THE ISLAMIC FUNDS & INVESTMENTS REPORT
تقرير الصناديق والإستثمارات الإسلامية

The Islamic Funds & Investments Report 2008

Outlining Opportunities in the Asset Management Landscape

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Dear Finance & Investment Executive,

It is with great pleasure that we introduce the 2nd Annual Islamic Funds & Investments Report (IFIR 2008), which has rapidly established itself as an indispensable reference source for decision-makers in the industry.

With the demand for and development of Shari'ah-compliant investments showing signs of exciting growth on the international stage, this year's Islamic Funds & Investments Report provides unique insights into the key trends that are shaping this dynamic industry. Launched exclusively at the 4th Annual World Islamic Funds & Capital Markets Conference, held in the Kingdom of Bahrain on the 26th & 27th of May 2008, the Report will provide a substantial research base for interactive discussions between speakers and 400 international delegates gathered at the Conference.

Our gratitude goes to leading audit and business advisory firm, Ernst & Young and their Islamic Financial Services Group led by Sameer Abdi, who have invested their considerable international talent and resources in leading the research project and in developing the insights contained in this Report.

We hope that the content of this second annual Report will be useful in your own strategic planning activities and will assist your organisation in its quest for success in this dynamically growing industry.

Yours sincerely,

David McLean
Managing Director
The 4th Annual World Islamic Funds & Capital Markets Conference
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Dear Investment Executive,

On behalf of Ernst & Young, I would like to take this opportunity to introduce to you the Ernst & Young Islamic Funds and Investments Report 2008. This year's report builds on the thought leadership offered by the inaugural IFIR 2007 report, which was very well received throughout the industry. The second edition of Ernst & Young's Islamic Funds and Investments Report will further explore the burgeoning Islamic asset management industry through a combination of in-depth desk-based research and extensive primary research. I hope that this report will be equally well received.

IFIR 2007 underlined the critical need for product development across asset classes to provide investment opportunities and support the growth of the Shari'a compliant wealth management industry. One year later, it is interesting to see how the Islamic landscape has changed - but it is clear that there is still much to do.

IFIR 2008 highlights continued economic growth across key markets and the resultant increase in liquidity held by major investor segments. It details demand-supply considerations across these investor segments and across geographical markets, before offering conclusions on existing and predicted gaps in Shari'a-compliant products and service offerings. The report examines key strategic risks currently affecting the Islamic asset management industry and mitigating strategies being adopted by market leaders.

At a time when the GCC region is enjoying unprecedented oil revenues, which may reach $9 trillion by 2020, Islamic asset management will only become more significant on the world stage. The industry is still in its early growth stages and the report outlines many of the ways in which market participants can prepare themselves to take full benefit of this sector as it matures.

I am confident that this report will be required reading for anyone involved with Islamic funds and investments. I hope that you find it informative, thought-provoking and a useful tool as you continue to contribute to the Islamic financial services industry.

Yours sincerely,

Sameer Abdi
Partner, Head of Ernst & Young's Islamic Finance Services Group
Ernst & Young Bahrain

Contents

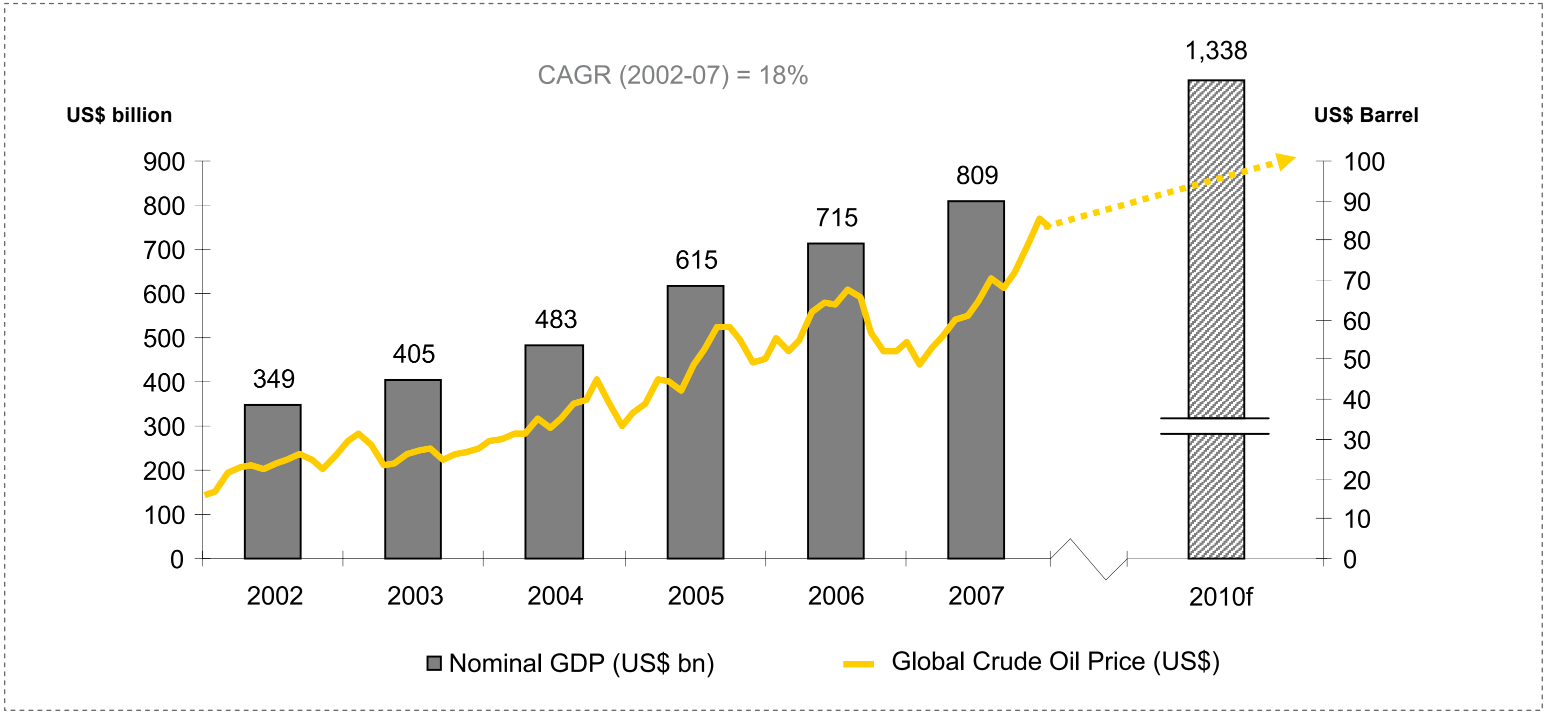
Macroeconomic update

The GCC continues to experience economic expansion and increased liquidity on the back of burgeoning oil revenues

Meanwhile, export growth and strong domestic demand have ensured continued economic growth in Malaysia and Indonesia

Economic expansion across the GCC is being facilitated by oil revenues

Global Average Crude Oil Price and Total Nominal GDP in the GCC



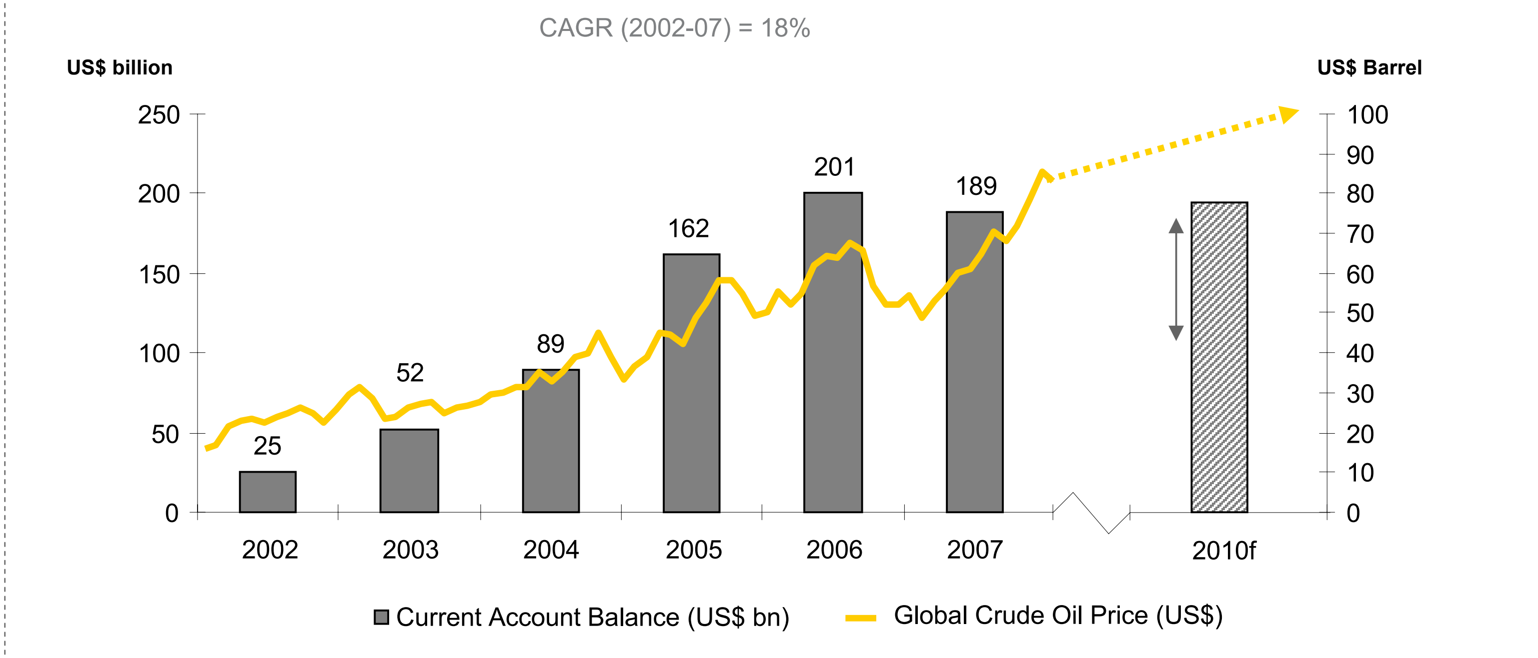
- The oil and gas industry remains the single largest contributor to GDP across the GCC

Source: Global Insight, Ernst & Young Analysis

Note: Forecast assumes a CAGR growth of 18% through to 2010

Conservative budgeting is resulting in massive government surpluses

Global Average Crude Oil Price and Current Account Balances of Governments in the GCC

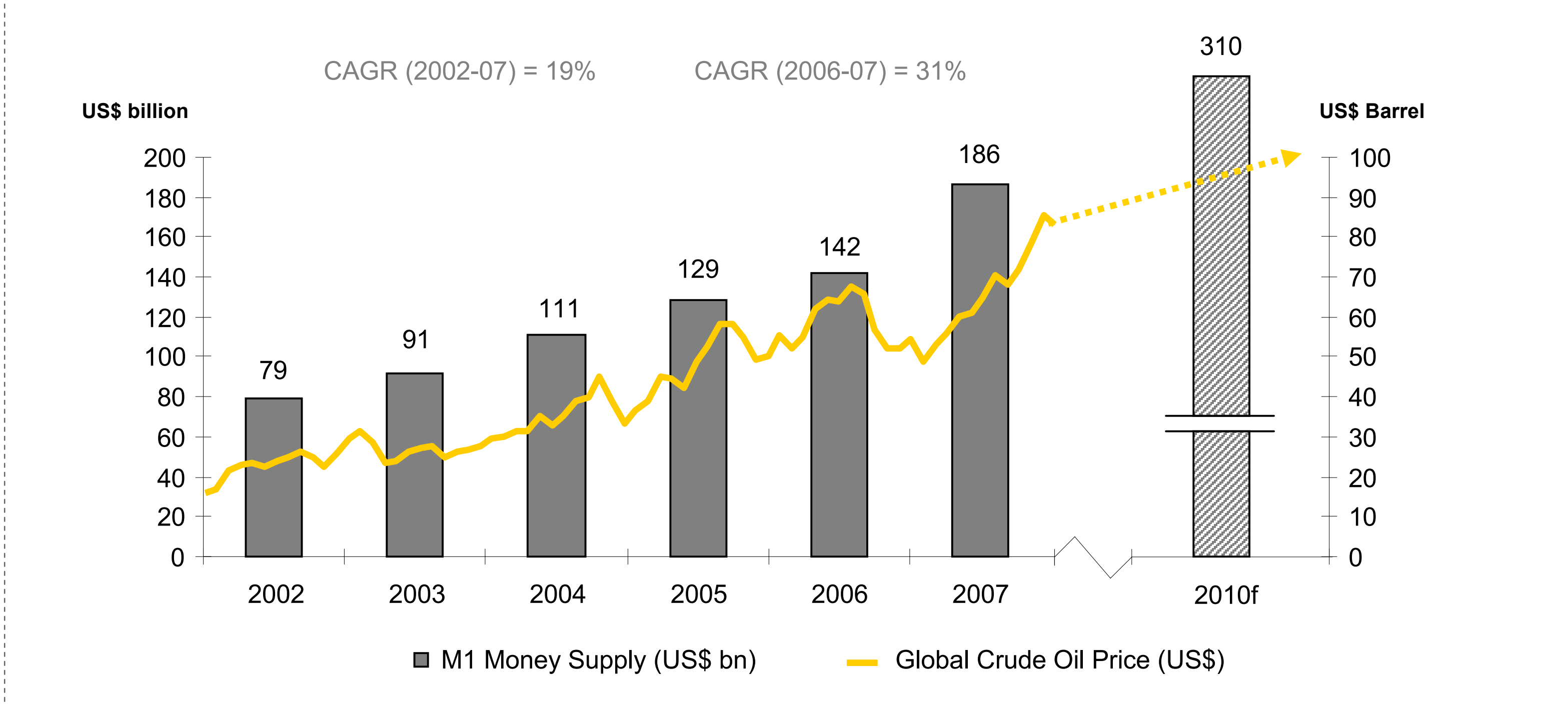


- The increase in oil prices is budgeted conservatively, resulting in massive surpluses
- Surpluses are being used to pay off debt and to invest (both internationally and regionally)

Source: Global Insight, Ernst & Young Analysis

Petrodollars are also fuelling rapid increases in liquidity

Global Average Crude Oil Price and Total M1 Liquidity in the GCC



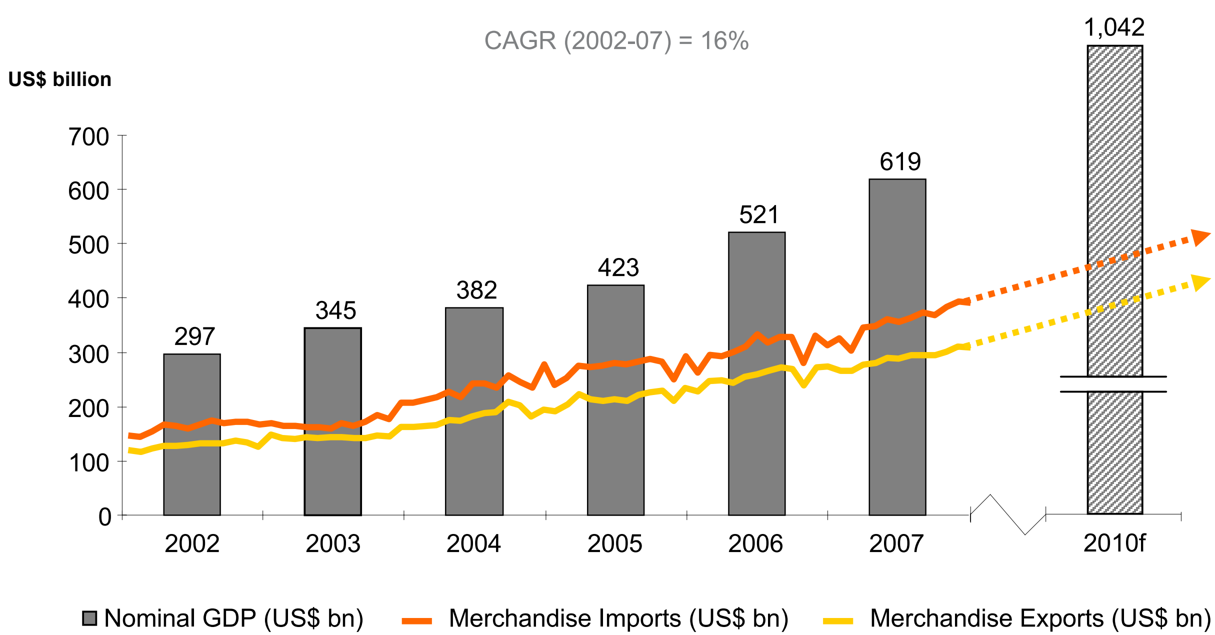
- Trickledown from increased government expenditure, regional investment and economic expansion is increasing liquidity and wealth

