BUILDING TRUST THROUGH FAITH

By promoting Sharia pension options we can do more to promote trust in financial services amongst underserved communities

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Workplace pension providers may not required to offer a Sharia option to staff, but employers do have an obligation to comply with the Equality Act. That is one reason why virtually all providers do offer a Sharia option. But despite the widespread existence of these options, they have until recently been relatively unsophisticated offerings, and they have rarely been given prominence as an option in the joining process.

For years, options for people wanting a Sharia pension have been very limited indeed, with a tech-stock heavy equity-only fund pretty much the only game in town.

For those who have jumped through the hoops required to access it, this has actually turned out to be a great choice, delivering stellar returns in recent years as the US tech giants have dominated markets.

But stock markets go in cycles and UK Muslims deserve better. So it is great to see that we are beginning to witness genuine innovation in the Sharia pension sector, with a number of new launches bringing lifestyling through Sukuk, which is effectively a Sharia-compliant instrument that shares bond-like qualities.

There is more that can be done – a step forward would be making the choice architecture more accommodating for those Muslims and non-Muslims looking for Sharia options. We know that most people are passive when it comes to selecting the investment options in their pensions. There is no point having an alternative if it is buried deep within the proposition.

This matters not just because it connects people to investments that match their beliefs, but also because it promotes that very valuable commodity – trust.

By offering tailored financial solutions that reflect the cultural and religious values of the Muslim community, Sharia-compliant investing demonstrates respect and understanding. These factors are essential for building long-term trust.

Sharia also promotes financial inclusion, enabling communities that might otherwise be excluded from mainstream financial systems to engage confidently in wealth-building activities. This trust fosters stronger relationships between financial institutions and these communities, paving the way for broader economic empowerment and social cohesion.

Sharia investing is not just about financial returns but about creating a just and equitable financial system that resonates with underserved communities, fostering trust and mutual respect.

SPOTLIGHT ON FAITH-BASED INVESTMENTS

ISLAMIC OPTIONS

Pension providers now offer a wider range of Sharia-compliant investments.
Muna Abdi finds out more

To date, Muslim savers have only had a limited choice of investment options for their workplace pensions. However, a number of providers are now expanding the range of Sharia-compliant investments available to ensure members have a variety of lifestyle and lower-risk options to choose from, while still investing in ways that align with their faith.

A Sharia-compliant fund (sometime spelled 'Shariah' in English) avoids investing in areas prohibited by Islamic law, such as firms involved in alcohol, gambling, and lending, as it is specifically forbidden to generate profits from interest. Funds are overseen by a board of Islamic scholars to ensure all underlying investments are compliant.

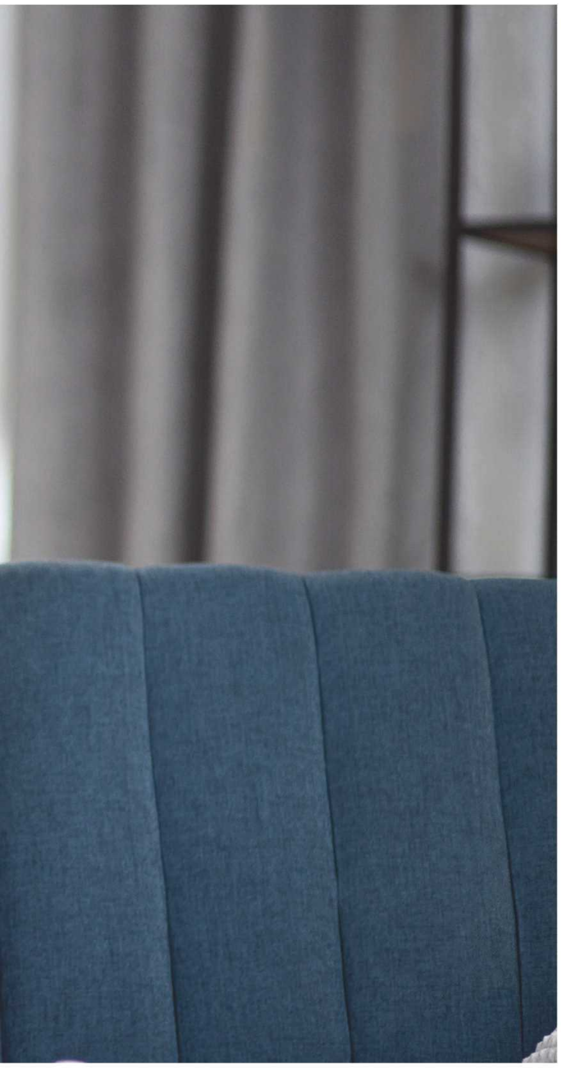
In terms of workplace pensions, many providers offer the HSBC Islamic Global Equity Index Fund, citing its reputable brand, strong industry presence, and cost-effectiveness as key reasons for their choice.

