

MMFs Central to AUM Divergence in Major Islamic Fund Domiciles

MMF Demand Supports Saudi Arabian AUM in 1Q20

Saudi Arabia and Malaysia are the pre-eminent Islamic fund domiciles. The widespread declines of assets under management (AUM) in mutual funds in 1Q20 that resulted from the coronavirus pandemic had materially different effects on the Islamic funds in these two markets.

AUM in Saudi Arabian Islamic mutual funds increased by around 3% in aggregate, while AUM in Malaysian Islamic funds decreased by around 15%. As a result, Saudi Arabia is now larger than Malaysia in terms of Islamic fund AUM. However, tax and policy initiatives in Malaysia, such as the five-year Islamic Fund and Wealth Management Blueprint and increased innovative offerings, including sustainable and exchange-traded funds, may result in the sector's incremental growth.

Saudi Arabian Islamic funds are dominated by money market funds (MMFs). As in other markets, investors responded to the pandemic by increasing exposure to liquid assets such as MMFs, resulting in Islamic MMF AUM increasing by around 14% in 1Q20. Other asset classes had outflows, although the relatively small size of these fund types in Saudi Arabia mitigated the effect on overall industry AUM.

In contrast, all Islamic fund types in Malaysia, except bond funds, had outflows in 1Q20. Islamic MMFs had outflows of 8% while Islamic equity fund assets fell by 20%, similar to the decline in Saudi Arabia.

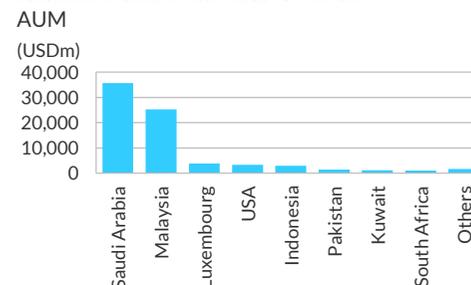
What to Watch

Recovery Scenarios: Saudi Arabia may be more vulnerable to future Islamic fund AUM declines than Malaysia in the event of a sustained market recovery. In *Korea*, MMFs had strong inflows in the early stages of the pandemic, followed by sharp outflows as restrictions decreased. Were this pattern to hold in Saudi Arabia, aggregate Islamic fund AUM could decline overall, given the MMF dominance, whereas Malaysia's more balanced Islamic fund mix means that aggregate Islamic fund AUM are less sensitive to developments in any one fund class.

Concentration Risk: The Islamic fund sector is substantially more concentrated in Saudi Arabia than in Malaysia. Not only is the Saudi Arabian Islamic fund segment significantly concentrated on MMFs, it also has fewer Islamic funds (around 200) than Malaysia (around 275), and the largest funds represent 80% of total AUM, which is considerably larger than Malaysia's 46%. Issues in larger Islamic funds in Saudi Arabia may have disproportionate overall market effects.

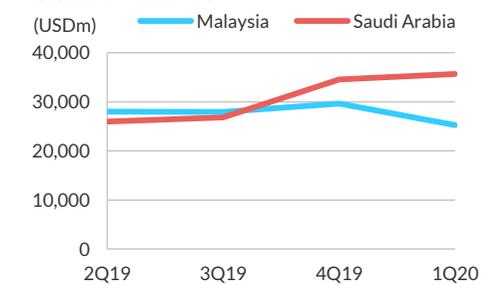
Minimum Regulatory Standards: While both Saudi Arabia and Malaysia have developed mutual fund regulations, MMF regulations are limited compared with international markets. For example, neither country specifies weighted average maturity limits (which are 60 days in the US and Europe). As a result, fund risk profiles may vary considerably.

Saudi Arabia and Malaysia are Largest Islamic Fund Markets Overall



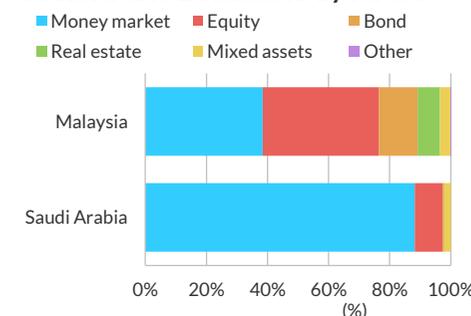
Source: Fitch Ratings, Lipper; 1Q20

Saudi Arabia Overtakes Malaysia in Islamic Fund AUM



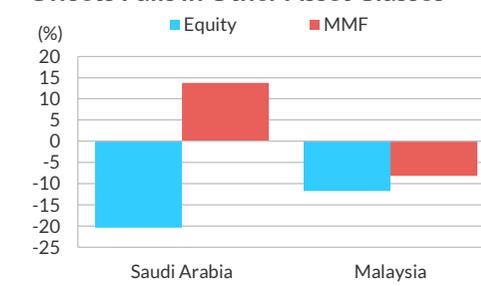
Source: Fitch Ratings, Lipper

Saudi Arabia Dominated by MMFs



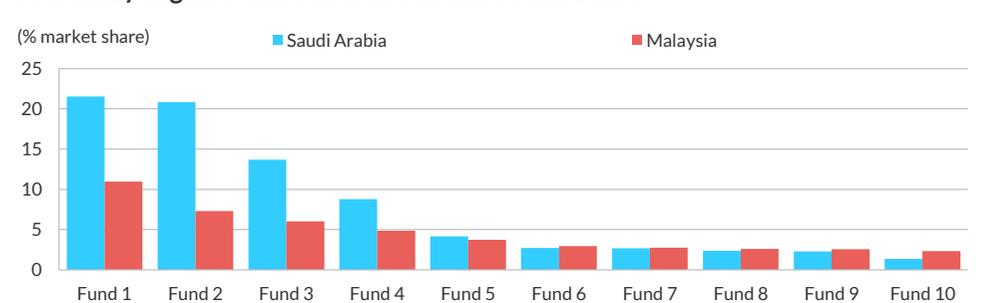
Source: Fitch Ratings, Lipper, 1Q20

MMF AUM Increase in Saudi Arabia Offsets Falls in Other Asset Classes



Source: Fitch Ratings, Lipper, 1Q20

Materially Higher Fund Concentration in Saudi Arabia



Source: Fitch Ratings, Lipper, USD-terms, 1Q20



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