Malaysia funds can target Shariah investing to excel offshore

The country's asset managers should use the ASEAN funds passport scheme to issue Shariah funds, but they face competition from regional fund companies on the conventional side, says Sandeep Singh of Franklin Templeton Investments.

The ability of Malaysian local funds to distribute offshore to Singapore and Thai investors via ASEAN funds passporting could shake up the local mutual fund industry, with local funds boasting an advantage in terms of Islamic finance but also facing mounting competition from aggressive market entrants.

Malaysia is an international leader in Islamic finance, and the country's Shariah, or Islamic law-compliant asset management products stand head-and-shoulders above those of regional asset management companies.

The introduction of the Association of Southeast Asian Nations' Collective Invest Scheme (CIS) – popularly known as the funds passport scheme, offers an effective avenue for these local Islamic funds compete for investor assets elsewhere.

Sandeep Singh, country head for Malaysia at Franklin Templeton Investments, supports the idea. "One area where I think Malaysian fund houses would gain and stand out is on the Islamic side, because of the large expertise available in Malaysia," he says.

Islamic finance refers to the practice of financial management within the boundaries of Islamic law. Malaysia has earned a name for itself as the leading Islamic finance jurisdiction, having actively worked to build this financial industry for over 30 years.

According to a report published by the Malaysia International Islamic Finance Centre (MIFC), the estimated asset size of the global Islamic finance industry was US$2.1 trillion as of end-2014. Malaysia is at the forefront of this activity in terms of innovation, ahead of the United Arab Emirates. Although concrete statistics aren't available, it is believed that Malaysia's share in the global Islamic finance industry is almost 20% of assets.

SANDEEP SINGH
Franklin Templeton Investments

Franklin Templeton's Global Investor Sentiment Survey (GISS) Malaysia in 2014 reported that 45% of Malaysians owned Shariah funds. The country houses the highest number of Islamic funds globally. It possessed 187 unit trust Islamic funds worth a net asset value of MYR47.75 billion (US$12.95 billion), and 69 wholesale funds worth MYR24.13 billion, as of January 2015. About 20 local and foreign companies hold Islamic fund management licences, some of which focus much more on retail products.

Singh believes the asset management industry in Malaysia can draw on the country's reputation and prowess for funds creation using Islamic finance to construct a variety of funds that are Shariah-compliant and attractive to investors overseas.

into the country," says Singh. Franklin Templeton has three funds in the country – global fixed income, Asian fixed income, and US equity – all of which are feeder funds. It intends to continue offering similar structures for the immediate future. Singh says these funds would largely be focused on a mix of international fixed income and equity assets.

He is relatively optimistic about the demand for such offshore funds, noting a gradual shift in local investor preferences away from local or South-east Asia equity and towards fund portfolios focusing on the US and, most interestingly, on Europe.

"Shariah products in Malaysia, whether they are international or local, have a great opportunity to be showcased in both Singapore and in Thailand and any other country which joins the passport."

"Shariah products in Malaysia, whether they are international or local, have a great opportunity to be showcased in both Singapore and in Thailand and any other country which joins the passport," he says.

INTENSIFYING COMPETITION

The advent of passporting offers little direct upside for Franklin Templeton and other foreign fund managers operating in Malaysia.

"The scheme is more beneficial to local names than to foreign ones in the current form, especially because a lot of funds are not eligible to be brought

"There is a growing acceptance of international products, which I think is down in part to the fallout from the drop of some emerging market currencies," says Singh. "This is especially true of the Malaysian ringgit, as the market links the currency to the oil price drop. It's still early days but I think this could lead investors to look more at funds focused on other regions."

PASSPORTING LIMITATIONS

This rising interest in international products could prove problematic for local fund managers, particularly given the spectre of greater offshore competition presented by passporting.

To compete effectively the local fund managers need to offer funds with regional or international investment themes. For many this is not a core strength.

Most local equity and fixed income fund managers offer domestic equity and fixed income funds, but fewer have top quality regional funds and very few can boast true international ones. While such local products may interest some off- shore investors, they are unlikely to buy them in great amounts because of the single country exposure they provide.

In contrast, countries like Singapore already possess dozens of international funds. In Singh's words, "there is a big choice of international managers already available in Singapore".

More than five funds from Singapore have reportedly been approved for passporting under the CIS scheme. If they can demonstrate strong performance, they are likely to quickly gain favour with Malaysia's yield-hungry retail investors and bank distributors.

This pressure is likely to mount, as the passports scheme is likely to soon extent to countries beyond Singapore, Thailand and Malaysia. Plus Malaysia could join other funds passporting schemes in the region, such as the Asia Regions Fund Passport being created by Singapore, Australia, New Zealand and South Korea. Malaysian fund managers seeking to be winners from this liberalisation had best move quickly.

Islamic finance products might offer them immediate advantage, but in the longer term they will need to demonstrate broader investment capabilities if they are to thrive. ■