This is a 100 per cent passively managed equity fund, tracking the Dow Jones Islamic Market Titans 100 Index, which follows the largest 100 global stocks that comply with Islamic investment guidelines.

HSBC also offers other Sharia-compliant funds, including a global sukuk fund—a type of Sharia-compliant bond—and a Sharia multi-asset fund, though these are not always available in all UK workplace pensions.

Some providers note a lack of choice in selecting Sharia options. Nest's chief investment officer, Elizabeth Fernando, explains that until recently there have been relatively few Sharia-compliant products to chose from. "I think the reason [many providers] have ended up using the HSBC equities product is it's very high quality. It has a board of scholars overseeing it, so you're not just relying on an index provider interpreting faith appropriately; you have scholars performing that extra level of check for you. It's also a reasonably large fund, which helps with liquidity and access, and we've been able to negotiate very good terms for accessing it."

Legal & General Head of DC Investments Jesal Mistry agrees: "We were looking to partner with an organisation that was credible in this space, with the scale and



size in this area. There are other funds out there that are more actively managed, but some of them, from a pricing perspective, were more expensive."

However, there are some downsides to solely offering this HSBC fund. As a 100 per cent equity fund, it is less suitable for members who are more risk-averse, particularly those nearing retirement.

The composition of this index also means it is overweight in technology stocks, which can add to the risk profile. That said, this fund, like other Sharia-equity options, has performed well in recent years, leading some non-Muslim savers to invest as well.

Wider investment choice

The landscape has recently evolved with the emergence of more sophisticated lifestyle arrangements. Providers are now launching their own lifestyle solutions, integrating both sukuk and existing equity funds into their offerings.

Franklin Templeton, like HSBC offers standalone Sharia equity and sukuk funds, and is working with providers like Standard Life to use building blocks to build a Sharia glidepath option for members.

As Franklin Templeton's head of retirement Ian Hollingworth points out this can offer a more balanced approach to risk. "Until now many DC Sharia options have only be avaialble on a self-select basis, which requires the individual to be more engaging and make decisions about de-risking. But working with providers to offer glidepath options can offer an investment option more aligned to what is offered to non-Muslim members."

Meanwhile, Smart recently launched a Halal Workplace Pension in partnership with Wahed, offering managed investment glidepath to reduce risk as members approach retirement. .

Smart Pension director of investment proposition James Lawrence says this approach addresses the concerns of Muslim employees, who remain a particularly underserved part of the DC pension market.

Wahed head of UK private client services Abul Fazal Salahuddin says this offers asset diversification, transitioning from higher-risk equities to lower-risk sukuk, gold, and cash 15 years before retirement.

Previously Muslim members approaching retirement have been exposed to signficant volatility, for example in the 2020 market crash due to Covid-19. Wahed follows rules set by the Accounting and Auditing Organization for Islamic Finance Institutions (AAOIFI), with an independent review board to audit compliance.

Other providers are also adopting similar approaches. Legal & General, in partnership with HSBC, offers a range of Sharia-compliant options, including sukuk bonds and multi-asset funds, which include a Sharia-compliant lifestyle plan for members nearing retirement.

Mistry says this is an important part of L&G's DEI strategy, and should help enhance pension adequacy for ethnic minorities.

Meanwhile, Nest has adapted its Sharia-compliant fund for workplace pensions, shifting from a 100 per cent equity allocation to 70 per cent equities and 30 per cent sukuk bonds. Fernando says this will help drive more consistent returns over the long term, in all market conditions.

"Nest has wanted to reduce the risk levels of its Sharia Fund, but was previously restricted to investing only in one asset class due to the limited availability of suitable diversifiers—such as sukuk funds—at an affordable price. But the market has evolved over the last decade, and there are now more suitable offerings available."