Source: Global Insight, Ernst & Young Analysis

Note: Forecast assumes a conservative CAGR growth of 19% through to 2010

Countries in the Far East are experiencing manufacturing-based economic growth

Combined Merchandise Exports and Nominal GDP in Malaysia and Indonesia

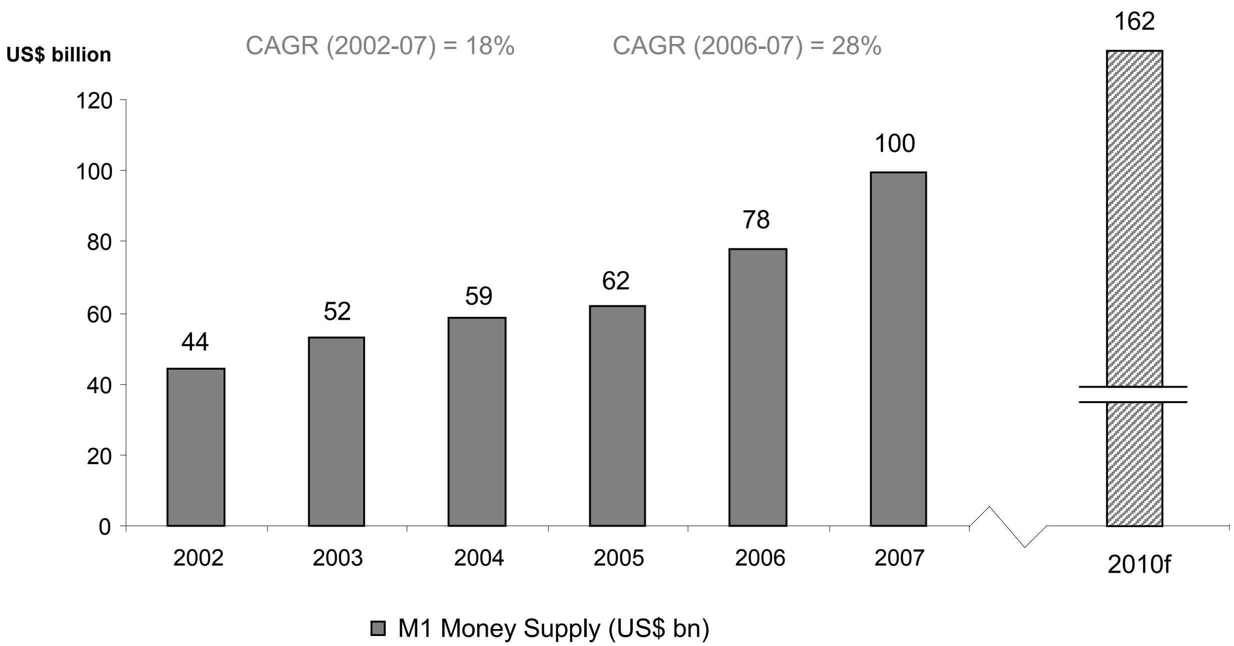


- Malaysia is an export-orientated economy with a trade balance equal to 20% of nominal GDP in 2007
- Indonesia's trade balance is much lower at only 6% of GDP in 2007 and economic expansion is largely driven by domestic demand

Source: Global Insight, Ernst & Young Analysis
Note: Forecast assumes a conservative CAGR growth of 16% through to 2010

Increased economic expansion is resulting in significant growth in money supply

Total M1 Liquidity in Malaysia and Indonesia



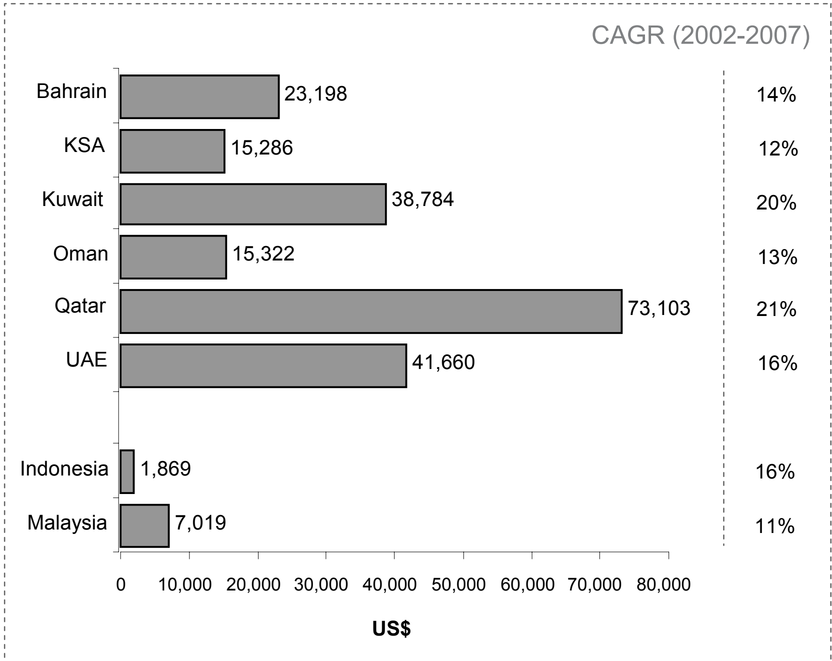
► Trickledown from economic expansion and increased government expenditure is increasing liquidity and wealth

Source: Global Insight, Ernst & Young Analysis

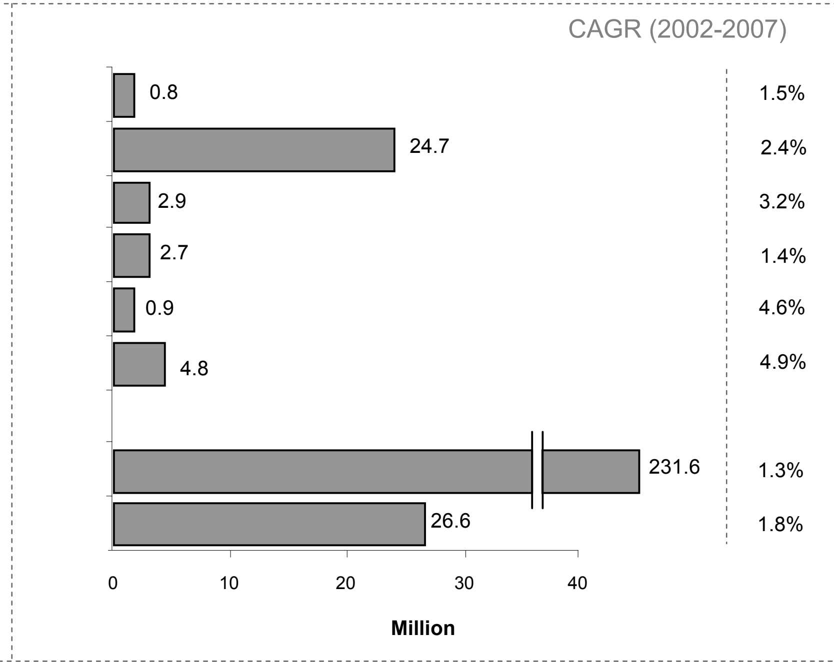
Note: Forecast assumes a conservative CAGR growth of 18% through to 2010

Economic expansion is in turn resulting in increasing wealth across the population

Nominal GDP per Capita and CAGR Growth



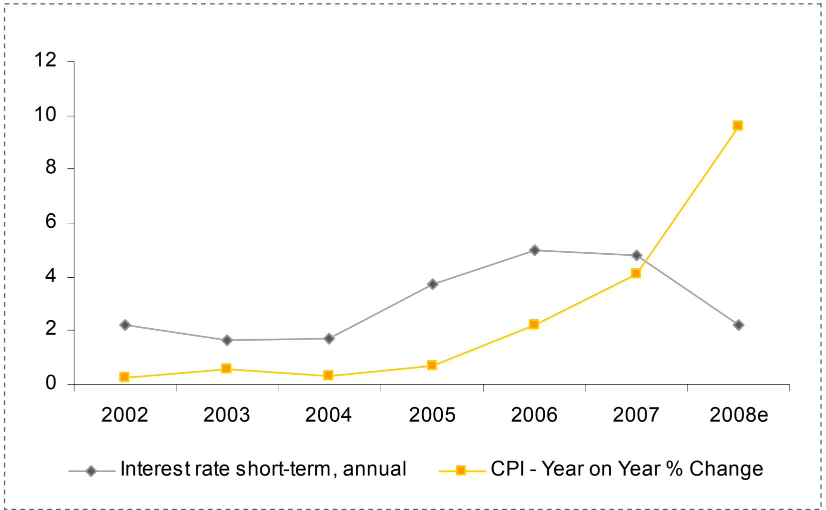
Population and CAGR Growth



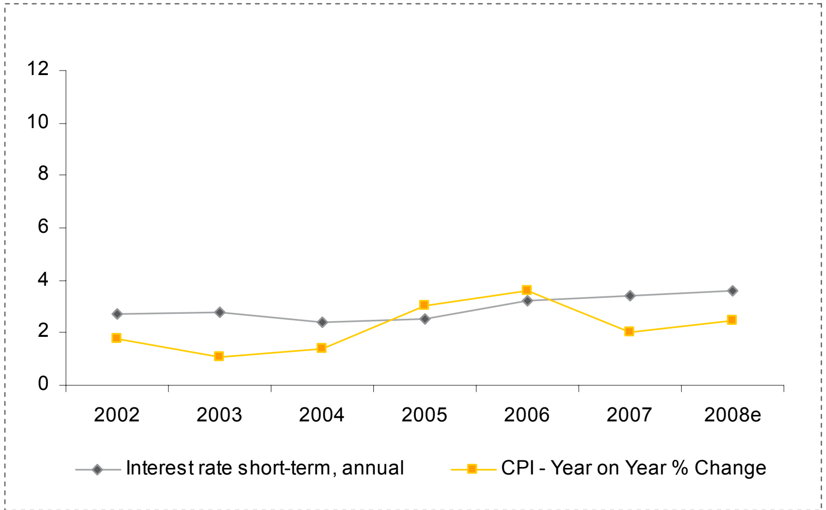
Source: Global Insight, Ernst & Young Analysis

Inflationary pressure differs between the two regions

Interest Rates and Inflation in Saudi Arabia



Interest Rates and Inflation in Malaysia



- The dollar peg has forced GCC governments (with the exception of Kuwait) to track US interest rates
- It is estimated that in 2008, inflation in the largest GCC economy - Saudi Arabia - will surpass short-term interest rates

- Malaysia has a history of price stability and low interest rates
- However, increased energy and food prices will result in upward inflationary pressures

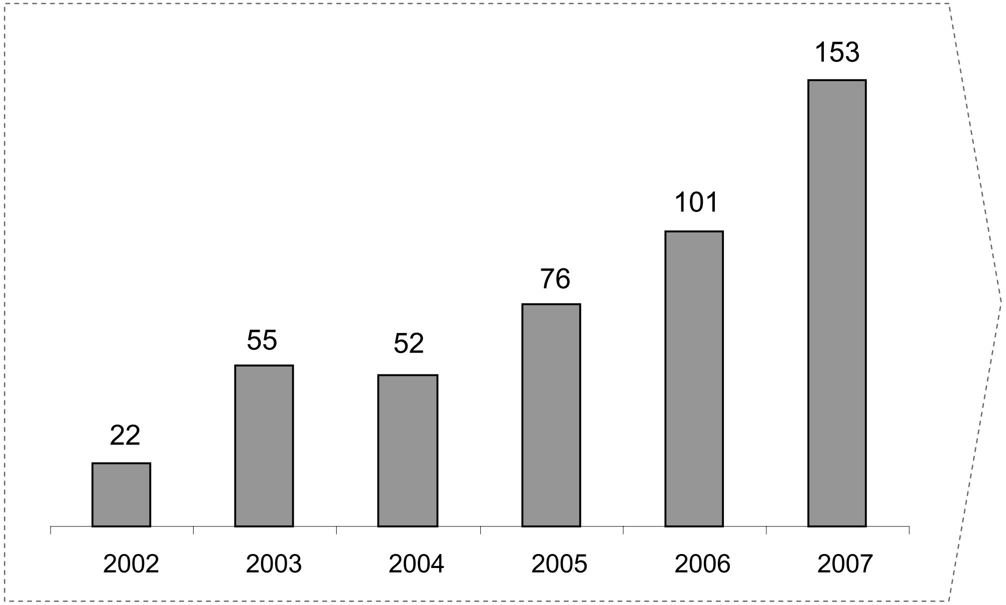
Source: Global Insight, Ernst & Young Analysis

Islamic funds landscape

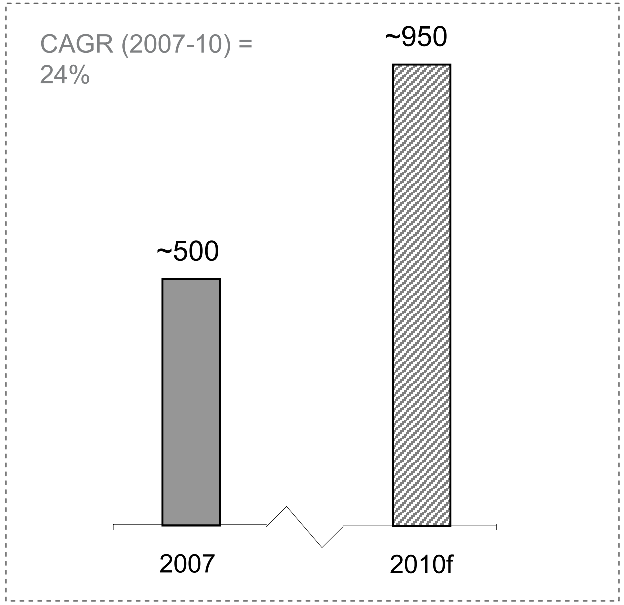
The Islamic funds universe continues to expand and is beginning to provide improved coverage across asset classes and geographical mandates

