



Islamic pension funds: The next big thing in Islamic finance



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A pension fund is a fund set up for the purpose of covering the retirement benefits of employees at the end of their careers, or when employees reach their retirement age. Pension funds are normally financed by contributions coming from employees themselves and their employers. Pension funds exist in one form or another in all developed countries. They are major institutional investors and players in both their own respective financial markets and global ones.

The total assets of pension funds of the 37 OECD member countries for 2019 were estimated at US\$32.3 trillion (OECD, 2020). Seven countries had over 90% of these fund assets. These were the US (US\$18.8 trillion), the UK (US\$3.6 trillion), Australia (US\$1.8 trillion), the Netherlands (US\$1.7 trillion), Canada (US\$1.5 trillion), Japan (US\$1.4 trillion) and Switzerland (US\$1 trillion).

At the beginning, most of the pension funds only invested in two major asset classes (bonds and equities) to make returns. However,

according to a study from PWC in 2016, pension funds started diversifying their investments toward more alternative investments such as hedge funds, infrastructure, private equity and real estate. The same study also showed that responsible and economic, social, and governance (ESG) investing is increasingly playing an important role in the investment decisions of major pension funds of developed countries.

Take for example AustralianSuper, the largest pension fund in Australia. It applies strict screening based on ESG standards in addition to financial criteria. The fund will not invest in companies considered as having, among others, human rights, labor, environmental and governance issues.

Review of 2020

As pension funds in developed countries have become major institutional investors playing a significant role in domestic and global financial markets, it is somehow surprising that the study on Islamic pension funds is still rare in international Islamic finance reports and literature.

Moreover, information on Islamic pension funds is usually just put as part of the studies on Islamic funds, and it is a minor part, as found in the Islamic Finance Development Report 2019. Other yearly major global Islamic finance reports such as the Islamic Finance Services

Industry Stability Report of the IFSB and the Islamic Finance Outlook of S&P Global did not even include information nor discussion on the subject.

One of the main reasons perhaps is because of the difficulty in getting data, or the size of the fund itself is not that significant. As seen in Table 1, even within the universe of Islamic funds only, pension funds only accounted for less than 0.5%.

Actually, the challenge for the development of Islamic pension funds is not just making the conventional pension funds Islamic; the institutional setup of the pension funds themselves is not that solid in most Muslim countries. Looking at the global list of the top 300 pension funds in Table 2, only three pension funds from two Muslim countries are listed: the Employees Provident Fund and the Retirement Fund of KWAP of Malaysia and the Public Institution for Social Security of Kuwait.

Even if we add some major pension funds not listed in this list such as the General Organization for Social Insurance (having assets under management (AuM) of US\$115.4 billion) and the Public Pension Agency (AuM: US\$51.5 billion) of Saudi Arabia (based on swfinstitute.org) and Indonesia's major state-owned social security entity, BPJS Ketenagakerjaan (AuM: US\$31.2 billion) (based on entity's audited accounts), the number is still less than one-ninth of the 56 Muslim countries grouped in the OIC – compared this to the US alone that has 142 funds in the ranking.

“ More alternative investments will also need to be considered, particularly in the area of developmental finance ”

Preview of 2021

Despite the facts that the current figures of the Islamic pension funds discussed are still limited, there is actually great potential possessed by the Islamic pension fund industry. It could start with the existing major pension funds located in Indonesia, Kuwait, Malaysia and Saudi Arabia that already have a relatively significant asset size. The total value of assets of six pension funds in those four countries stood at US\$542.47 billion, almost five times the overall Islamic fund figures in 2018.

Marmore MENA Intelligence estimates that the total pension fund assets in the GCC in 2020 stand at US\$602.4 billion. If the investment is converted into Islamic instruments over a period of time, then Islamic pension funds would really be the next big thing in the Islamic finance industry. This is not to mention possible conversions taking place in Indonesia and Malaysia.

Another potential major player is Turkey, which had around US\$21.3 billion of assets in pension funds and other retirement vehicles in 2019 (OECD, 2020). Potential also exists among Muslim minorities in developed countries. The UK is a case in point. There are already some offerings of Islamic pension funds for the Muslim community in the UK. Among these companies are Options, previously known as Carey Pensions, the HSBC Life Amanah Pension Fund and the B&CE People's Pension.

Conclusion

Although specific data on Islamic pension funds is rather scarce, it can be inferred that the existing size of Islamic pension funds is too

Table 1: Islamic funds' outstanding value by universe 2018 (US\$ billion)

Rank	Fund	Outstanding value
1.	Mutual funds	97
2.	ETFs	9
3.	Insurance funds	2
4.	Pension funds	0.37

Source: Islamic Finance Development Report 2019

Table 2: Position of selected pension funds of Muslim countries in the global list of top 300 pension funds (in US\$ million)

Rank	Fund	Market	Total assets
1	Government Pension Investment Fund	Japan	1,555,550
2	Government Pension Fund	Norway	1,066,380
3	National Pension Fund	South Korea	637,279
4	Federal Retirement Thrift	US	601,030
5	ABP	Netherland	523,310
6	California Public Employees	US	384,435
7	National Social Security Fund	China	361,087
8	Central Provident Fund	Singapore	315,857
9	Canada Pension	Canada	315,344
12	Employees Provident Fund	Malaysia	226,101
17	Employee' Provident	India	168,095*
23	AustralianSuper	Australia	129,025
50	Public Institution for Social Security	Kuwait	81,247*
127	Social Insurance Funds	Vietnam	38,464*
135	Retirement Fund of KWAP	Malaysia	37,019*

Source: Thinking Ahead Institute, Willis Towers Watson, 2020

Note: *Estimate

small compared to its potential. There are at least four ways Islamic pension funds could grow much bigger in the near future.

Firstly, it will be through a gradual conversion of existing conventional pension funds in major Muslim countries mentioned previously. Secondly, it will be through the reform of the social security system in most OIC member countries so that it is expected that more viable pension and retirement-related institutions could emerge. Thirdly, it will be through the new awareness of Muslims living in the mostly western developed countries preferring to use Islamic pension funds. Last but not least, it will be through the need to align more closely Islamic finance and sustainable/responsible (ESG) investing as these two approaches are basically intertwined.

In addition, more alternative investments will also need to be considered, particularly in the area of developmental finance. At the end, people nowadays do not only seek financial returns, but also have a desire to contribute positively to the world. ☺