She notes that the addition of sukuk may result in a slight reduction in the fund's real returns, it will significantly reduce volatility: "We expect a projected reduction in fund volatility of almost 4 perc ent—an annualised reduction rate from 14 per cent to 10.9 per cent."

She says this change will allow Muslim members to have a comparable risk profile to those in ethical funds or default strategies.

Tick-box exercise

Despite these changes, Hymans Robertson head of DC provider relations Shabna Islam points out that for many Muslim pension savers, Sharia-compliant options remain limited compared to conventional funds.

She says: "If you don't have that belief, then you've got a choice of hundreds or thousands of funds." She says she would like to see more options and a wider variety of lifestyle arrangements, including those targeting cash, annuity, or drawdown.

Salahuddin says many providers have been hesitant to adopt Sharia-compliant options due to a lack of understanding and expertise. In some cases, he says providers have included just one Sharia fund as a "mere tick-box exercise."

He also says a significant educational effort was needed between Wahed and trustees, investment management teams, and corporate advisers to clarify what Sharia compliance entails. He is optimistic this will change, as more companies introduce fully compliant, actively managed options.

Diversification

Experts say partnering with established asset managers in this sector, like Franklin Templeton and HSBC, and developing in-house solutions both have advantages, but providers also need to better evaluate investor needs.

They emphasise that members considering Sharia investment products should recognise that, while these options align with their values, they also involve concentration risks, particularly in tech stocks.

Mistry highlights the importance of diversifying Sharia-compliant equity funds, where possible, due to their concentration in US tech stocks. If this , sector underperforms, it could significantly impact these funds, he says, given nearly 50 per cent of these investments can be in the top 10 tech names. To mitigate this ▶

risk, L&G has introduced additional asset classes and options for members. "Equities can be very volatile and the heavy concentration, in US tech stocks, brings its own set of risks. Sukuk, on the other hand, has different risk factors that are more asset-based rather than market-driven. The limited choice in Sharia-compliant investments has restricted investors' experiences. However, we believe diversifying risks across different asset types can benefit members, especially as their fund values grow and they seek more stability in drawing their income over time."

Salahuddin also emphasises the importance of diversification, pointing out that relying on a single fund limits risk management.

To enhance diversification, Salahuddin explains that portfolios now incorporate multiple funds, increasing stock holdings to 300-400—compared to the 100 stocks in the single HSBC equity fund.

While some tech stock overlap remains, this approach broadens exposure to emerging markets, such as Latin America and the Far East.

Salahuddin highlights the inclusion of HSBC Sharia-compliant funds that track other indices, enhancing geographic and industry exposure, which he says is essential for a well-rounded investment portfolio.

Better communication

In most cases, Sharia-compliant investments are not the default choices for members, so engagement is crucial to encourage Muslim members to invest.

Smart has made its Wahed product the default for its members but stresses that engagement and good communication are central to its approach. Lawrence says Smart raises awareness through digital campaigns, app nudges and outreach in Muslim communities, promoting Sharia-compliant pensions to employers and advisers and using digital tools to boost engagement.

Wahed also emphasises that these offerings aren't solely for Muslim investors, using investment guides to explain Sharia compliance and highlighting differences between traditional and asset-backed bonds for those unfamiliar with Islamic finance. Wahed offers an educational series for accountants and decision-makers ensuring employers and employees are well-informed.

Islam notes that many employers rely on providers and standard communication channels to introduce Sharia-compliant products. She says employers should go further, evaluating these products' suitability and benefits for employees and clearly communicating this. Engaging internal community groups, such as Diversity, Equity, and Inclusion (DEI) forums, can help raise awareness and encourage use of these benefits.

Most employers have community groups within their organizations focused on minority groups, and tapping into this resource can be effective for communication. This is an important issue for employers, trustees and providers, particularly given the ethnicity savings gap.

Mistry says: "We need to focus much more on this. The Muslim population is growing, and we've seen a significant gap in savings between them and other communities." Having products that meet the needs of a wider range of Muslim savers and effectively communicating information about them can begin to address this problem, helping this faith-based group save for their future. ■

KEY ISLAMIC INVESTMENT TERMS

Riba (Prohibition of Interest)
Riba, or interest, is prohibited in Islamic finance, as it is seen as being exploitative in nature. For pensions, this means in focusing on asset-backed investments that provide stable, inflation-adjusted income without relying on interest, in compliance with Sharia principles.

