Chapter 6. Islam and Private Wealth Management

The Islamic wealth management (IWM) industry is the fastest growing segment of Islamic finance. The segment represents an estimated US$1.3 trillion of personal Muslim wealth in the Gulf Cooperation Council (GCC) countries alone.[21] In addition, significant wealth is being created in India, Malaysia, and Indonesia.

The growth of the IWM sector of financial services has been fueled by rising personal wealth in the Middle East and Southeast Asia as oil prices have dramatically risen, coupled with strengthening demand for *Shari'a*-compliant wealth generation products as Muslims seek to identify with the teachings of Islam. In addition to unprecedented oil-related wealth creation, wealth has multiplied in the Muslim community because of widespread robust macroeconomic growth in emerging Asian nations, diversification in business and financial investment in the Middle East, and new foreign direct investment in Southeast Asia driven by rising commodity prices (Lim 2008; KFH Research 2008).

The scope of IWM, as in conventional private wealth management or private banking, is much wider than simply investment management. It encompasses liability and risk management as well as inheritance and tax planning for high-net-worth (HNW) individuals. Practically speaking, however, other than overlaying Islamic principles on investment selection and obeying religious restrictions on wealth transfer in a decedent's estate, Islamic private banking essentially shares the same goals and practices as conventional private banking.

This chapter focuses on the Islamic definition of wealth, the Islamic wealth creation and management cycle, Islamic inheritance law, the size of and prospects for this market sector, and the drivers of and challenges to the continued growth of global Islamic wealth and Islamic wealth management.

Wealth and Islam

Islam teaches that wealth can be obtained through effort or through inheritance but that all wealth (*maal*) belongs to Allah and that mankind is only a trustee of this wealth. In Islam, wasting wealth is scorned. Money should be earned, invested, and spent in approved (*halal*) ways—that is, in compliance with Islamic principles. Only in this way will a Muslim, his or her family, and society (*ummah*) obtain rewards in this life and also hereafter (Salim 2006).

---

[21] The GCC consists of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates. See Nambiar (2008).

Islam does not discourage the acquisition of wealth, but it maintains that obsessive preoccupation in accumulating and building wealth by an individual leads to the sidelining of the most essential part of the self—one's spirituality. The same is considered true for a government or a society. And although Islam does not view the accumulation of wealth negatively, it does frown on excessive accumulation of wealth in the hands of a few. The *zakat* tax system, which effectively redistributes wealth from the "haves" to the "have-nots," is one of the five pillars of Islam. Inheritance rules also ensure that wealth is evenly shared among the *ummah*.

Islam requires that Muslims seek to acquire enduring *and endearing* wealth. For this purpose, Islam encourages Muslims to work and earn a legitimate income for themselves and their families and implores every Muslim to work hard to achieve perfection and excellence in his or her chosen profession. Thus, the practices of Islamic wealth management incorporate the creation, enhancement, protection, distribution, and purification of wealth.

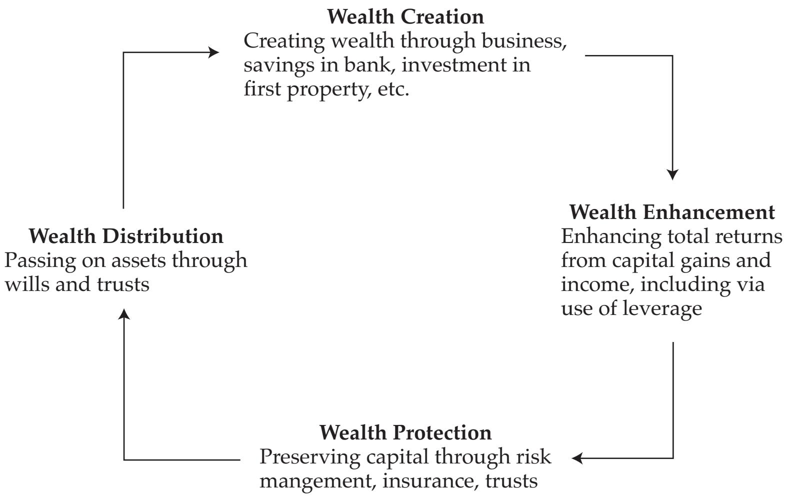
The Islamic Perspective on Wealth Creation, Management, and Distribution

