Islamic asset mgt needs products, distribution to thrive

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* Islamic asset management has strong growth potential

* Products and distribution channels are lacking

* Larger industry needed to shore up sukuk markets

By Frederik Richter

MANAMA, Oct 25 (Reuters) - The infant Islamic management industry lacks a large enough range of products and distribution channels to increase to challenge its conventional peers in catering to Muslim wealth, experts said.

The nascent $1 trillion Islamic finance industry is walking a fine line between replicating conventional products and establishing its own genuine products that adhere to Islam's prohibition of interest.

Asset management is seen as a sector where the industry could easily create products according to its own set of values, but it has not yet established the range of products to compete with conventional asset management.

There were some 750 Islamic mutual funds with less than $50 billion under management as of the first quarter of 2009, a fraction of global asset management, and there are only 14 funds larger than $500 million, according to a report published by Ernst & Young this year.

"The demand is there, but we need products, products, products," said John Sandwick, an Islamic asset management consultant.

"Pension funds are coming up in the Middle East," he said, adding that the nascent but strongly growing Islamic insurance industry, or takaful, particularly in Saudi Arabia, will also give a boost.

Experts said that it has been a weakness of Islamic fund products to focus on equities and real estate, not offering the comprehensive asset diversification of conventional funds that typically allocate a large portion to fixed-income investments.

"There is still a gap in terms of plain vanilla products," said Mark Smyth, managing director at consultancy Failaka.

Saudi Arabia and Malaysia are the only two Muslim markets with strong retail banking.

Smyth said Islamic fund managers were caught between catering to the contested Malaysian retail market with very low margins and creating off-shore funds to target Gulf Arab institutional investors.

But these, including the multi-billion sovereign wealth funds managing the region's oil wealth, are almost exclusively investing in conventional products, he said.

"To attract liquidity without existing clients is very difficult," he said. "It's very difficult for Islamic funds to get it off the ground, and they're all saying it's distribution."

Islamic asset managers are prohibited from investing in companies that are highly leveraged and in certain sectors, such as financials, alcohol and gambling.

SUKUK INJECTION

A bigger Islamic asset management industry would give a much needed money injection to the market for sukuk, or Islamic bonds, a key product of the industry.

Issuance fell by more than half to $14.9 billion last year, Standard & Poor's has said, and issuance in the Gulf Arab region this year has entirely hinged on issuance from governments and state-affiliated institutions.

This in turn would provide asset managers the much needed fixed-income component, for which they have in so far used short-term money market instruments such as murabaha.

Only a handful of sukuk funds exist today, Failaka's Smyth said.

"There is this wall between the products and the money that needs to be torn down," said Silke Bernard, a Luxembourg-based lawyer specialising in funds at law firm Linklaters said.

She said Islamic funds lacked access to the large distribution platforms used by asset managers and that Islamic funds often lacked the required minimum size of typically $100 million and a track record of several years required by large asset managers.

(For a Reuters story on the conventional fund industry in the Gulf Arab region, click on [ID:nLJ87845]) (Click on [ID:nISLAMIC] for more Islamic finance stories and ISLAMIC for a speed guide)

(Reporting by Frederik Richter; Editing by Sugita Katyal)