The Islamic funds universe continues to show strong growth trends

Number of Incepted Shari'a Compliant Funds Per Year



Total Number of Shari'a Compliant Funds



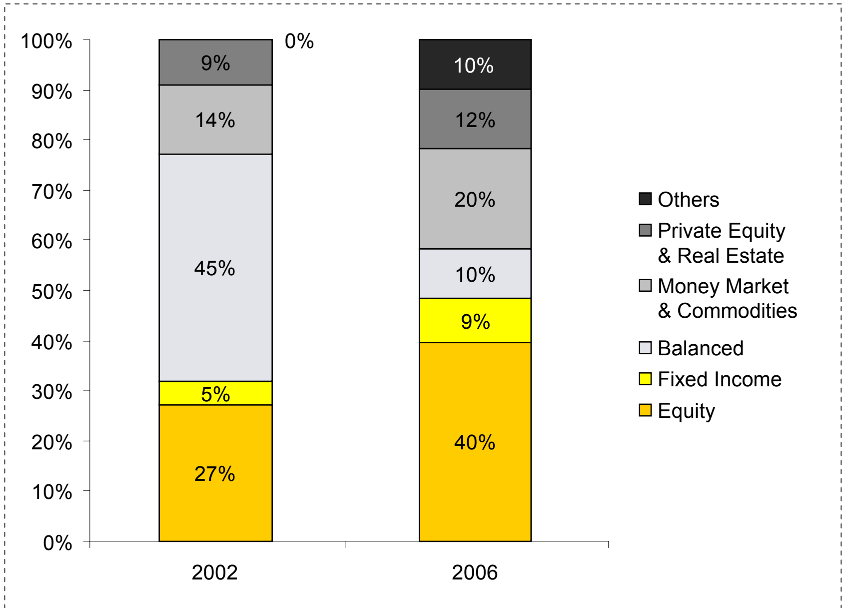
- At the end of Q1 2008, there were over 500 Shari'a compliant funds in the world
- New fund issuance has increased significantly with 153 funds established in 2007 alone
- The total Islamic funds universe could easily reach 1,000 funds by 2010

Source: Eurekahedge Islamic Funds Database, Ernst & Young Analysis

Note: Forecast assumes a conservative additional 160 funds a year and an attrition rate of 10 funds a year through to 2010

Asset allocation of the Islamic funds universe is increasingly diversified

Target Asset Classes of Issued Islamic Funds



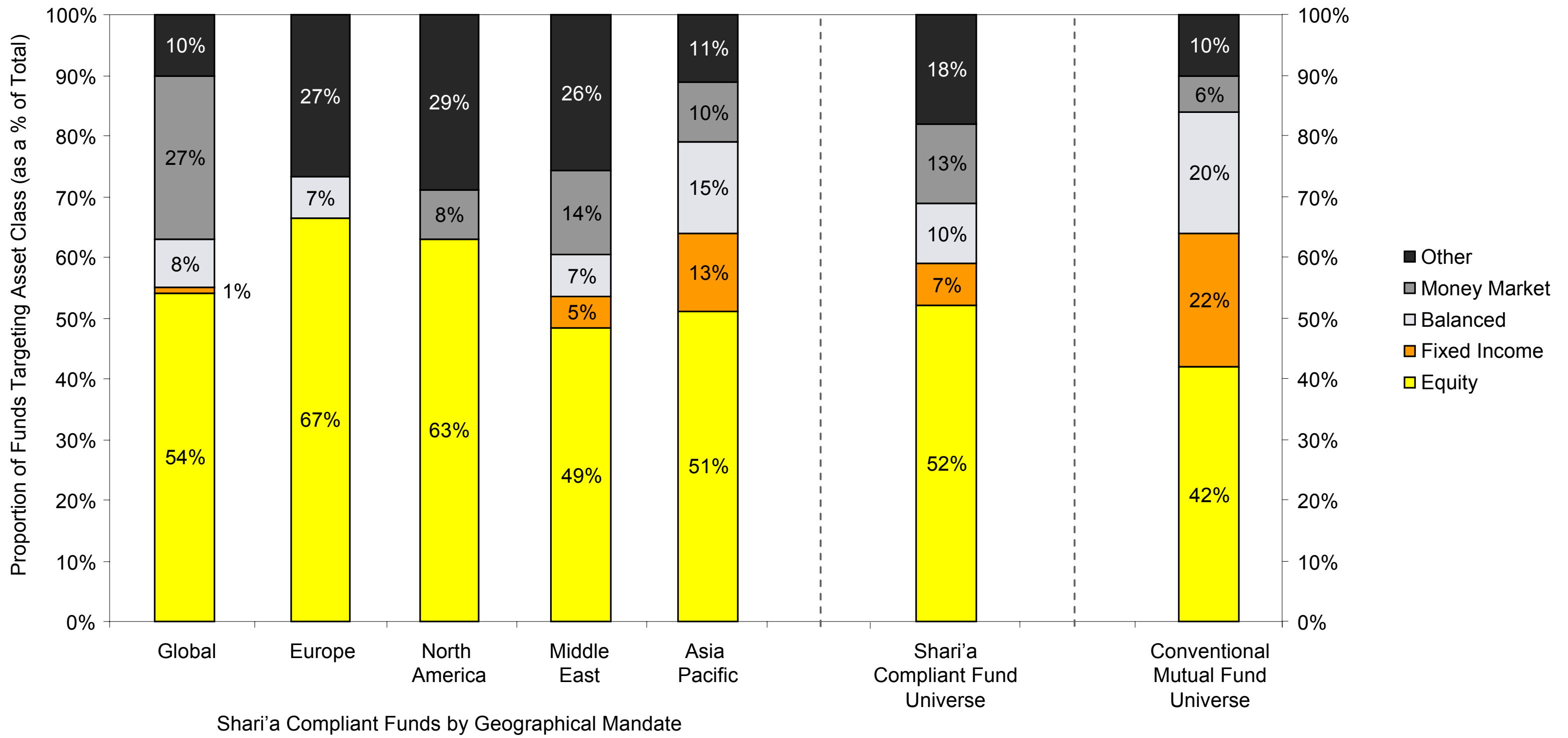
- Equity funds issuance, although still dominant, has recently stabilised at approximately 40 funds a year
- Liquid instruments, including money market and commodity funds, experienced strong growth in 2006, while alternatives, including private equity and real estate, have also increased

Source: Eurekahedge Islamic Funds Database, Ernst & Young Analysis

However, gaps still exist when compared to conventional offerings

Target Asset Classes of Shari'a Compliant Fund Universe

Compared to the Global Conventional Mutual Fund Universe (% of funds targeting that asset class)



Source: Eurekahedge Islamic Funds Database, Investment Company Institute, Ernst & Young Analysis

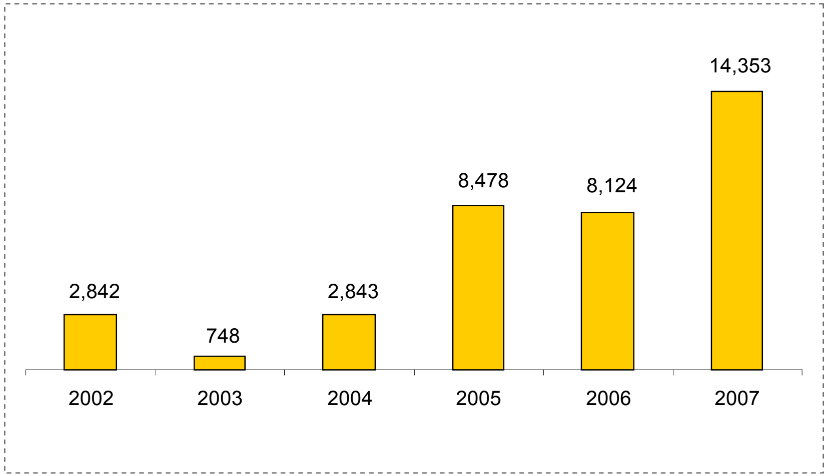
Note: Asset class allocation in conventional mutual funds is from over 61,000 mutual funds from across the world

A number of asset classes still dominate the mandates of Islamic funds

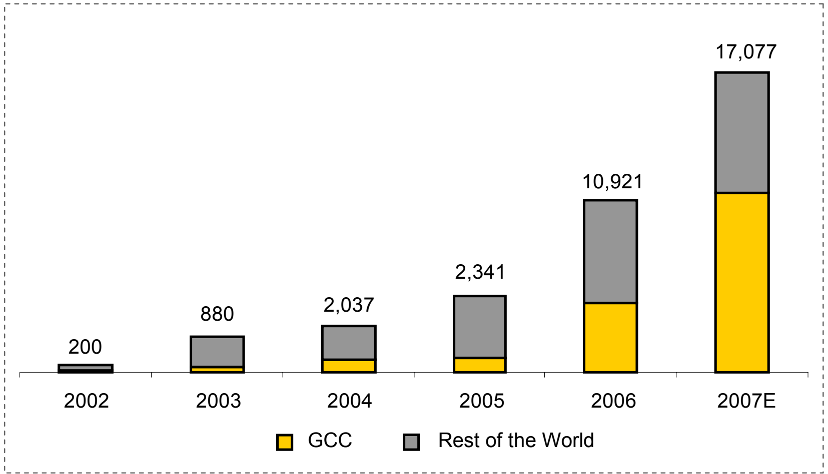
Equities	► Remain the dominant asset class for Islamic funds with allocation above that found in conventional mutual funds ► Cognisant with Islamic funds through the use of screening mechanisms
Fixed Income	► Underdeveloped as an asset class with allocations reflecting a lack of depth in Sukuk and other fixed income product offerings ► Increasing issuance will alleviate supply shortages, while increasing sophistication may potentially lead to further diversification into fixed income
Balanced	► Underdeveloped, particularly in markets where fixed income assets are limited ► Funds providing exposure to equities and money markets would appear to be a potential growth area as both asset classes are popular
Money Market	► Popular in comparison to conventional mutual funds ► Largely a reflection of increased demand in the Middle East for less risky investments following stock market corrections
Other	► Allocations to real estate and private equity are significantly above that found in conventional mutual funds ► Both asset classes fit well with Shari'a compliant investments

Regional equity markets and, to a lesser extent, fixed income markets are deepening

Value of Equity Capital Raisings in MENA Stock Exchanges (US$ mn)



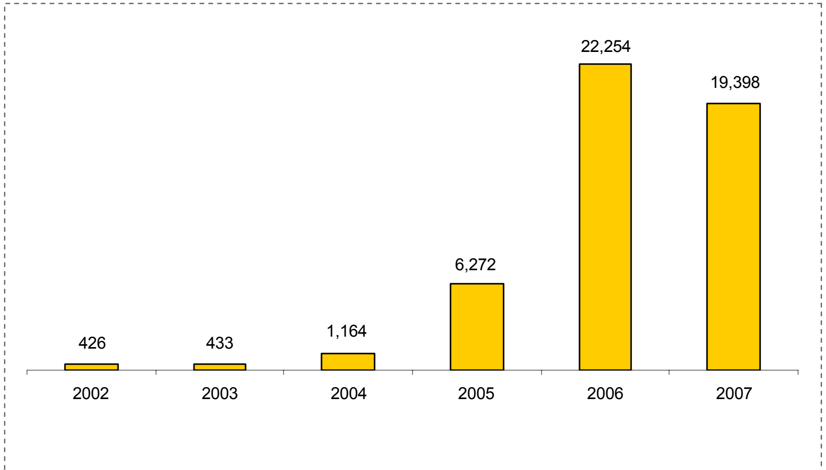
Value of Sukuk Issues by Broad Geographical Region (US$ mn)



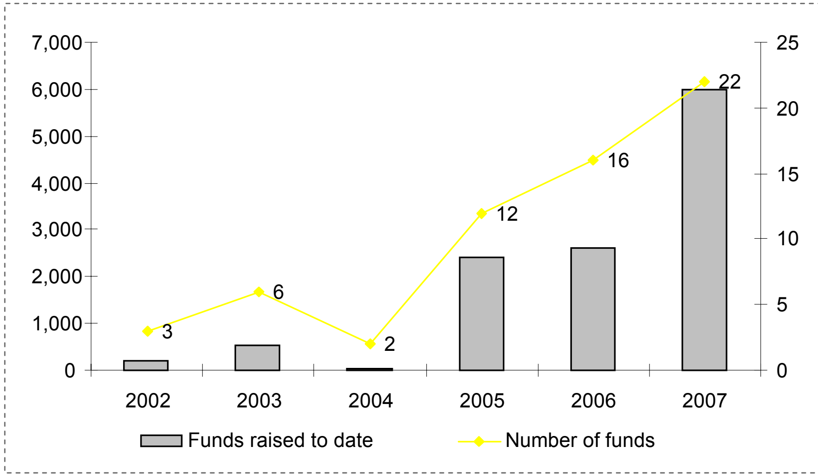
Source: Islamic Financial Information Services, Zawya, Ernst & Young Analysis

Alternative asset classes continue to show strong growth, albeit from a lower base

Global Value of Islamic Financed Real Estate Projects Per Year (US$ mn)



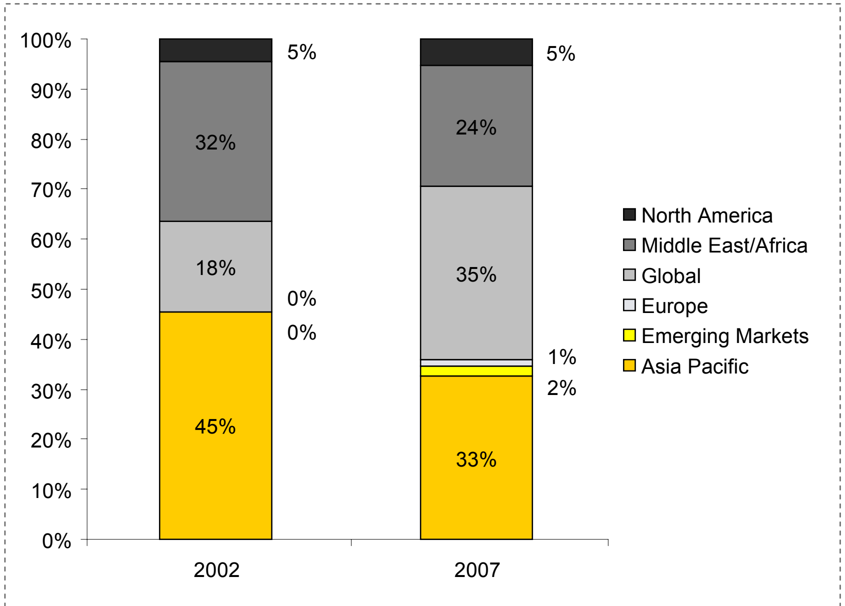
Total Number and Value of PE Funds Raised in MENA (US$ mn)



Source: Islamic Financial Information Services, Zawya, Ernst & Young Analysis

Target market strategies of Islamic funds are becoming more global

Geographical Mandate of Issued Islamic Funds



- In 2007, 66% of incorporated Islamic funds had either Asia Pacific or Global mandates
- For the first time, Islamic funds also exclusively targeted emerging markets
- This marks a significant shift away from Middle East/Africa, which has traditionally been the focus of Islamic funds

Source: Eurekahedge Islamic Funds Database, Ernst & Young Analysis

Asset class allocation differs significantly between geographical mandates

Global	► Large allocation to money market funds and equities, which reflects increased demand for geographical and asset class diversification
Europe	► Limited to equity and alternative investments (particularly real estate), reflecting the limited availability of certain assets classes in this region ► Allocation to other assets classes may be bolstered by future sovereign Sukuk issuances
North America	► Similar to Europe, with allocation focused on equity and alternative investments (particularly real estate)
Middle East	► Equity allocation is lowest of any region, with underinvestment also evident in fixed income and balanced funds when compared to conventional mutual funds ► Inflationary environment has made fixed income returns less attractive ► Significant over-allocation to alternatives, reflecting the popularity of real estate
Asia Pacific	► Allocation is most similar to that found in conventional mutual funds ► This reflects the region's relative maturity and depth across asset classes, particularly with regard to availably of Sukuk for fixed income


Value
9,179.53
11,426.60
9,611.01
7,189.65
6,550.22

Investor Segmentation

Buoyed by economic expansion, investors and their investable assets are rapidly expanding in both the GCC and Far East

