involved with Islamic Investment Funds, I see other areas I wished they were covered.

I-

a) The writer had set for himself a very clear (and extremely worthwhile) objective for this paper: “how investment funds can be managed in a manner acceptable from an Islamic perspective” (P.1).

One would expect that the Shari'ah aspects of Investment Funds will be the core of the paper. This is because the *raison d’être* for there Funds is the Shari'ah restrictions on investment. Nevertheless, this part of the paper is hardly two pages.

b) The Shari'ah basis of Investment Funds is not just avoiding alcohol and pork products. Rather, it addresses the very essence of modern corporate finance where capital structure of corporations is examined and standards for equity investment based on both Shari'ah and financial facts are developed. For example:

What is so special about the 1/3 limit on debt, what is the significance of the argument for market capitalization Vs book values in screening company shares and how “major purpose” of companies as he called it, is translated into workable criterion for investment”, what is the Shari'ah basis of the 15% (if there is any)?…etc.

More importantly purification, which constitutes an important element of the Shari'ah acceptability of these funds (particularly equity funds) was not given its due importance.

c) Very little attention is given to Shari'ah boards. Although most Shari'ah boards are not exactly in the limelight, their role is important, particularly in the Islamic equity funds. More important, is the role of these boards in making sure that the manager follows, on a continuous basis, the Shari'ah requirements, and their relationship with fund managers..

d) Prof. Wilson identified two approaches to Islamic equity investment. The first is to "screen" companies for Shari'ah capability, the other, is to select companies in "Muslim countries" (P.1). I know of no investment fund of the second approach. I wish there was[1].

II-

a) In his comparison between Musharakah, Mudarabah and conventional equity, the writer appears to ignore the contemporary forms of Musharakah and Mudarabah contracts. Contrary to what Prof. Wilson depicts, both can be liquid, divisible and create capital gains. In fact the whole idea of "limited liability" and the "corporation" is being assimilated into Islamic jurisprudence via these two contracts. The Islamic jurisprudence Academy of the OIC has taken a decision permitting Mudarabah certificates, which negotiable.

b) Two aspects of Islamic Funds are left by Prof. Wilson. Those relating to leasing funds. There are a number of them and they pose different and extremely interesting issues. Secondly, the introduction of the Dow Jones Islamic Market Index (DJIMI). This benchmark represent a very significant development in the field of Islamic equity investment.

[1] Banks claim that there will be no takers for such funds.

III-

a) How would we identify an Islamic Fund?

The simple answer is for a fund to be Islamic, it must he Shari'ah complaint. Do all the funds surveyed by Prof. Wilson are Shari'ah complaint! The answer is not clear to the reader as he didn’t reveal the criterion on which he designated these funds to be Islamic. Certainly, a “trade” or “non-interest” fund don’t necessarily make it Islamic. I say this because I know some of the funds listed on P.10 are not. On P.18, some of the funds are highlighted in bold type. The question is why list the rest if they are not Islamic.

b) Prof. Wilson appears to be under the impression that trade funds in Saudi Arabian banking system are active in financing the Kingdom trade. (PP. 11,12).

I don’t know of any investment fund in the Kingdom engaged in domestic investment with the exception of local equity funds. Even the riyal based trade funds are actually, financing deals Internationally.

IV-

a) In his review of Sharp’s asset pricing model where return represent excess return above the risk free asset, Dr. Wilson felt that interest rate to represent riskless asset in an Islamic economy is not legitimate. What is not legitimate is interest to be part of a lender-borrower relationship. But as index the most we can say is that it goes against the Islamic *taste*.

b) I wished Prof. Wilson benefited us with some details and sources of date mentioned in the paper. For example:

- the date on Saudi Arabia on P.16
- the Figh Academy ruling of 1996 on P.3

c) On P.27, the average leverage ratio 35%. If the maximum is 1/3, how could the average be 35%?

These are only minor points which, in no way, reduce the value of significance of this important paper.