Shari'a teaches that wealth serves many purposes and should neither be expended on unlawful products and services nor spent in vain or ostentatiously. According to *Shari'a*, the need to attain wealth provides the motivation to work hard. The ability of a person to create and to equitably distribute wealth gives hope to the poor and needy, and the need to manage wealth provides the discipline to save in order to support family and society. By saving even a small portion of income or profits and eschewing wasteful spending, a Muslim can help fight consumerism and inflation (Salim 2006). **Figure 6.1** portrays the cycle of wealth creation, enhancement, protection, and distribution with which all private banking functions, conventional and Islamic, are concerned.

Wealth Creation. In Islam, Allah owns the wealth and bestows it on mankind. Allah is the absolute owner of wealth; mankind is the trustee of wealth. Wealth should be earned and multiplied in an Islamically permissible way, which means income and capital appreciation must not be generated from prohibited business activities.

Wealth Enhancement. Enhancement of wealth in Islam is achieved through investing only in *Shari'a*-complaint financial products—that is, products entirely free from *riba* (usury) and largely free of *gharar* (uncertainty) and *maisir* (gambling); moreover, the investing must not involve *haram* (forbidden) products, such as pork and alcohol. Such financial products include stocks, investment funds, bonds (*sukuk*), insurance (*takaful*) plans, *wadiah* and *mudharabah* savings plans, and the funding of new investment through *Shari'a*-compliant financing arrangements. The goal of IWM, which is similar to the goal of conventional wealth management, is to garner reasonable capital growth while preserving accumulated wealth.

Figure 6.1. Cycle of Wealth Creation, Enhancement, Protection, and Distribution



Source: Lim (2008).

Wealth Protection. The protection of wealth is crucial according to Islam; every conceivable financial risk and threat must be considered and provided for. Therefore, risk management and Islamic insurance (*takaful*) play an important role in the practice of IWM. And investing in *Shari'a*-compliant financial products that are viewed as being structured to avoid *gharar* is consistent with the Islamic admonishment to protect wealth.

Wealth Cleansing and Distribution. Islam requires both physical and spiritual cleanliness. Cleanliness of the spirit involves cleanliness of the mind, so that it is free of bad intent or desire to commit unlawful acts, and cleanliness of the heart, so that it is free from jealousy, hypocrisy, and evil desires. Spiritual cleanliness is associated with hope, truthfulness, forgiveness, and compassion. To aid Muslims in achieving spiritual cleanliness and wealth purification, Islam espouses the *zakat* tax system. It is mandatory for every Muslim whose wealth has reached a certain level to pay *zakat*, which is fixed at a rate equivalent to 2.5 percent of a person's or household's financial assets or tradable goods. *Zakat* is a means of narrowing the gap between rich and poor and a way to help meet the needs of less fortunate members of society.

Wealth distribution also takes place through the inheritance law, or *faraid*, which governs the distribution of the estate of a Muslim after death.

Faraid

Faraid, or the Islamic law of inheritance, automatically includes the spouse, parents, and children (known as Quranic heirs) of the decedent as the heirs to the decedent's estate. Grandchildren, adopted children, illegitimate children, foster parents, non-Muslim parents, non-Muslim children, and non-Muslim family members are not automatically included as heirs under Islamic law. A Muslim may dispose of one-third of his or her estate as he/she wishes. Therefore, up to one-third of a decedent's estate may be bequeathed among non-*Shari'a* heirs through the provisions of a will. A will (*wasiyat*) is considered to be a religious obligation of all Muslims, but it may be either oral or written. Normally, the will must be declared in the presence of two witnesses in order to be valid, but an exception exists, according to the Islamic schools of Maliki and Hanbali—namely, a will is still acceptable if it is written in the known handwriting of the testator or bears his or her known signature.

The size of the estate is determined after payment of funeral expenses and debts and the discharging of spousal rights to mutually acquired properties, incomplete lifetime gifts (*hibah*) and after-death legacies to nonheirs (made via the *wasiyat*). The majority view is that debts to Allah, such as *zakat*, should be paid regardless of their mention in the will, although this view is a matter of debate among Muslim jurists (Hussain, no date).