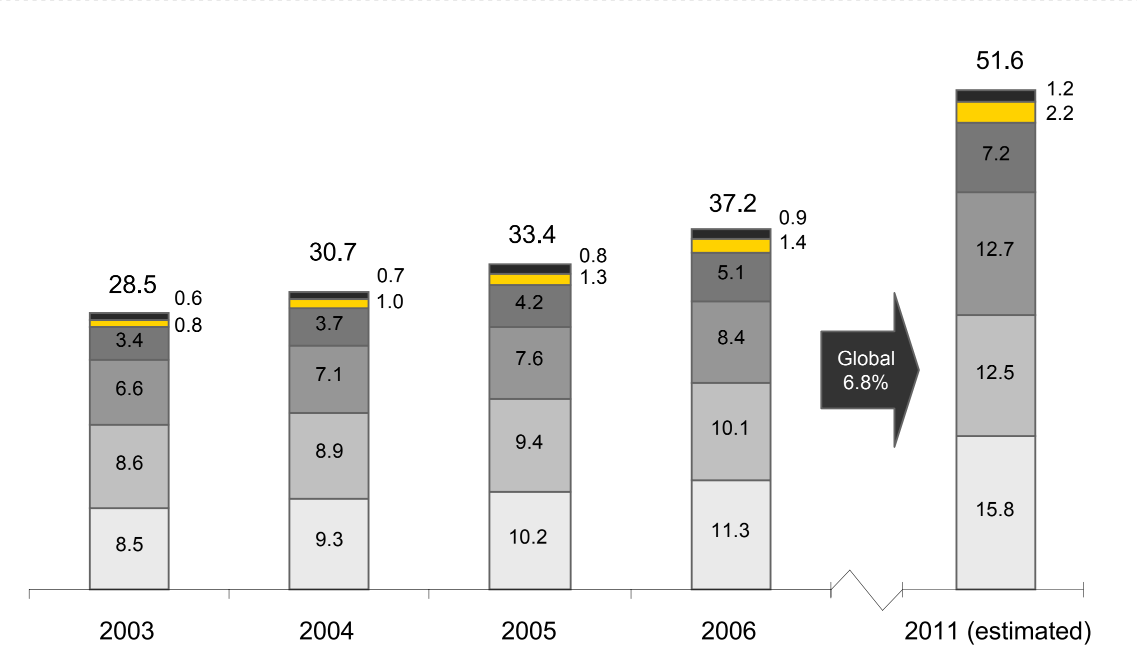
Key investors in the Islamic space can be split into four distinct groups

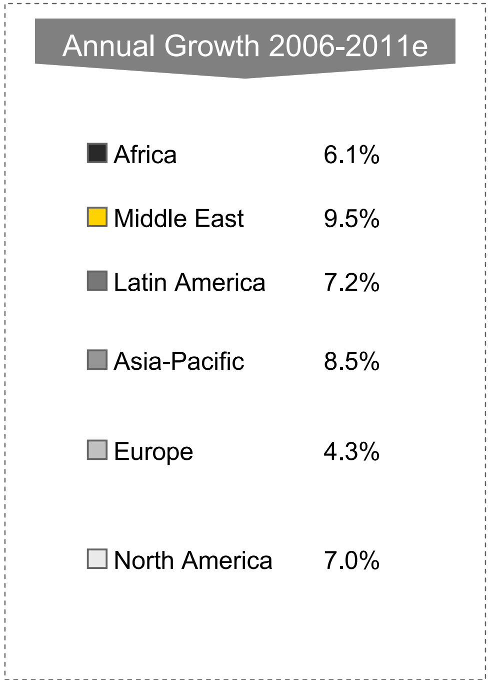
Mass Affluent	► Individuals with liquid wealth of US$ 60k to US$ 400k	► High propensity for Islamic products ► Account for approximately 80-90% of wealthy individuals but only 30-50% of total liquid wealth
HNWI UHNWI	► Individuals with liquid wealth of US$ 400k to US$ 4 mn ► Individuals with liquid wealth in excess of US$ 4mn	► High propensity for Islamic products ► Account for approximately 10-20% of wealthy individuals and 50-70% of liquid wealth
Corporate	► Including pensions funds and Takaful operators	► Pension funds increasingly likely to invest in Islamic products ► Takaful operators invest entirely in Islamic products
SWF	► Government run and owned investment funds that seek primarily to acquire foreign assets	► Not predisposed towards Islamic product ► Most adopt an ethical investments strategy

Source: Datamonitor 2005, Industry Interviews, Ernst & Young Analysis

HNWI wealth in the Middle East is forecast to increase faster than any other region

HNWI Financial Wealth Forecast by Region (US$ tn)

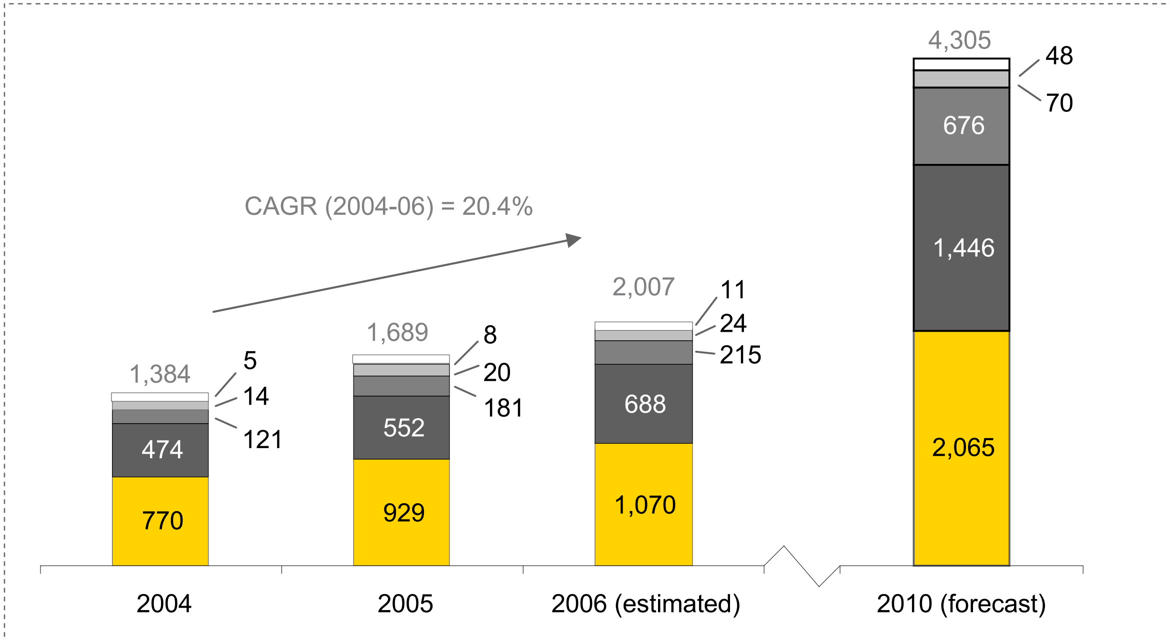




Source: Capgemini and Merrill Lynch 2006 and 2007, Ernst & Young Analysis

Takaful operators are increasingly seen as key Islamic institutional investors

Global Gross Takaful Contributions by Year (US$ mn)



CAGR 2004-2006

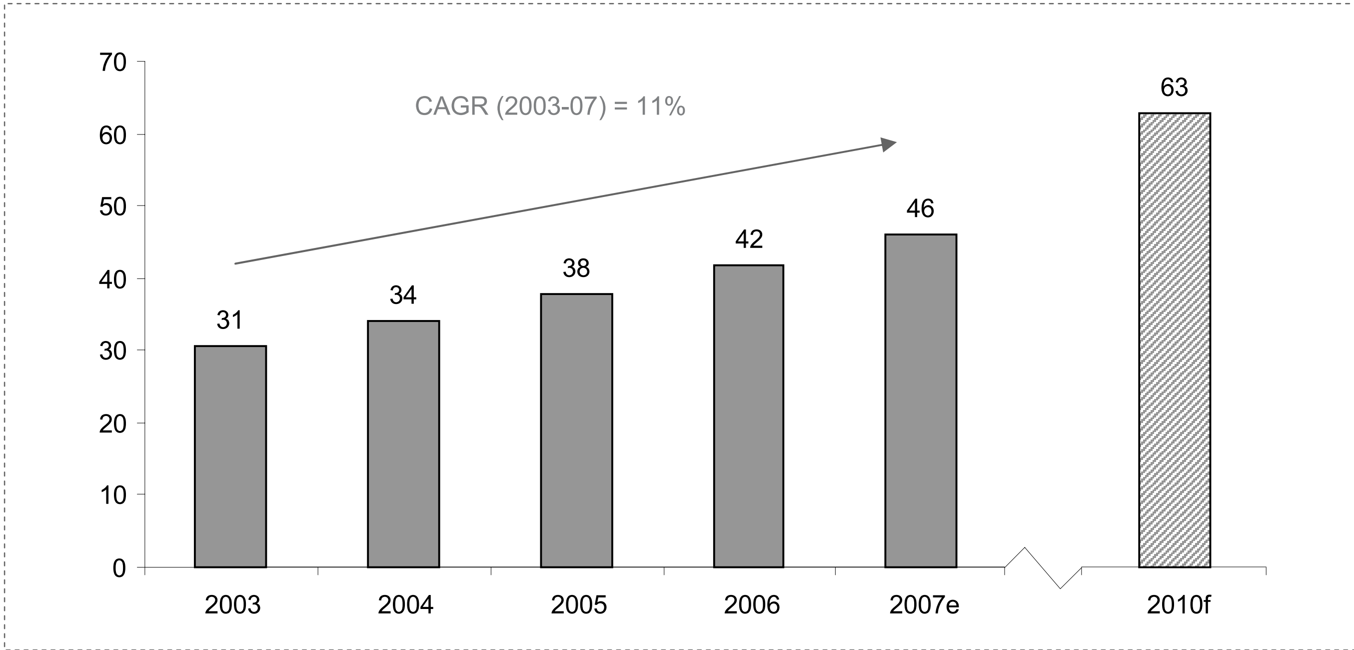
Indian Sub-Continent	44.0%
Levant	31.2%
Africa	33.3%
Far East	20.4%
GCC	17.9%

Note: Iran's financial services sector, which is entirely Islamic, has been omitted from the global analysis. The forecast for 2010 assumes growth at the individual regions' respective CAGR for 2004-2006.

Source: Takaful Re Limited and Middle East Insurance Review (2008), Ernst & Young Analysis

Pension funds in the GCC have estimated assets of over US$ 46 bn

Assets of Pension Funds in the GCC (US$ bn)



Note: Assets of Bahrain-based pensions funds, for which data is publicly available, have been used as a proxy and combined with available employee figures for other GCC funds to estimated total assets. Forecast assumes a conservative CAGR growth of 11% through to 2010.

Source: Annual Reports, Zawya, Ernst & Young Analysis

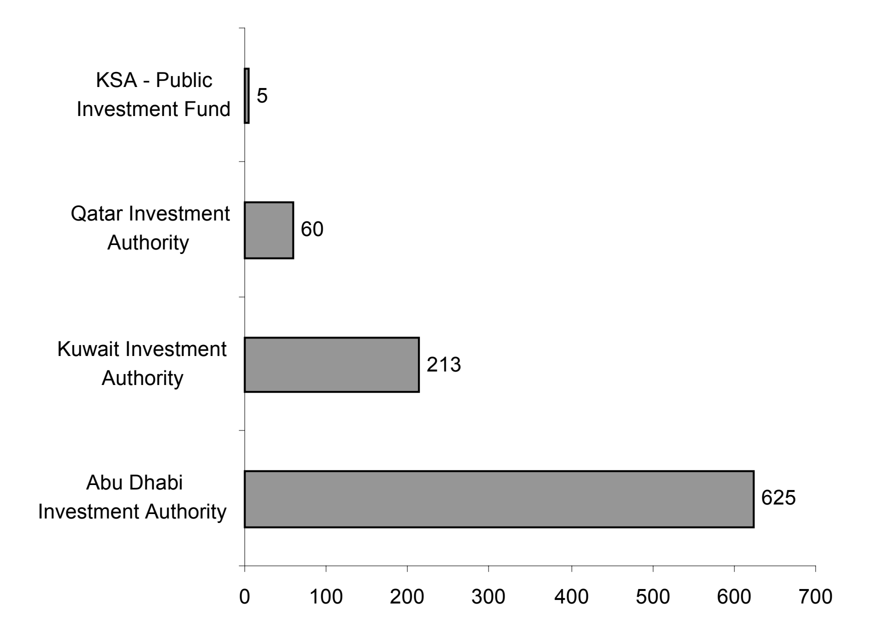
Assets of GCC based pension funds are potentially Shari'a sensitive

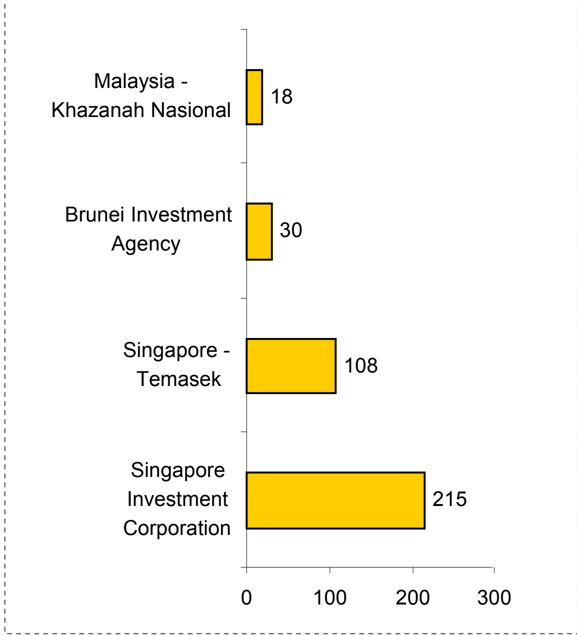
Country	Fund Name	Employees & Estimated Assets	Purpose & Strategy
KSA	General Organization for Social Insurance (GOSI)	▸ Employees: 1,750 ▸ Assets (US$ billion): 19.4	▸ Provides social protection to private sector workers and some public sector workers.
Kuwait	Public Institution for Social Security (PIFSS)	▸ Employees: 12,000 ▸ Assets (US$ billion): 13.3	▸ Major investor on the Kuwait Stock Exchange and in Arab and Islamic countries, with excess funds invested in the US ▸ Covers old age and disability.
Qatar	General Retirement and Pension Authority (GRPA)	▸ Employees: 90 ▸ Assets (US$ billion): 1.0	▸ Retirement benefits for the government, semi-government and private sectors.
Oman	Civil Service Employees Pension Fund	▸ Employees: 126 ▸ Assets (US$ billion): 1.4	▸ Investments in various sectors. ▸ Pension fund for the benefit of civil service employees.
UAE	General Pensions and Social Security Authority (GPSS)	▸ Employees: 200 ▸ Assets (US$ billion): 2.2	▸ Administration of pension and security insurance plans for the benefit of nationals in the government and private sectors.
	Abu Dhabi Retirement Pensions and Benefits Fund (ADRPBF)	▸ Employees: 70 ▸ Assets (US$ billion): 0.8	▸ Provides retirement benefits for the government, semi-government sectors in Abu Dhabi.
Bahrain	General Organization for Social Insurance (GOSI)	▸ Employees: 400 ▸ Assets (US$ billion): 3.3	▸ Invests in the Bahrain Stock Exchange and in a diversified portfolio of investments in the US, Europe and Japan. ▸ Social security system for all workers in the private sector.
	Pension Fund Commission (PFC)	▸ Employees: 300 ▸ Assets (US$ billion): 4.5	▸ Social security system for civil servants and military personnel.

