

ANALYSIS-Western banks eye billion dollar Islamic market

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GENEVA/CAIRO, Aug 8 (Reuters) - Switzerland's UBS becomes the latest of just a handful of Western banks to open to Islamic banking next month, aiming to capture a slice of a \$180 billion market they say is underserved and expanding.

Noriba Bank, a fully-owned UBS unit, said it will start up in Bahrain offering banking products and services compliant with Islamic sharia law to rich individuals and institutions.

"This is a market which is underserved. A lot more needs to be done to come up with the same range of products and services that you find in conventional investing," Mohammad Toufic Kanafani, chief executive of Noriba, told Reuters.

Western banks, whether due to a lack of understanding or an unwillingness after the September 11 attacks on the U.S. to be associated with the Muslim world, have been distracted from this market, creating a niche for newcomers.

As Muslims make up 20 percent of the world's population, an untapped market of such size is music to the ears of financial firms who are eagerly eyeing growth pockets.

Among those who offer Islamic services Citigroup has Citi Islamic Investment Bank in Bahrain, while HSBC operates in Dubai via its Amanah Finance Co.

"People are now beginning to recognise that there really is interest in the Arab world in investing Islamically," said Elisabeth Jackson-Moore, Managing Director at Moody's in Cyprus.

"There is believed to be around \$100 billion invested Islamically, and perhaps we could see at least as much again were there more products available," she added.

Islamic fund management was boosted by the issuance of a fatwa, or religious ruling, in the mid-1990s that investment in modern-day equities did not violate sharia principles.

Banks have the tricky task of designing products around these rules, which prohibit investing in conventional financial services because interest is regarded as usury. They also ban investing in industries with connections to, among others, alcohol, gambling, tobacco, weapons or pork-related products.

Kanafani said UBS noticed that Islamic investors had limited access to some products like alternative investments and, until recently, bonds. Only in June, Malaysia completed the world's first Islamic global bond issue, lead managed by HSBC.

"We've identified the opportunities that are there and the products that are missing. We believe we can fill in a lot of gaps and make profits for both the customer and UBS," he said.

Noriba bank will be UBS's global platform for Islamic banking products and services. UBS is Switzerland's biggest bank and the world's largest provider of wealth management services.

Rushdi Siddiqi, Director of Dow Jones Indices, hope UBS's move may stoke interest in the region, creating a more efficient and flourishing capital market. "It's exciting to have a blue chip institution looking at this market so seriously. It brings additional credibility," he said.

GOOD TO BE HOLY, BETTER TO PERFORM

Experts say the growing popularity of Islamic-style investing is not necessarily a backlash against the West, prompted by the differences of opinion on Washington's war on terrorism and heightened scrutiny of funds from the Middle East.

Tariq Al-Rifai, independent director of Failaka International Inc., said Muslim investors were searching for profit along with all other investors.

"Just because you are Muslim doesn't mean you want a halal product," Al-Rifai said, using the Arab term for "religiously permissible", similar to the Hebrew word Kosher.

Islamic investors also want flexibility and diversification in any product provider, an explanation for why some of the Islamic funds or products offered by Western institutions have failed or been withdrawn from the market, Al-Rifai said.

Rather than offer Islamic investment vehicles exclusively, a few Gulf Arab banks in Saudi Arabia and Kuwait have used trained marketing specialists to sell Islamic products to their regular customers along with other services.

UBS hopes to learn from that. It will target non-Muslim investors, who may appreciate the values and in-built safeguards sharia investing affords, as well as Islamic investors globally.

Being religious does not mean Islamic investors will dump money into poorly performing bank accounts or funds just to be holy. They too want diversity, choice and performance.

"The key for a success is to say: 'We have these products that are just as good as any other product. However, we have one added benefit that makes it better than the guy next door'," Al-Rifai said.

"But if I can say, mine is a halal product, a sharia-compliant product, then a customer who had never thought of investing in a Islamic product could say: Well, I'll feel better about myself if I do it that way," Al-Rifai said.

At the moment, the bulk of Islamic money is invested abroad in bank accounts or investment vehicles which are not necessarily sharia-compliant, and if Islamic investments don't perform, that is the way it will stay, experts said.

That theory has been borne out in the Islamic mutual fund industry, where around 105 Islamic mutual funds have an estimated \$3.5 billion in assets -- a fraction of both the total funds arena and the market of Islamic investments.

While some research predicts the market will grow 12 to 15 percent per annum, the market remains in the doldrums for now.

Failaka's Al-Rifai said Islamic equity funds had fallen in line with world stock markets in the past two years.

"As far as mutual funds and stuff, the (Islamic) investor will behave the same, they go with the market," Al-Rifai said. "If the market is going down they will pull out."

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