Shariah pensions – an untapped market

Shariah compliant pensions have yet to be explored by Islamic financial institutions. As per the PWC research report, 'Asset management 2020', the global size of pension fund assets would reach US$57 trillion by 2020 from the current figure of US$36 trillion, whereas MENA and Asia Pacific will constitute US$5 trillion and US$6.5 trillion respectively by 2020. SHARJIL AHMED explores.

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The majority of the 1.7 billion Muslim population live in MENA (20%) and Asia Pacific (62%) which are potentially major markets for Shariah pensions. If Shariah pensions can take only 10% of this potential market by 2020, it could be projected to reach US$1 trillion by 2020.

The emergence of Shariah pensions will support the Islamic asset management industry which is yet to achieve its critical mass. It will encourage existing Shariah asset managers and the new breed of asset managers to develop targeted Shariah investment solutions for their pension clients. Global asset managers can also take their share by offering their long-standing experience in managing pension funds and can offer the same by bringing Shariah investment solutions.

As per the Thomson Reuters report on Islamic asset management, the Islamic asset management industry constitutes only about 5% of the approximately US$1.8 trillion Islamic banking industry. There is a huge potential for the industry to grow but regulations and a lack of expertise are hindering the growth of this market.

Islamic pensions could be a game changer for the entire Islamic banking market, especially for Islamic asset management and Takaful. Islamic asset managers need to be more proactive and innovative rather than only concentrating on equity and fixed income funds; they need to concentrate on alternative asset classes and come up with more diversified and innovative Shariah compliant pension products.

The Islamic asset management industry needs to be institutionalized as currently it's heavily dependent on retail investors (80% of retail investors and 20% of institutional investors), while on the other hand, the conventional industry represents 20% retail and 80% institutional investors.

It's a huge opportunity for asset managers who can develop Shariah pension solutions for their own Shariah funds and offer them to their clients. It will help them build up the Shariah pension industry and increase assets under management for their own funds on a regular basis.

Currently, only a few Islamic financial institutions are offering Shariah pension solutions to their clients. This puts Islamic financial institutions at the forefront to develop Shariah investment solutions that can produce consistent and strong returns to match future liabilities. Savings for a pension is a long-term commitment and it's very important for financial institutions to come up with regular savings and capital-protected products so that investors can achieve their long-term investment goals.

Technology is another important factor which can play a very important role in the development of the Shariah pensions industry. It enables all stakeholders to keep track of their investments on a regular basis.

As per the World Bank, the three-pillar pension system, followed by most of the developed markets, is as follows: Pillar 1 – state/government-run pension; Pillar 2 – pension provided by employer; and Pillar 3 – privately-funded savings scheme.

Most of the developing countries have yet to adopt the World Bank's three-pillar system. Although public pension funds in some countries have been launched, they are still at the infant stage. Pension reforms are the key to strengthening pension systems in the developing world.

We have recently witnessed the support by some of the governments to develop this important untapped market. Without government support and reforms, this industry won't be able to achieve its true potential. In Malaysia, the Employees Provident Fund recently announced its ambition to start a US$26 billion Islamic savings plan. The Dubai Islamic Economy Development Center also lately declared that it will support the development of Shariah pensions which is a major step forward in developing this sector.

We have seen major development and the effect of reforms in Turkey, Pakistan, Malaysia and Australia in recent years which have helped these countries to build up a strong pension infrastructure and significantly increase the sale of pension policies and funds.

Due to the decline in oil prices, the reduction of subsidies and the increase in commodity prices, the MENA region is heading toward a change in lifestyle and moving more toward savings and pensions. This gives Islamic financial institutions an opportunity to position themselves as the provider of choice for Shariah compliant savings and pension products.

Last but not the least, education is the most important factor for the growth of the Shariah pension industry. As mentioned earlier, the Shariah pension is a fairly new concept for the developing world and it may take time, energy and effort to create awareness of this important sector.

Conclusion

It's fair to say that the Shariah pension industry is comparatively new compared to the traditional pension industry. Islamic financial institutions need to come up with well-structured and tailor-made pension solutions which can be marketed to retail and corporate clients. The pension industry definitely has a void in the market but with the right know-how and government support, the Shariah pension industry can grow and flourish immensely.