Source: Annual Reports, Ernst & Young Analysis

SWFs in the GCC and Far East are estimated to hold assets worth almost US$ 1.3 tn

Estimated Assets (US$ bn) of Select Sovereign Wealth Funds in the GCC and Far East





Source: Standard Chartered Bank, Zawya, Ernst & Young Analysis

SWFs in the GCC are financed by soaring oil revenues

Country	Fund Name & Source	Description	Asset Allocation & Investment Policy
UAE (Abu Dhabi)	▸ Abu Dhabi Investment Authority (ADIA) ▸ Oil	▸ Launched: 1976 ▸ Value (US$ billion): 625.0 ▸ Value (% of GDP): 520.7% ▸ Growth rate: 10% p.a ▸ Ownership: UAE government	▸ No investments in commodities or Middle East stock markets. ▸ 50-60% in equities, 20-25% in fixed income, 5-8% in real estate, 5-10% in private equity and 5-10% in alternatives.
	▸ Abu Dhabi Investment Council (ADIC) ▸ Oil	▸ Launched: 2007 ▸ Ownership: UAE government	▸ Focus on investments within the Middle East, while also investing internationally. ▸ Receives portion of Abu Dhabi's oil revenues to invest, as does ADIA.
Kuwait	▸ Kuwait Investment Authority (KIA) ▸ Oil	▸ Launched: 1953 ▸ Value (US$ billion): 213.0 ▸ Value (% of GDP): 268.7% ▸ Growth rate: 30% (2006) ▸ Ownership: Ministry of Finance	▸ Future Generations Fund (US$ 174bn) only invests outside Kuwait, assets cannot be withdrawn. US$ 39bn is placed in the Public Reserve Fund. ▸ Investments are in private equity, hedge funds and real estate.
Qatar	▸ Qatar Investment Authority (QIA) ▸ Gas	▸ Launched: 2005 ▸ Value (US$ billion): 60.0 ▸ Value (% of GDP): 185.3% ▸ Ownership: Qatar Government	▸ No stipulated asset allocation or investment policy. ▸ Qatar Investment Authority (QIA) plans to expand its investments in Asia to 40% of its portfolio (with the rest in the Americas and Europe).
Saudi Arabia	▸ Public Investment Fund (PIF) ▸ Oil	▸ To be launched in 2008 ▸ Authorized capital (US$ billion): 5.3 ▸ Growth rate: estimated 20% p.a ▸ Ownership: Saudi Government	▸ No details on investment policy. ▸ One of the objectives is to enhance the development of the Kingdom's financial services sector by building up the national labour skill base.

Source: Standard Chartered Bank, Zawya, Ernst & Young Analysis

SWFs in the Far East are financed through reserves or debt

Country	Fund Name & Source	Description	Assets Allocation & Investment Policy
Singapore	▸ GIC ▸ Reserves	▸ Launched: 1981 ▸ Value (US$ billion): 215 ▸ Value (% of GDP): 169% ▸ Ownership: Government owned	▸ Long-term focus and diversification across equities, fixed income, foreign exchange, commodities, money markets, alternative investments, real estate and private equity.
Singapore	▸ Temasek ▸ Reserves and Reinvested Profits	▸ Launched: 1974 ▸ Value (US$ billion): 108 ▸ Value (% of GDP): 85% ▸ Ownership: Ministry of Finance	▸ Long-term focus with a geographical mix as follows: Singapore (38%); rest of Asia (excluding Japan) 40%; OECD economies (excluding South Korea): 20%; others 2%.
Brunei	▸ Brunei Investment Agency (BIA) ▸ Foreign exchange reserves	▸ Launched: 1983 ▸ Value (US$ billion): 30.0 ▸ Value (% of GDP): 509.4% ▸ Ownership: Part of the Ministry of Finance	▸ Holdings in the United States, Japan, ASEAN countries and Western Europe. ▸ Objective is to increase Brunei's foreign exchange reserves..
Malaysia	▸ Khazanah Nasional (BHD) ▸ Non-commodity; partly debt financed	▸ Launched: 1993 ▸ Value (US$ billion): 17.9 ▸ Value (% of GDP): 12.3% ▸ Growth rate: 23% (annual average May 2004-May 2007) ▸ Ownership: Ministry of Finance	▸ Investments in over 50 companies, in Malaysia and abroad. ▸ The major sectors are utilities (23.5%), media and communications (22.3%), and infrastructure and construction (18.2%).

Source: Standard Chartered Bank, Zawya, Ernst & Young Analysis

Investor Preferences

Investment preferences differ substantially between investor segments and geographies in the Islamic space

Mass affluent investors focus on equity exposure through mutual funds

Shari'a Sensitivity

- Between 70% and 90% of investors prefer Islamic products
- Saudi investors are much more likely to demand Islamic investments than investors from other GCC states

Product Focus

- Small ticket appetite means investment is made almost exclusively through mutual funds using local service providers
- Seek annuity and insurance linked products that require small monthly contributions

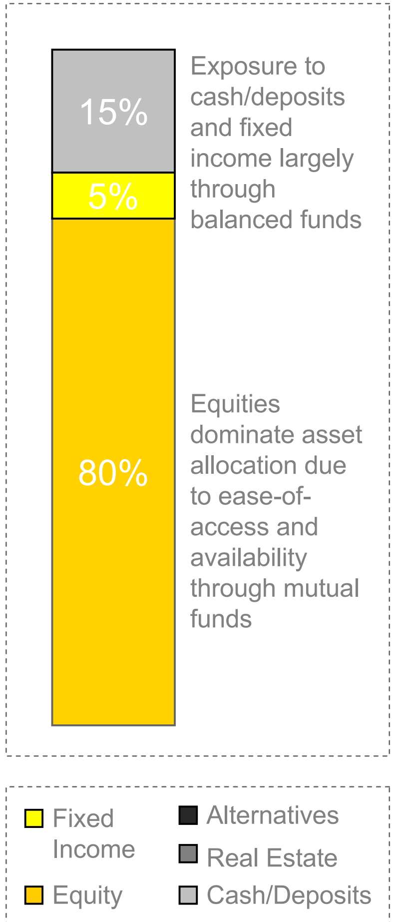
Asset Class Allocation

- Focus on equities, particularly local
- Seeking diversification following market corrections in the GCC
- Drawn to balanced funds which include exposure to cash and fixed income asset classes

Product/ Asset Class Gap

- Currently limited number of Islamic mutual funds with low initial/minimum subscription requirements
- Also a lack of mixed asset allocation through balanced mutual funds or exposure to international Islamic investments

Typical Asset Allocation



Source: Industry Interviews, Ernst & Young Analysis

HNWI and UHNWI are preference driven but tend to allocate across asset classes

Shari'a Sensitivity

- Shari'a sensitivity will depend upon preference of the decision-making individual
- Between 70% and 90% of investors tend to prefer Islamic products
- Their public profile furthers their desire to invest in Islamic products, particularly in more religious countries
- Prepared to invest in conventional products when there is no viable Islamic alternative

Product Focus

- Unlikely to invest through mutual funds
- Utilise discretionary portfolios with specialised asset managers, both local and international, with whom relationships have been developed
- Big-ticket appetite allows access to structured products
- Will demand opt-out clauses when investments are made in conventional products to avoid haram industries and excessive leverage

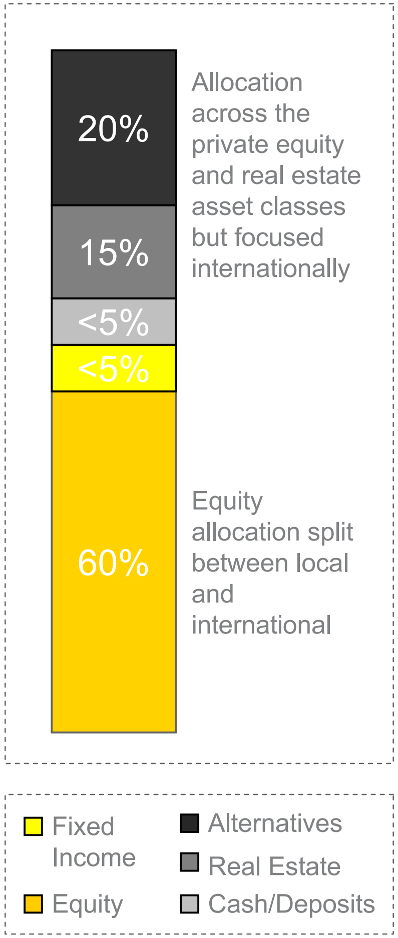
Asset Class Allocation

- Equity allocation still dominant, but geographically diverse with investments in local markets, mature and emerging international markets
- Cash/deposits largely used to meet short-term liquidity requirements
- Limited availability of fixed income and low returns make this asset class unattractive in the inflationary environment of the GCC

Product / Asset Class Gap

- Ijarah (leasing) investments, particularly with tenures of 6-12 months, offer an attractive substitute for fixed income with reduced zakat obligations
- Islamic alternative and real estate investments which target emerging or mature international markets

Typical Asset Allocation



Source: Industry Interviews, Ernst & Young Analysis

Takaful operators are required to invest all assets in Islamic products

Shari'a Sensitivity

- Are required in invest all contributions in Shari'a compliant investments
- A lack of depth in Islamic investments, particularly in the fixed income asset class, forces many operators to reinsure large portions of their risk

Product Focus

- Equity investments made either through mutual funds or direct participation
- Investments for family Takaful require products that provide long-term maturities
- Islamic banks engaged for cash/deposits

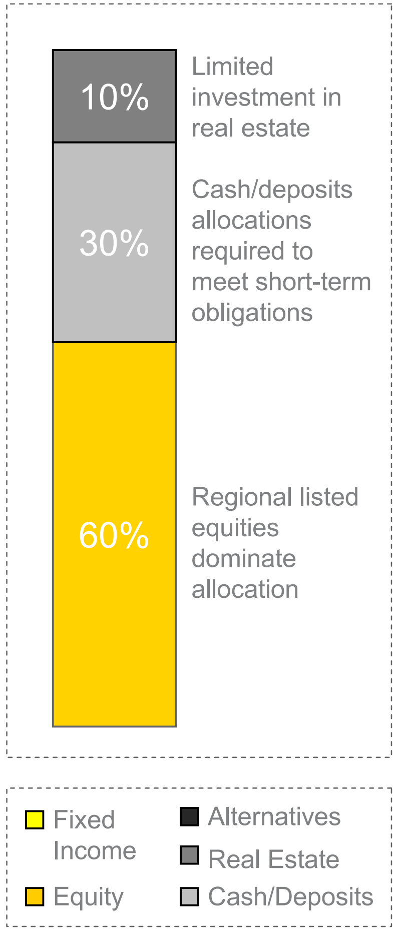
Asset Class Allocation

- Regional equities dominate asset allocation for Takaful operators as fixed income investments remain underdeveloped and illiquid
- Large allocation to cash/deposits with Islamic institutions is necessary to meet liquidity requirements and service potential claims
- Limited local real estate exposure

Product / Asset Class Gap

- Liquid investments in the fixed income asset class
- Listed/tradable products which can be easily exited

Typical Asset Allocation



Source: Industry Interviews, Ernst & Young Analysis

Pension funds are not Islamic investors but they do engage with Islamic institutions

Shari'a Sensitivity

- Have no Islamic requirements but this does not preclude involvement in Islamic investments
- As awareness of Shari'a compliance grows, these funds will be increasingly pressured into allocating more to Islamic offerings

Product Focus

- Potential to engage in big-ticket investments allowing for direct local investments
- Local conventional and Islamic banks engaged for cash/deposits
- International investments in listed instruments, conducted through international portfolio managers with a focus on mature markets, particularly the US, Europe and Japan

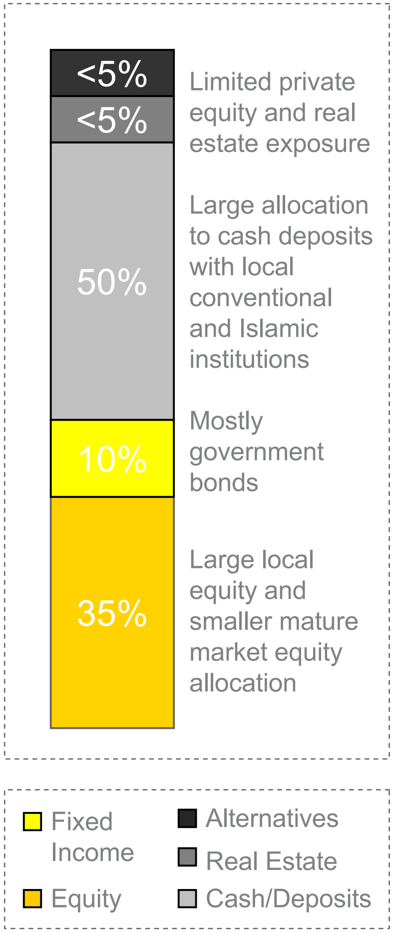
Asset Class Allocation

- Large allocation to cash/deposits with short-term maturities
- Local stock exchange investments account for the majority of equity allocation, with the remaining portion invested in mature markets
- Fixed income is dominated by local government bonds, but also includes limited exposure to international issues
- Real estate and PE allocation is small and predominately local

Product / Asset Class Gap

- Alternatives to cash/deposits that provide attractive returns but are low risk and allow for short tenures
- Islamic mutual funds that can provide stable returns through exposure to international equities in mature markets

Typical Asset Allocation



Source: Industry Interviews, Ernst & Young Analysis

SWFs are not Islamic investors but most adopt ethical investment strategies

Shari'a Sensitivity

- Are not predisposed to Islamic investments
- The majority are required to adopt ethical investment strategies and avoid some industries that are considered haram, including armaments, pork-related and certain entertainment industries
- Conventional financial institutions are not excluded from their investment strategies

Product Focus

- Will invest through well established and reputable international brands, with whom long-term relationships have been established
- Have single management limits which forces multiple relationships
- Demand sophisticated corporate governance and reporting frameworks
- Also conduct big-ticket direct investments

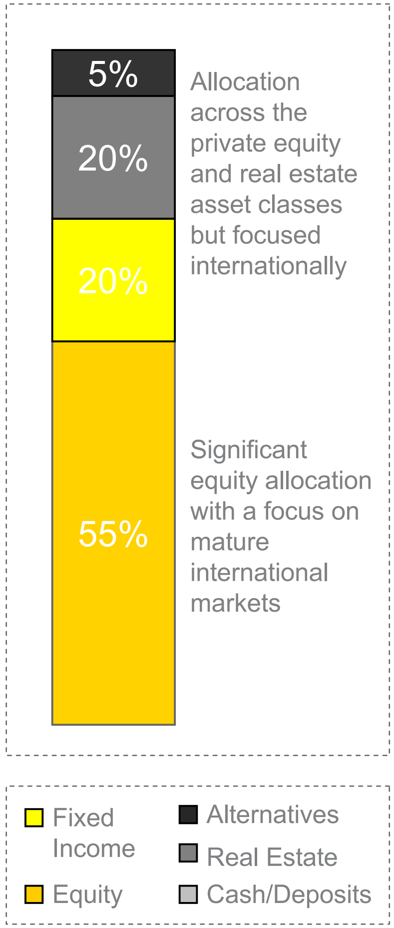
Asset Class Allocation

- Significant exposure to equities, which have traditionally focused on developed markets; funds established in recent years have had greater exposure to emerging markets and regional investments
- Exposure to fixed income is largely investment in US government bonds
- Significant exposure to alternatives, with a large portfolio of income generating real estate assets, again focused largely in developed economies

Product/ Asset Class Gap

- Sophisticated structured product offerings and exposure to international markets
- Product that can compete, in terms of price, returns, scale and service quality, with best-of-breed conventional product offering
- Niche offerings that provides diversification through an ethical investment strategy that targets regional investments with low correlation to mature market returns

Typical Asset Allocation



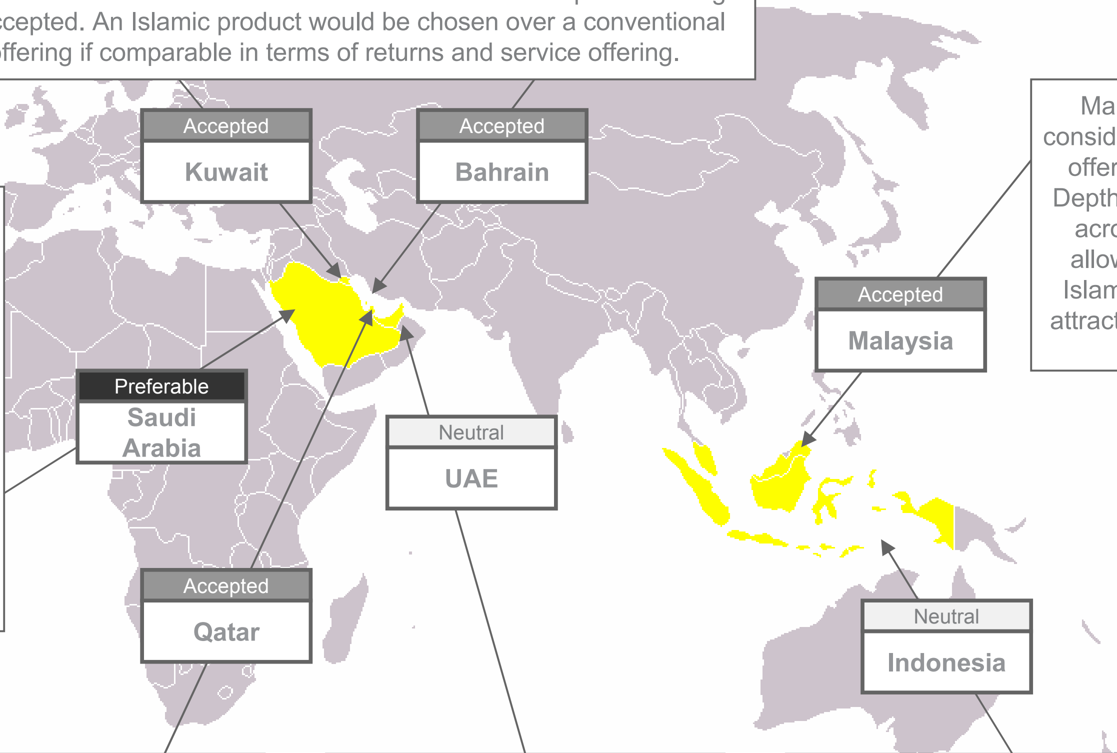
Source: Industry Interviews, Ernst & Young Analysis

Investor preferences also vary between key markets in the GCC and Far East

Both Kuwaiti and Bahraini investors consider Shari'a compliant offerings as accepted. An Islamic product would be chosen over a conventional offering if comparable in terms of returns and service offering.