The differences between Muslim and non-Muslim wills are enumerated in **Exhibit 6.1**.

Exhibit 6.1. Differences between Islamic and Non-Islamic Wills

Islamic Will	Non-Islamic Will
Islamic law determines the disposition of the majority of a decedent's assets.	The disposition of all the decedent's assets is determined by the decedent.
Distribution of a decedent's estate to Quranic heirs (spouse, children, and parents) is provided for under the inheritance law. No changes can be made to this predetermined distribution by a decedent's will.	A decedent has full discretion in determining the distribution of the estate to spouse, children, parents, and any other heirs specified.
Only one-third of a decedent's estate can be distributed to non-Quranic heirs without the consent of the Quranic heirs.	A decedent may determine the disposition of 100 percent of his or her estate.

Zakat

Paying *zakat* is considered to be a form of worshipping Allah. The original meaning of the word *zakat* is both "purification" and "growth." Paying *zakat* is an obligation for Muslims to fulfill. It is the third of the five pillars of Islam, and its importance is no different from that of the other obligations.[22] Giving *zakat* means "giving a

[22]The other pillars of Islam are faith, prayers, fasting, and *hajji* (or pilgrimage).

specified percentage of certain assets to certain classes of needy people." Muslims believe that payment of *zakat* leads to cleansing the heart from evil. There are two main types of *zakat*:

- *Zakat fitr* is due from the start of Ramadan until the prayer ending Ramadan (*eid al-fitr*). Every Muslim except those living in absolute poverty must contribute a certain amount of staple foods or the equivalent in money.
- *Zakat* on *maal*: This type of *zakat* is payable on traditional types of wealth, such as agricultural produce, reared animals, a business, gold, and silver.

The belief is that wealth is a gift from Allah; if able, one has the duty to use part of it to help one's needy brethren. This redistribution of wealth is a way to reduce social inequality.

Prospects for Islamic Wealth Management

The report "Tapping Global High Net Worth Individuals" (KFH Research 2008) states that more and more Muslim HNW individuals are turning to Islamic wealth management. Many are strongly committed to using financial services that are fully compatible with *Shari'a* principles and are shunning investments in industries viewed as unethical, such as alcohol or gambling. Increased financial transparency and disclosure and regular monitoring for compliance by the relevant *Shari'a* boards have also encouraged demand. In general, acceptance of Islamic financial services and products, such as *sukuk*, private equity, and structured products, has been growing.

In 2008, Muslim private wealth is estimated to have represented some 5 percent (US$2.1 trillion) of global private wealth, up from an estimated 4.8 percent (US$1.9 trillion) in 2007. And Muslim private wealth is projected to rise by 2020 to an estimated US$4 trillion as the world's Muslim population increases to an estimated 2.5 billion, up from the current estimate of 1.5 billion (KFH Research 2008).

Although growth of the Islamic wealth management sector has been strong, IWM faces the same challenges that Islamic finance, in general, faces if it is to expand to its full potential. A major hurdle for future growth of the industry is a skills shortage. The number of religious scholars with sufficient credentials to issue rulings on new products is limited, as is the number of well-trained lawyers, bankers, and technical staff who are needed to implement contracts and develop new products. An Islamic scholar must train for about 15 years in Islamic jurisprudence and finance. Players in the industry often lack the necessary information, and academic research and market data are often incomplete and inconsistent.

In addition to skilled and educated human capital, for IWM to advance, it needs a higher level of standardization in investment products and consistency in the application of screening criteria for *Shari'a* compliance. Often, no single interpretation of Islamic law prevails throughout a particular jurisdiction, so each financial institution in that jurisdiction has its own board of religious scholars to determine which products are *halal* (permissible) under Islam.

Affluent and HNW Islamic investors are becoming markedly more sophisticated and adventurous in their financial demands than in the past, however, and are turning to hedge funds and other complex capital market products to earn a competitive return. Although the religious credentialing of financial products is important to these investors, the potential for return may be the deciding factor. A common position taken by private and institutional investors is that they prefer to invest in Islamic funds when possible, so long as they do not have to sacrifice return to do so.