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Global Islamic Asset Management: Setting the Foundation

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ISLAMIC ASSET MANAGEMENT

INTRODUCTION

Key steps in establishing the foundation for global Islamic asset management

- 1** Developing Islamic track records that will be an effective “showcase” for the industry
- 2** Making sure these track records are highly credible and visible to investors
- 3** Preparing for investor due diligence
- 4** Setting the foundations for a profitable industry

DEVELOPING THE RIGHT KINDS OF TRACK RECORDS

Key early focus: developing a limited number of broad market track records managed against well recognized benchmarks

- Islamic global equities
- Islamic emerging market equities
- Global sukuk
- Islamic Asia ex-Japan equities (given where Malaysia is located)

Investment guidelines to focus on:

- Expected performance relative to the benchmark on a total return basis
- Risk parameters consistent with the performance target

Risk parameters need to be:

- Clearly defined
- Actionable by managers
- Consistent with the performance target
- Mutually consistent
- Appropriate to each manager's investment process

DEFINING RISK PARAMETERS

Tracking error tends to be the most widely accepted measure of overall portfolio risk

- It is a measure of the difference between portfolio return and benchmark return
- Can be measured ex-post (after the fact) or ex-ante (on a predictive basis)
- Ex-post tracking error is often used in analyzing past performance but is not used as a risk management guideline
- Typical practice for risk management is an ex-ante tracking error range

Other typical risk parameters:

- Equities mandates – region, sector and stock limits relative to benchmark
- Fixed income mandates – region, sector, duration and security limits (the latter often by credit quality)

TYPICAL BENCHMARKS AND TRACKING ERROR

Capability	Typical Benchmarks	Typical Tracking Error Range*
Global equities	<ul style="list-style-type: none"> • Dow Jones Islamic Market World Index • FTSE Shariah All-World Index • MSCI Global Islamic Index 	3% to 7%
Emerging market equities	<ul style="list-style-type: none"> • Dow Jones Islamic Market World Emerging Markets Index • FTSE Shariah Emerging Index • MSCI Global Islamic Index – Emerging Markets 	3% to 7%
Asia ex-Japan equities	<ul style="list-style-type: none"> • Dow Jones Islamic Market Asia/Pacific ex-Japan Index 	4% to 9%
Global Islamic bonds	<ul style="list-style-type: none"> • Dow Jones Citigroup Sukuk Index • HSBC/DIFX Sukuk Index 	2% to 4%

* Indicative ranges are calculated from five year realized (ex post) tracking errors sourced from eVestment Alliance for conventional benchmarks

CREDIBILITY OF TRACK RECORDS - GIPS

Global Investment Performance Standards (GIPS)

- **Voluntary set of ethical principles built on the foundation of fair representation and full disclosure of presenting investment performance**
- **Promote transparency by allowing investors to compare performance results across investment firms that use a standardized process for calculating and presenting investment performance**
- **Consistency in calculation and presentation of performance results, such as frequency of valuation, treatment of large cash flows and handling of accruals**
- **Full disclosure of important details on performance data presented such as fees, composite construction criteria, dispersion of returns, etc.**

BENEFITS OF GIPS

For Investors: Designed to provide assurance for investors who want reliable performance metrics based on the principles of fair representation and full disclosure

- **Recognized globally - 31 countries have formally adopted GIPS**
- **Foster trust**
- **Promote full-disclosure**
- **Updated regularly**
- **Promote confidence**

For Investment Managers: Designed to help investment managers on a voluntary basis build an environment of credibility and trust through compliance with the GIPS

- **Global passport**
- **Promote market efficiency**
- **Provide framework for stronger internal controls**
- **Provide credibility**

VISIBILITY OF TRACK RECORDS – UCITS FUNDS

Benefits of setting up track records using UCITS* Funds:

- **Wide acceptance as the most robust regulatory regime for offshore funds**
- **Favourable tax and regulatory environment**
- **Can be sold in a very wide range of countries**
- **UCITS track records are a highly effective shop window for managers' capabilities**
- **Majority of global managers have UCITS fund ranges domiciled in either Dublin or Luxemburg**
- **Dublin based UCITS funds have over \$1trillion in AUM, across 5000 funds and 350 providers****

Tax Status – Dublin UCITS Funds

- **Funds not subject to Irish tax on income or capital gains**
- **Non-Irish investors receive income distributions and redemption proceeds without deduction of withholding tax**
- **Double taxation treaties with over 45 countries reduce withholding tax burden on fund investments**

*Undertakings for Collective Investments in Transferable Securities

** As at Dec 31 2008. Source: Irish Funds Industry Association

KEY REQUIREMENTS TO BE RFP READY

- Stable organization with demonstrated commitment to investment management
- Well resourced and stable investment team
- Transparent and credible investment philosophy and process
- Sound risk controls
- GIPS compliant track record:
 - Generally of at least five years in length
 - Sufficient AUM to be credible
- Strong operational and compliance infrastructure
- Well developed client service capability

INVESTOR DUE DILIGENCE

Following the request for proposal (RFP) process and "beauty parade", typical practice is for a half to full day due diligence visit to the investment manager's office

Focus is on operations and compliance as well as the front office

Typical content of due diligence visits:

Front Office

- **Meet with senior management, CIO, portfolio managers and analysts**
- **View live demonstrations of key portfolio management tools**
- **Talk through examples of how particular stocks got into the portfolio**
- **Discuss risk guidelines and how they are implemented**
- **Review portfolio positioning and attribution**

Operations and Compliance

- **Meet with Chief Operating Officer, Chief Compliance Officer and Head of Operations**
- **Review and discuss:**
- **Key policies and procedures (pre-trade compliance, trading, proxy voting etc.)**
- **Segregation of duties**
- **Monitoring tools and processes**
- **Compliance reporting**

PROFITABILITY

Key drivers of profitability:

- Product scale - it is vital for managers to manage a limited number of strategies each with large AUM, rather than a proliferation of different strategies, each with small AUM
- Use of UCITS funds for smaller investments- smaller amounts (e.g. below US\$50m) should go into UCITS funds, not individual portfolios
- Leverage of resources, including outsourcing
- Appropriate pricing
 - Fees should be consistent with global practice for the relevant capability and commensurate with value added potential

Thank You

CIMB-Principal Islamic Asset Management Sdn Bhd
Full spectrum of Islamic investment solutions
customized to best meet global investors' needs and objectives.

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