Saudi investors consider Shari'a compliant offerings as preferable. An Islamic offering is generally chosen over a conventional equivalent even if some return is forgone as a result. Islamic products are considered essential for asset managers wishing to target investor segments in the Kingdom.

Malaysian investors consider Shari'a compliant offerings as accepted. Depth of product offering across asset classes allows for competitive Islamic investment that attracts even non-Muslim investors.



Qatari investors consider Shari'a compliant offerings as accepted, meaning an Islamic product would be chosen over a conventional if comparable in terms of price and service offering.

Investors in the UAE consider Shari'a compliant offerings as neutral. An Islamic product would generally be given no preference over a comparable conventional offering.

Indonesian investors are neutral with regard to Shari'a compliant offerings. This attitude is largely a result of an underdeveloped Islamic banking and investment landscape and a lack of consumer awareness.

Source: Industry Interviews, Ernst & Young Analysis

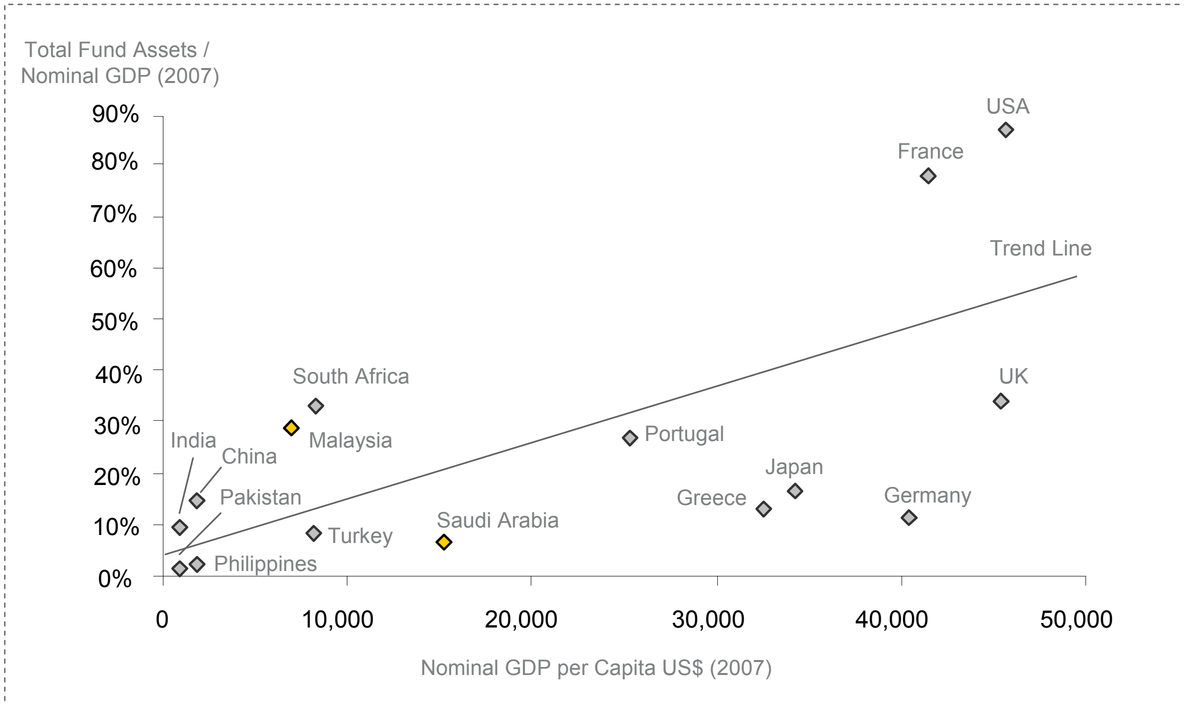
Key Markets

Saudi Arabia and Malaysia are the two largest markets for Islamic asset management in the world.

However, investment strategies differ significantly and reflect two ends of the evolutionary spectrum.

Mutual fund penetration in Saudi Arabia is low, especially when compared to Malaysia

Mutual Fund Penetration and Nominal GDP per Capita in Select Countries



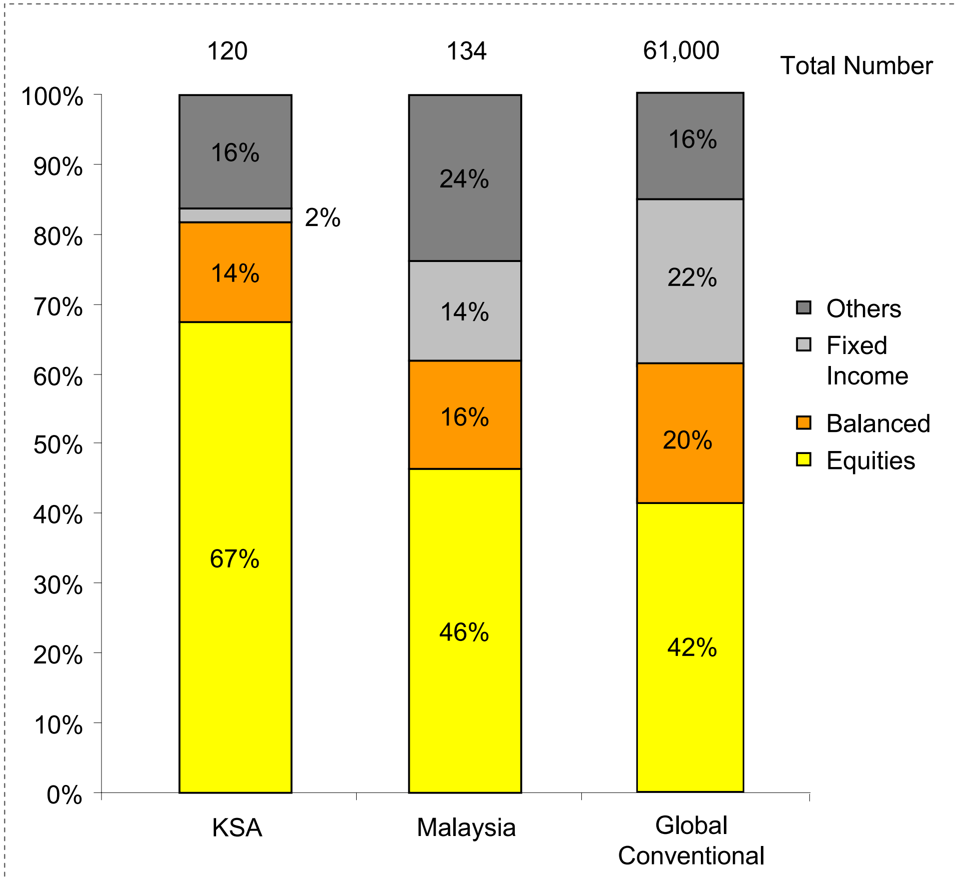
Source: Global Insight, Investment Company Institute, Tadawul and SAMA for KSA, Securities Commission for Malaysia, Ernst & Young Analysis

Note: Analysis include all mutual funds, whether Islamic or conventional

Investment strategies for Islamic mutual funds differ substantially

- The size of the Islamic mutual fund landscape is similar in both Saudi Arabia and Malaysia
- However, investment strategies in Malaysia are more mature and closer to those found in the conventional mutual fund industry
- Investment strategies in Saudi Arabia remain focused on equities

Investment Strategies of Islamic Mutual Funds in Saudi Arabia and Malaysia and Conventional Mutual Funds Globally in 2007 (% of total funds)



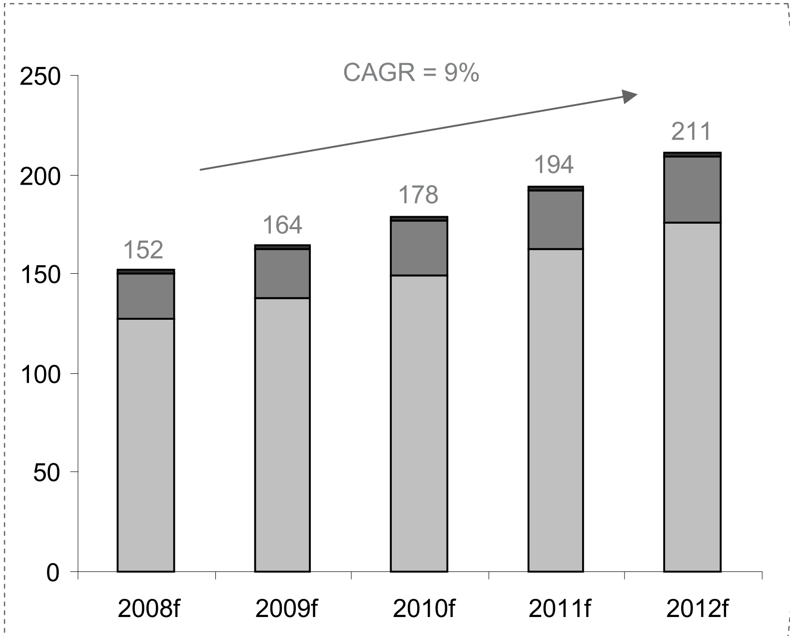
Source: Capital Markets Authority KSA, Securities Commission Malaysia, Investment Company Institute, Ernst & Young Analysis

Saudi Arabia

Saudi Arabia, the largest market for Islamic investments in the GCC, remains underserved and investors remain nervous following stock market corrections

In Saudi Arabia, wealth is concentrated within a small number of UHNWIs

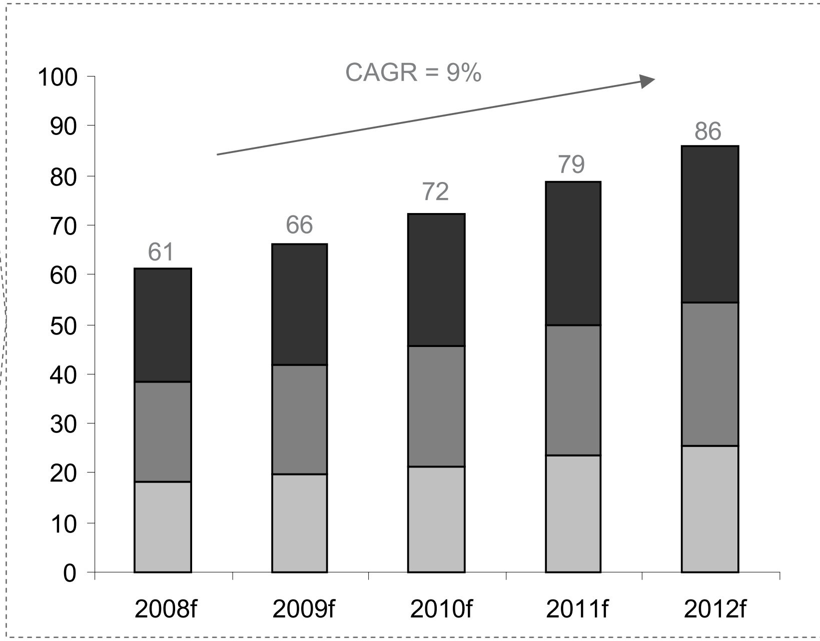
Number of Wealthy Individuals (thousands) by Wealth Band in KSA



CAGR 2008-2012

Wealth Bands (US$)		
	UHNWI (4mn+)	10%
	HNWI (400K-4mn)	9%
	Mass Affluent (60K-400K)	8%

Onshore Liquid Wealth Held by Wealthy Individuals (US$ bn) by Wealth Band in KSA



CAGR 2008-2012

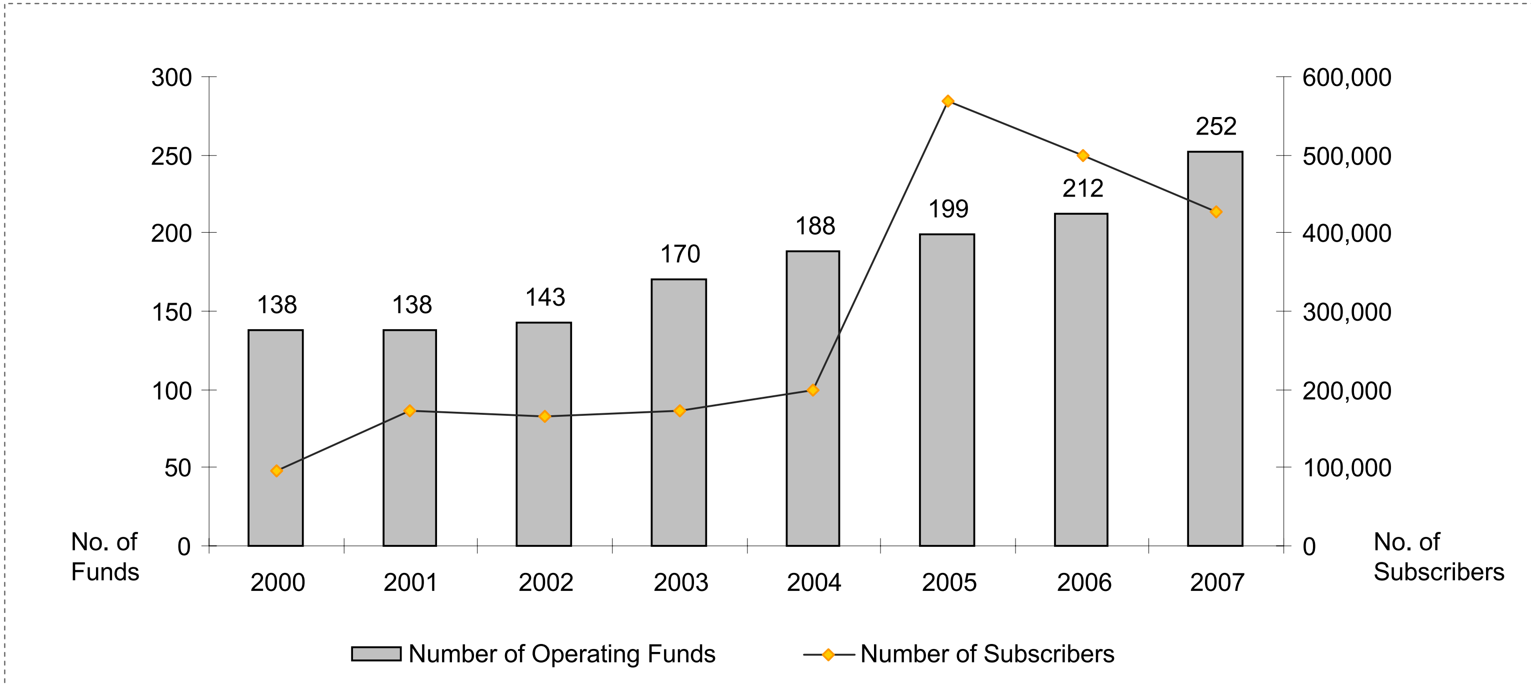
Wealth Bands (US$)		
	UHNWI (4mn+)	9%
	HNWI (400K-4mn)	9%
	Mass Affluent (60K-400K)	9%