Sukuk (Islamic Bonds)
Sukuk is a Sharia-compliant, interest-free alternative to bonds, offering returns from asset-backed projects. This stable income supports long-term growth aligning with the low-risk needs of pension portfolios.

Gharar (Prohibition of Uncertainty)
Gharar refers to excessive uncertainty in contracts, which is prohibited in Islamic finance to ensure clear and fair terms. For pensions, avoiding gharar means investing in products with well-defined risks, returns, and terms.

Mudarabah (Profit-Sharing)
A partnership model where investors and fund managers share profits based on a set ratio. For pension funds this offers growth potential and shared risk, ensuring stability for longer-term investments.

Musharakah (Joint Venture)
In this joint venture, both parties share capital, profits, and losses. This enables pension funds to invest in halal sectors, ensuring fair distribution of risks and rewards that support long-term growth.

Ijara (Leasing)
Ijara allows pension funds to earn returns from rental income instead of interest. This offers steady, sustainable Sharia-compliant income that can meet pension funds' long-term growth ambitions.

Takaful (Islamic Insurance)
Takaful is a mutual risk-sharing system, and avoids profit-driven insurance models.

SPOTLIGHT ON FAITH-BASED INVESTMENTS

PRINCIPLED INVESTMENT

Providers have developed sophisticated investment strategies catering to a range of ESG preferences. Many investors now also want options aligned to religious beliefs and personal values. **Niamh Smith** finds out more

ESG investment strategies have become increasingly sophisticated, with funds now tailored to a range of investor preferences. While most of these focus on sustainability issues — many investors also want to see strategies that reflect religious beliefs and personal values.

Religion might be deeply personal, but common values exist between the millions who adhere to each of the main faith groups. In the UK almost half (46.2 per cent) of the population identifies as Christian, while 6.5 per cent are Muslim, according to the latest Office for National Statistics census on the topic.

Many pension scheme members have strong religious beliefs, which has led to a growing interest in faith-based investment strategies.

These investments can fall under the broader category of impact investments, which seek to generate positive social and environmental outcomes alongside financial returns. But these faith-based investments will also seek to align with the specific beliefs of these different groups — with strategies varying depending on the unique missions, ministries, goals and values of each faith tradition.

Increasingly such funds are no longer being viewed as a 'tick box' for asset managers and pension providers, but instead seen as an important way to improve engagement, retirement adequacy and customer satisfaction.

Sin stock exclusions

Several faith-based investment strategies are available. For example, the CCLA Catholic Investment Fund acts in alignment with the mission of the Catholic Church to deliver positive change in society, while BlackRock's Catholic Charities Growth & Income Fund also excludes direct investments in companies which profit from products like alcohol, gambling and pornography.

Many faith-based organisations that offer these types of investments will also make similar exclusions in their strategies, in order to avoid investing in stocks that are contrary to the moral and social teachings of their faith.

For example, investment strategies tailored to Catholics would typically avoid investing in abortion, armaments, capital punishment, embryo stem cell research and animal abuse because they contradict what the Church considers the intrinsic dignity of human life.

However, Matthew Jensen, director of faith-consistent investing at FaithInvest, says that rather than just excluding so-called "sin stocks", faith-based investment strategies also need to focus on actively directing money to help make a material change and deliver a wider impact in the world.

"Many faiths know what they don't want to do, and when we work with faith-based asset owners, they often have restricted lists, so the challenge is about really determining what they want to do with their assets," he says.

Dave Zellner, executive chair of FaithInvest, adds that although exclusions are an important first step to developing a faith-consistent investment portfolio, they are not sufficient to achieve a broader impact for the good of people and the planet. This requires a more comprehensive strategy.

"While exclusions are an important element of faith-aligned investing, increasing numbers of faith-aligned investors are adopting a more nuanced and impactful approach that incorporates three elements: invest, engage, and avoid," he says. "Such a strategy allows an organisation to maintain strong financial performance, while more actively pursuing its mission of driving positive change."