Source: Datamonitor 2005, Ernst & Young Analysis

Note: Forecasts beyond 2009 are made using CAGR for 2005-2009

Saudi investor confidence remains low following stock market corrections in 2006

Number of Funds and Subscribers in KSA



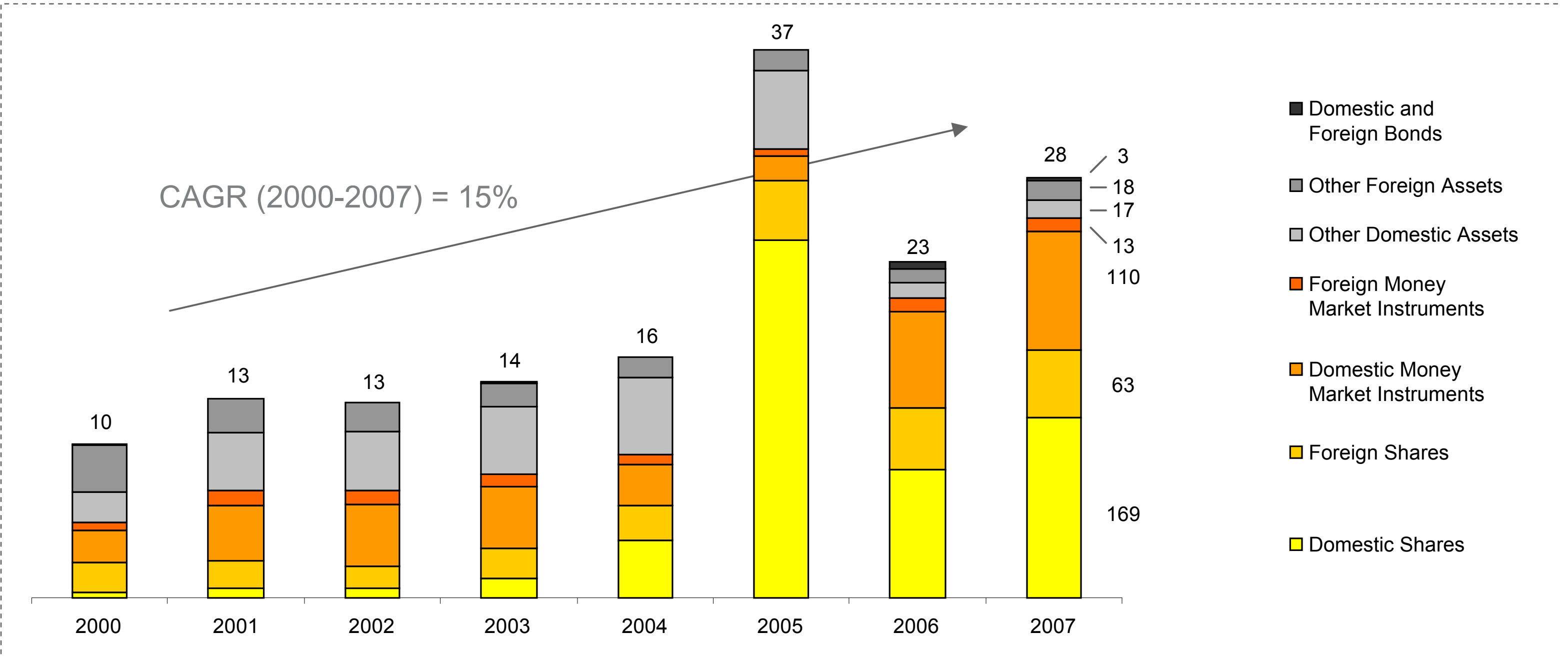
- Stock market corrections have had little effect on the number of fund launches
- However, investor confidence has not returned and the number of subscribers continued to fall in 2007

Source: Saudi Arabian Monetary Agency, Ernst & Young Analysis

Note: Funds here include all funds registered with the CMA

However, assets of Saudi investment funds have begun to once again gain momentum

Assets of Saudi Investment Funds (US$ bn)



- Total assets held by all Saudi investment funds has increased by a CAGR of 15% since 2000 and totalled US$ 28 bn in 2007
- However, total assets have not yet reached levels seen in 2005

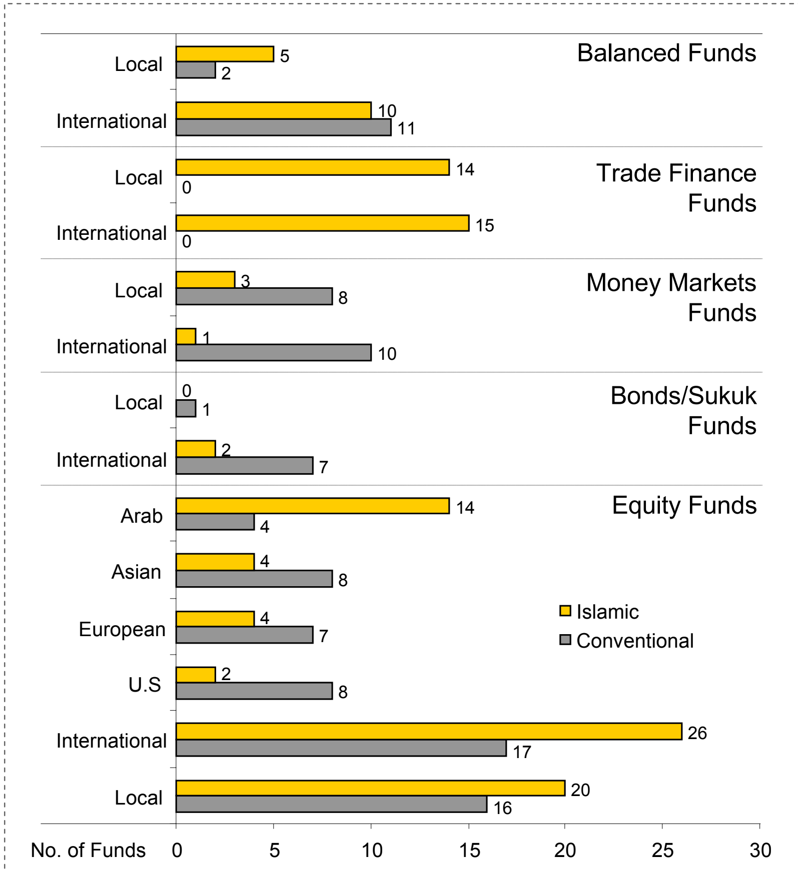
Source: Saudi Arabian Monetary Agency, Ernst & Young Analysis

Note: Funds here include all funds registered with the CMA

The majority of Saudi funds are mutual funds, over half of which are Islamic

- Of the 252 registered funds in Saudi Arabia, 219 are mutual funds
- Islamic mutual funds account for 55% (120 funds) of the total in Saudi Arabia
- There continues to be an emphasis on equity investments, with 58% of all Islamic mutual funds targeting this asset class
- There exists only two Sukuk funds, both of which target international assets
- Islamic trade finance funds have emerged as popular investment products

Number of Mutual Funds in Saudi Arabia (Q1 2008) by Investment Strategy and Geographical Mandate



Source: Tadawul, Ernst & Young Analysis

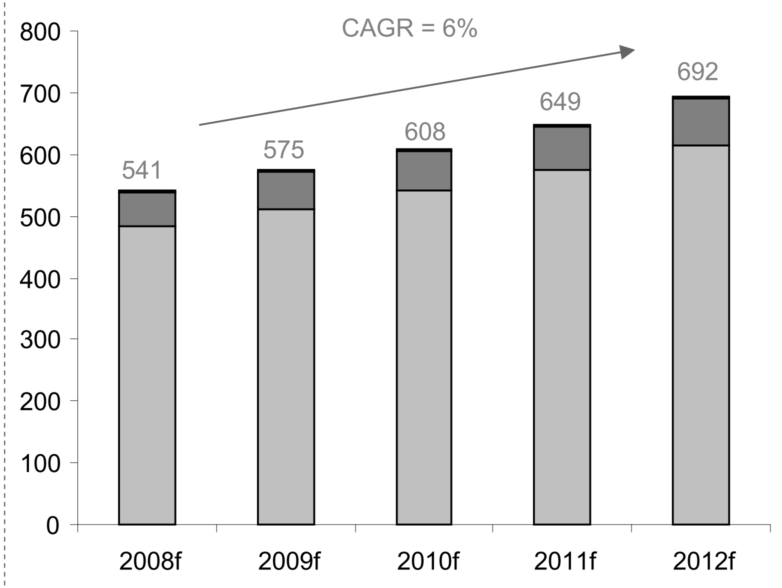
Note: Funds here are only mutual funds

Malaysia

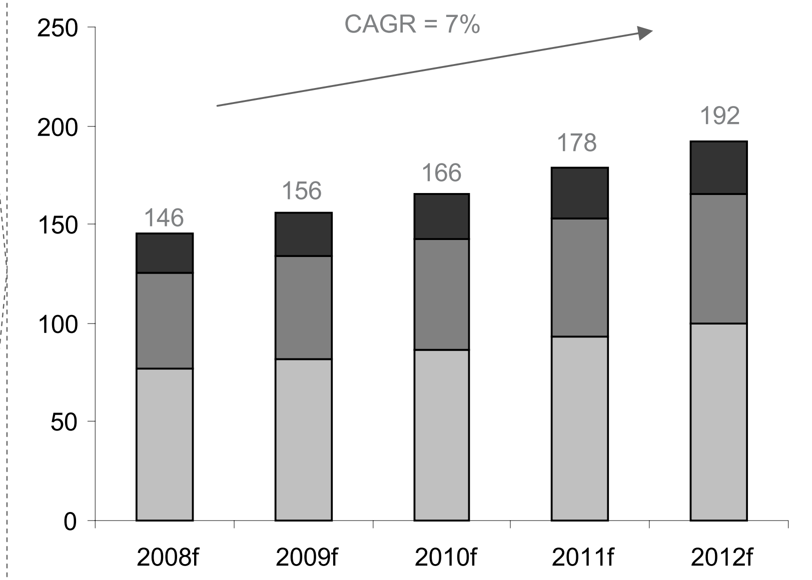
Malaysia, the largest market for Islamic investments in the Far East, is more mature, has greater depth of offering and higher levels of investor sophistication

Wealth in Malaysia is concentrated within the Mass Affluents

Number of Wealthy Individuals (thousands) by Wealth Band in Malaysia



Onshore Liquid Wealth Held by Wealthy Individuals (US$ bn) by Wealth Band in Malaysia



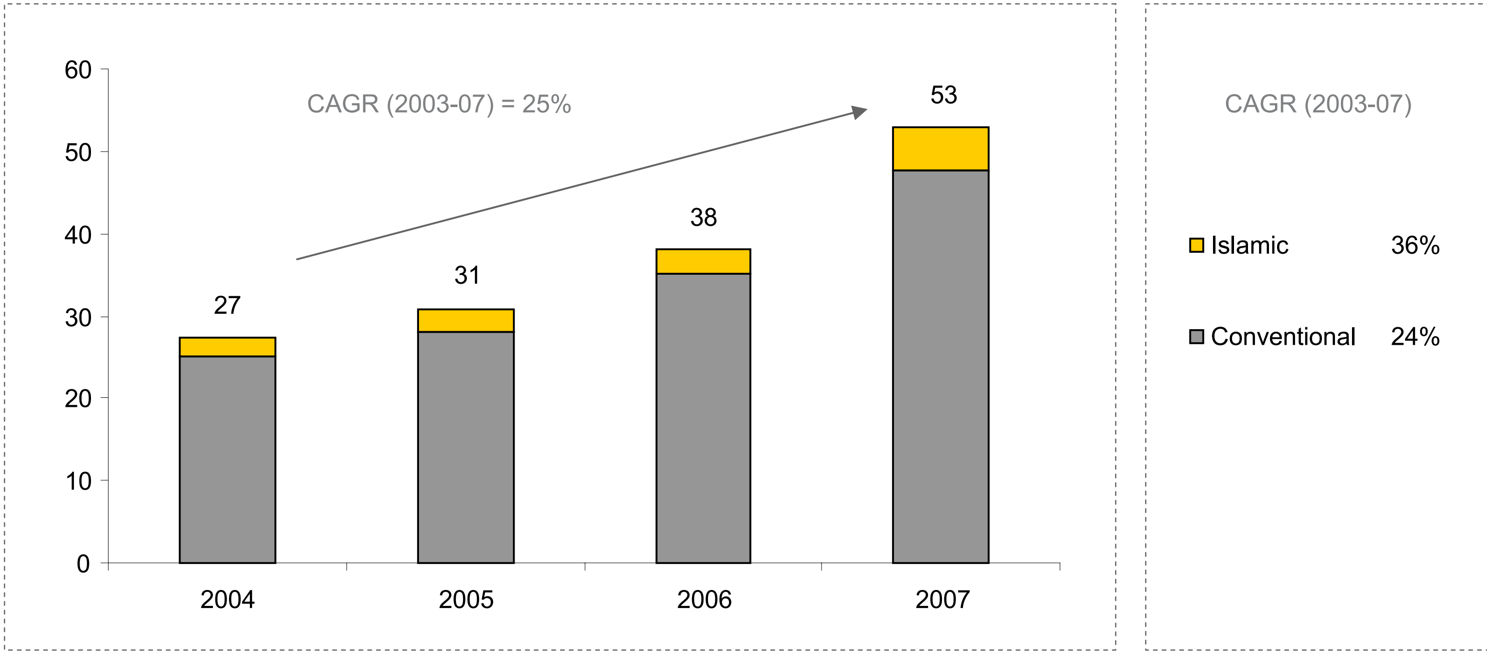
Wealth Bands (US$)	CAGR 2008-2012 (Number of Wealthy Individuals)	CAGR 2008-2012 (Onshore Liquid Wealth)
UHNWI (4mn+)	9%	8%
HNWI (400K-4mn)	8%	8%
Mass Affluent (60K-400K)	6%	7%