Meeting different beliefs

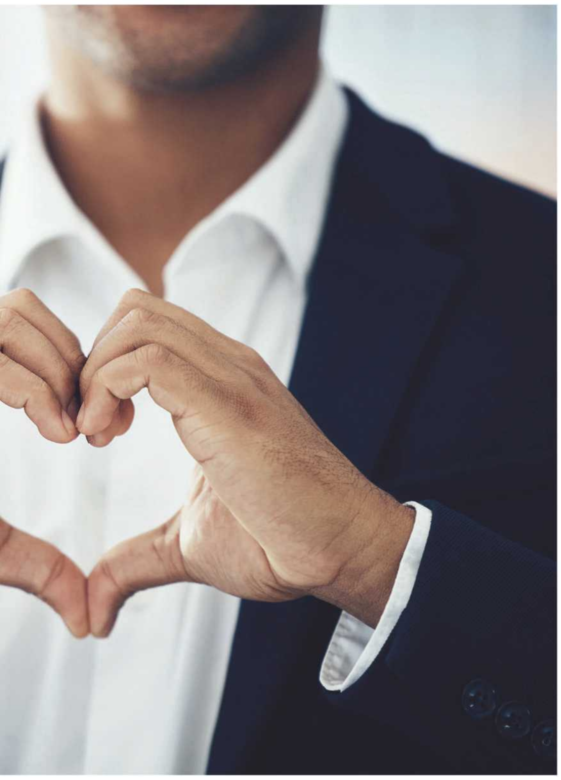
When it comes to providing faith-based strategies, it is important for providers to understand that there is no one-size-fits all, notes Susie Weldon, director of communications at FaithInvest.

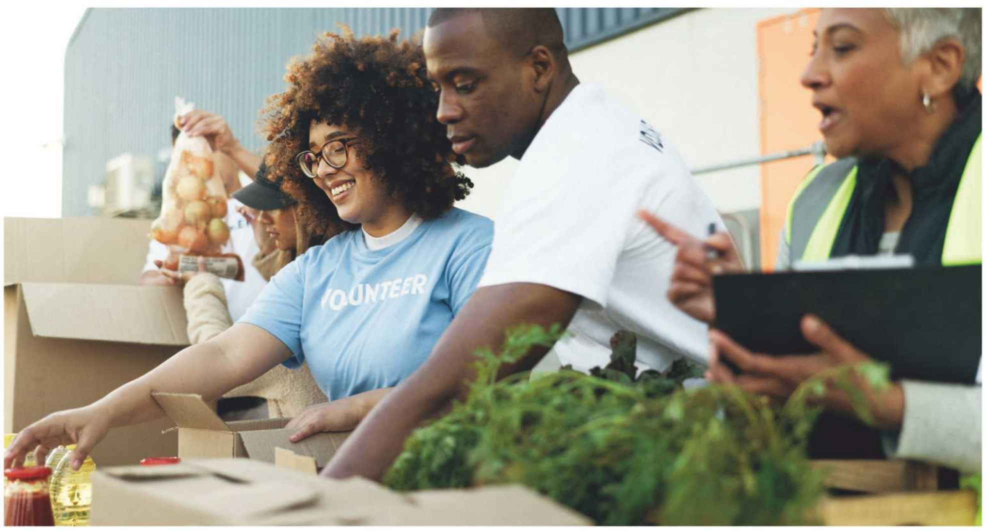
She says that while many faith traditions share common values, such as care for the poor and vulnerable, human dignity and

social justice, each faith organisation will be different in terms of the emphasis they place on these principles in their investment strategies.

"One faith group might focus on the principle of stewardship to emphasise responsible management of resources which, in investment terms, may translate to a focus on long-term value creation rather than short-term gains. But another might focus on the concept of human dignity to prioritise investing in companies with strong labour practices and community engagement."

As values are a deeply personal thing and can differ from person to person even





within the same religion, this actually presents an opportunity for providers to review how existing options could be positioned to meet investor's different beliefs and values before they create a separate faith-based fund, according to Jesal Mistry, head of DC investments at Legal and General.

"We're looking to take part in a review looking at whether we should offer other faith-based type funds, or are they more general ethical-type solutions?" he says. "We have lots of sustainable solutions already available, could they be better communicated so they meet the requirements of other faiths?"

However, he cautioned that this doesn't apply to all faith-based investments. For example, Sharia-compliant investment strategies must strictly adhere to Islamic law, which means Sharia funds avoid investing in bonds or other interest-bearing investmnets.

Maiyuresh Rajah, director of investments at Aviva agrees that some providers do not realise that existing strategies could already be meeting the beliefs of some investors.

"A number of our clients that are religious organisations use our sustainable stewardship default strategy." Rajah adds that this won't cover all faith-based groups, which is why it also offers Sharia-compliant funds.