Source: Datamonitor 2006, Ernst & Young Analysis

Note: Forecasts beyond 2010 are made using CAGR for 2006-2010

Islamic mutual funds in Malaysia have shown relatively strong asset growth

Total Assets of Mutual Funds in Malaysia (US$ bn) and Islamic/Conventional Split



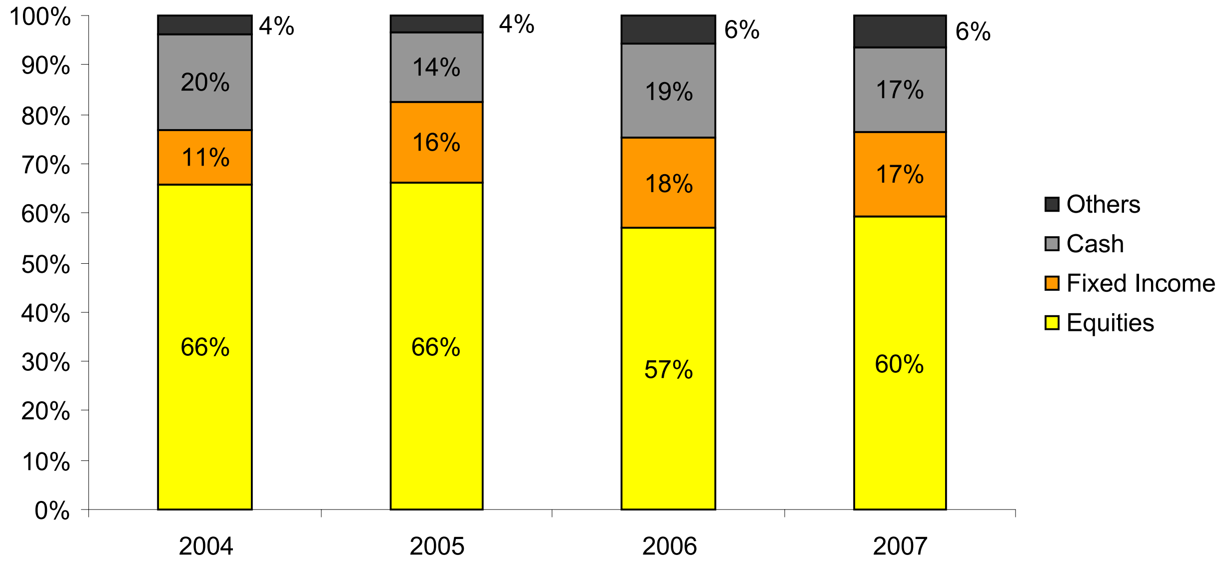
- Assets of mutual funds in Malaysia have grown by a CAGR of 25% since 2004 and held assets worth US$ 53 bn in 2007
- There are 134 Islamic mutual funds in Malaysia, accounting for 10% of total assets held in the mutual funds
- Assets of Islamic mutual funds have shown stronger growth than conventional funds

Source: Bank Negara, Securities Commission Malaysia, Ernst & Young Analysis

Note: Funds here are only mutual funds

Asset allocation of mutual funds in Malaysia has been historically stable

Assets held by Malaysian Mutual Funds by Asset Class, Islamic and Conventional (% of total assets)



- Asset allocation in Malaysia has remained relatively stable over the past 3 years

Source: Bank Negara, Securities Commission Malaysia, Ernst & Young Analysis

Note: Funds here are only mutual funds

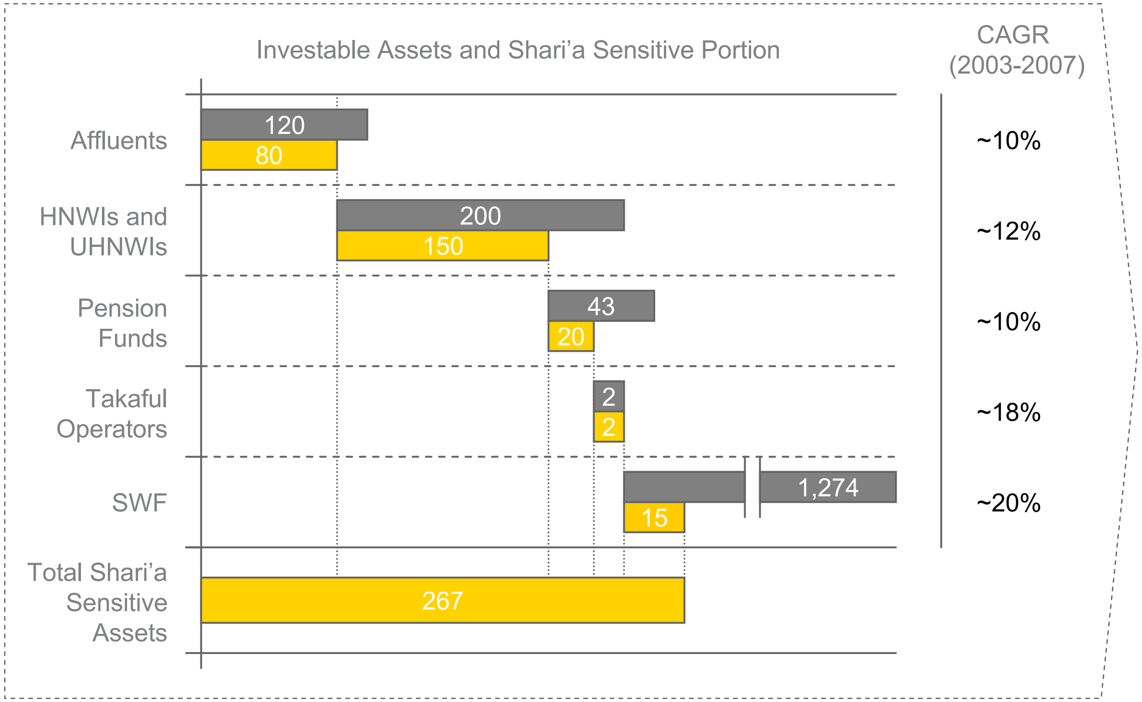
Potential Revenue Pool

Total investable assets of investors who could potentially invest in Islamic investments combine to create a sizable revenue pool with impressive growth potential

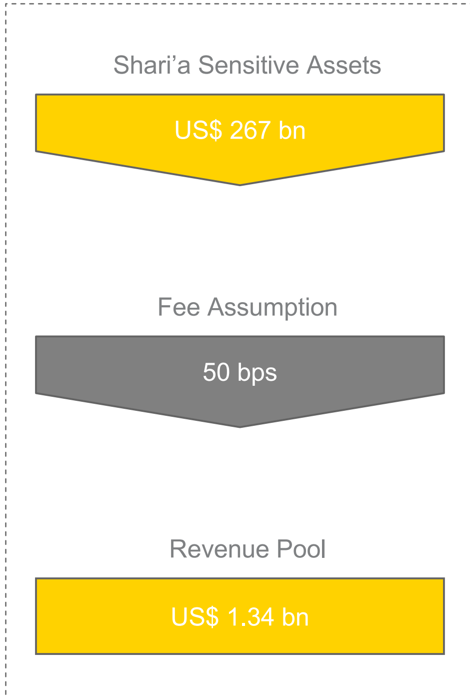
Islamic asset management has a potential revenue pool of over US$ 1.3 bn

Illustrative

Shari'a Sensitive Investable Assets in the GCC and Far East by Investor Segment in 2007 (US$ bn)



Potential Revenue Pool (2007)



Source: Industry Interviews, Data Monitor, Ernst & Young Analysis

Note: Total investable assets and Shari'a sensitive portion for investor segments are assumed using sources found in the investor segmentation and key markets sections of the report and supported by industry interviews. Wealthy individuals are for the GCC, Malaysia and Indonesia. Pension funds are only those in the GCC. Takaful operators and SWF are for the GCC and Far East. .

Strategic Business Risks

There are a number of risks identified by industry players as being key considerations for the Islamic asset management industry

Market players identified a number of key strategic business risks

Question: In order of priority, which factors would you consider your most pressing strategic business risks?

Source: Industry Interviews, Ernst & Young Analysis

Human resources will continue to be a key risk to Islamic asset managers

Human Resources	► The demand for human resources across the entire Islamic financial services industry is high. ► As the Islamic asset management industry develops and institutions expand or are established, the demand for seasoned human resources will only increase. ► According to interviewees, job-hopping and unfulfilled contractual obligations are become more common in the industry, particularly for start-ups and institutions that lack properly executed retention strategies. ► However, human resources was less of an issue for conventional incumbents, who cited access to global resources as key to ensuring staffing does not become a major risk.
Retention	► Interviewees widely accepted that an institution's ability to attract and retain quality staff was becoming a competitive advantage. ► As recruitment costs increase, asset managers will need to shift their focus from recruitment to retention - a shift that, while cost-effective, requires a well-developed human resources function and financial incentives that lead to a vested interest in the employer. ► Financial incentives are key (particularly in the GCC where inflation and the weak dollar are negatively affecting real wages) but a number of interviewees claimed that employees, at all levels, were demanding unreasonable wage increases which are unsustainable in the medium to long term. ► Interviewees also identified an attractive working environment and opportunities for professional and career development (particularly for younger employees) as key contributing factors towards retention.
Expertise	► Interviewees agreed that, on its own, Shari'a compliance is not an absolute competitive advantage in the asset management space because markets invariably include investors that require a diverse and competitive product offering that can match conventional benchmarks. ► The expertise of human resources is therefore essential if Islamic product offerings are to match those provided by their conventional counterparts. ► Innovation and bottom up product development was touted by many interviewees as being key to ensuring continued growth in the Islamic asset management space.

Source: Industry Interviews, Ernst & Young Analysis

Developing coverage is necessary to compete with conventional incumbents

Coverage	▸ Islamic financial institutions will always be required to compete against conventional institutions for certain investor segments. ▸ This competition will only be met if Islamic asset managers commit to developing the sort of coverage, in terms of geographies and asset classes, that is currently held by their conventional counterparts. ▸ As demand for diversification grows, Islamic institutions will face the risk of losing significant market share to conventional institutions that can provide more comprehensive coverage.
Conventional Alternatives	▸ Interviewees on the investment side acknowledged that conventional products and services were being bought when Islamic alternatives were unavailable. ▸ In such cases, Shari'a compliance is ensured not by the institution providing the service, but by the investor through internally capabilities and opt-out clauses that allow for flexibility in investment decisions. ▸ This approach is especially evident for mature market mandates, particularly in the US, where conventional institutions have the capabilities necessary to develop best of breed products.

Gaps in Existing Coverage from Islamic Asset Managers

Geographical Mandates	Asset Classes and Products	
▸ Emerging markets - Africa, India and China ▸ Malaysia - Tapping Chinese wealth ▸ US - distressed play	▸ Fixed income ▸ Commodities ▸ Real estate - open-ended funds, Islamic REITS for certain jurisdictions	▸ Zakat-friendly products, particularly short and medium term Ijarah ▸ Absolute return products - fund of funds

Source: Industry Interviews, Ernst & Young Analysis

Successfully expanding product offering requires effective distribution

Big-ticket vs. Scalability	► The majority of Islamic asset managers adopt an "either or" approach to investor segments - they will either target big-ticket investors or retail through scalability. ► Servicing big-ticket investors will involve small volume, high value transactions in the form of structured and other sophisticated product offering. ► This segment is dominated by established global institutions that hold significant brand equity - distribution is less important a consideration.
Retail Investors	► Servicing retail investors requires scalability and will involve high volume, low value transactions in the form of plain vanilla product offerings. ► This segment is more fragmented but largely serviced by institutions that have extensive physical distribution networks that can facilitate the high volumes necessary to create profitability. ► Asset managers that focus on the retail offerings need to enhance volume creation through the provision of a broad product portfolio that allows for enhanced cross selling. ► A number of interviewees described the difficulties they faced when attempting to develop distribution channels by engaging existing institutions with large physical branch networks.
Investor Segmentation	► Increased competition for investors will force asset managers to adopt demand-driven methodologies to develop products and services. ► Sophisticated investor segmentation facilitates the development of products and services that are tailored to the needs of specific segments and enhance product cross selling (share-of-wallet).

Source: Industry Interviews, Ernst & Young Analysis

Competitive pressures are compounded by the open-market nature of asset management

Competition

- The Islamic financial services industry is still at a nascent stage of development with new market entrants combining with conversions and Islamic service offerings from established conventional players to create an increasingly crowded competitive landscape.
- Scepticism surrounding the Islamic offerings of conventional institutions has provided Islamic players with an opportunity to rapidly develop market share.
- Economic growth and the resulting increases to wealth are currently offsetting significant growth in competition, but a prolonged economic down turn, much like that seen after the last oil price hike, could result in serious competitive risks, particularly for smaller market players.

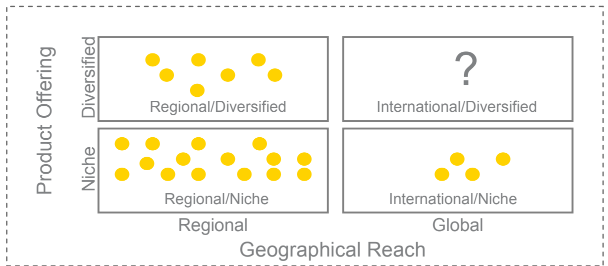
Open-market

- Asset management is effectively an open market industry with investors being serviced by institutions regardless of geographical presence.
- Regulatory restrictions have a limited influence on an institution's ability to target investors - an influence that is even further diluted as you move away from the retail segment and towards big-ticket investors.
- As a result, interviewees that were employed by institutions not based in the region argued that they were not considered competition even though they serviced regional clients.
- This business model, they argued, was ideal for maintaining their niche/focused approach.

Competitive Landscape

- The majority of Islamic asset managers are regional and provide a niche offering; a smaller number can be considered diversified.
- Very few Islamic asset managers have a global mandate; those that do provide only a niche product offering.
- The white space in Islamic asset management is a diversified product offering with a global mandate.

The Current Islamic Asset Management Competitive Landscape



Source: Industry Interviews, Ernst & Young Analysis

With increased geographical diversification, comes exposure to global financial shocks

Global financial shocks	► As regional economies develop, they will invariably become more intertwined with the global economic system, which, when paired with demand for greater geographical diversification, will increasingly expose investors to risk from global financial shocks. ► The depth and impact of the sub prime problem is still unrealized and will likely remain so for some time - a number of regional banks have announced significant write downs. ► As financial markets become more complex, maintaining risk management systems and regulatory regimes that keep abreast of risk, exposure and modelling of such, will be critical.
Diversification	► The stock market crash that affected the GCC resulted, to some degree, in increased demand for geographical diversification for a number of investor segments. ► An overemphasis on equities does though still exist in the GCC, with further asset class concentration in real estate; this is a problem that is evident across the entire Islamic financial services industry. ► As the industry matures, further diversification will be expected.
Reputation Risk	► A number of interviewees warned of the industry wide reputation and Shari'a compliance risk which could emerge if an Islamic financial institution were to run into financial difficulty or be accused of not conforming to Islamic law. ► Such an eventuality would be further compounded by the industry's nascent state and potentially undermine its existence as an Islamic alternative to conventional banking.

Source: Industry Interviews, Ernst & Young Analysis

Regulatory regimes, while improving, have historically impeded development

Regulatory Regimes	▶ Regulation of the asset management industry, particularly funds, varies substantially between jurisdictions in the GCC and Far East and remains largely weak relative to developed markets. ▶ While the regulatory environment is improving, a number of jurisdictions remain under regulated potentially exposing both the industry and investors to undue risks.
Industry Risk	▶ A number of interviewees warned of the industry wide reputation and Shari'a compliance risk which could emerge if an Islamic financial institution were to run into financial difficulty or be accused of not conforming to Islamic law. ▶ Such an eventuality would be further compounded by the industries nascent state and potentially undermine its existence as an Islamic alternative to conventional banking.
Investor Risk	▶ An under regulated jurisdiction exposes investors to undue risk, prevents market confidence from developing and ultimately stifles an industries development. ▶ A number of interviewees questioned the effectiveness of existing regulation in enhancing investor confidence, but also acknowledged improvements that had recently been made in a number of jurisdictions. ▶ Further improvements to regulation will assist the asset management industry to mature and grow.

Source: Industry Interviews, Ernst & Young Analysis

Conclusions

- Rapid economic growth continues in both the GCC and Far East
- Investable assets of investors segments are also expanding
- The Islamic funds landscape still exhibits a number of gaps and lacks depth in certain asset classes
- Investor preferences vary between investor segments and geographies
- Human resources and coverage risks are considered most critical in the Islamic asset management industry

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