Meanwhile, faith-based investments may not cater solely to religious beliefs—they can also align with personal values and lifestyles, such as vegetarianism or veganism, to meet the diverse beliefs of all investors.

Animal rights organisation Peta has created a guide to cruelty-free funds and US-based firm Beyond Investing offers the US Vegan Climate ETF, which aims to avoid investments in companies that contribute to animal suffering, environmental destruction and climate change.

Creating products for all

Although trustees' fiduciary duties centre around acting in the best financial interests of members, many members are now expecting trustees to consider non-financial factors, such as their personal beliefs and values, especially if it doesn't negatively impact financial returns.

Aviva's spokesperson said where possible, pension providers should seek to reflect the diversity of their customer base with the investments they offer. This includes offering lifestyle solutions and funds catered to different ethical or religious beliefs, as well as common requests such as different price points and different levels of investment sophistication.

Growing demand for investment strategies aligned to personal beliefs, not only meets consumer expectations but can also help close pension savings gaps and enhance retirement adequacy, Mistry adds.

Legal & General first started exploring faith-based investments when it was trying to drive increased participation and savings rates across the board. When research revealed an ethnicity pensions gap, the firm realised the right solutions weren't available to its Muslim members, which led to the creation of its first Sharia-compliant investment strategy.

Mistry says that it was important to ensure this product was similar to other DC default options, so it's simple for investors to access, meaning they don't have to be an investment expert to invest in a way aligned with their beliefs.

"That was really important because that means that we can now work with employers to provide it to people as part of their new joiner journey or communicate to employees that there's something ready-made and easy for you to join," he says.

This provides a good foundation to close the pensions savings gap, he says, but more education and communication is needed to make sure all members are fully aware of these options. ■

Q&A

SMARTER SHARIAH OPTIONS

» **Lee Hollingworth** head of retirement policy, Franklin Templeton (left) and **Callum Stewart** head of investment proposition, Standard Life

Franklin Templeton head of retirement Lee Hollingworth says asset managers are now offering a wider range of Shariah investment products. He and Standard Life head of investment proposition Callum Stewart explain how this should encourage more Muslim employees to save into DC workplace schemes.

What faith-based fund options are available to Muslim members of DC workplace schemes?

LH: Most DC schemes now offer access to Shariah-compliant investment funds on a self-select basis. These are typically equity funds meeting Islamic finance principles, meaning they avoid interest-bearing assets and do not invest in shares of companies involved in alcohol, gambling or other activities prohibited under Shariah law.

But participation remains relatively low. According to ONS data, around 6.5% of the UK population identifies as Muslim, yet a smaller percentage of DC scheme members invest in Shariah-compliant funds.

There are several reasons for this: not all Muslims may require or want a strict Shariah-based investment fund, and poor communication from employers could mean some are unaware of these options. But there is also the issue that a 100% equity strategy won't suit more risk-averse Muslims, particularly those approaching retirement.

Recognising this, Franklin Templeton now offers a fund investing in Sukuks — Shariah-compliant debt securities. This offers a lower-risk option when compared to an equity-only approach.

How can these help with life-styling and default strategies?

CS: Currently, we make Shariah equity, Sukuk and Multi Asset funds available for people as self-select options, meaning members must choose how their money is invested, and when to move towards lower-risk Sukuk options. In contrast, these decisions are made for most DC members though managed default glidepaths.

At Standard Life, we can now start to utilise these specialist Sukuk funds to offer similar options for Muslim members. We are working with asset managers like Franklin Templeton to create life-styling strategies. This ensures a smoother process for savers who might not be familiar with managing risk in their pensions.

Modelling suggests that a portfolio of 60% Shariah equity and 40% Sukuk funds could reduce overall risk by about 50%, while still delivering around 70% of equity market returns

This will require cooperation from employers, to ensure employees know that this is one of the pathways available. Eventually, we expect this could become the main default option for companies with a high proportion of Muslim employees.

How have Shariah-compliant investments performed?

IH: Over the last decade, Shariah equity funds have delivered strong returns. However, they have also experienced higher levels of volatility. Sukuk funds have a low correlation with Shariah equity funds, providing effective diversification. Modelling suggests that a portfolio of 60% Shariah equity and 40% Sukuk funds could reduce overall risk by about 50%, while still delivering around 70% of equity market returns. This offers Muslim a more balanced approach to risk and return.

Why is this important from a diversity and inclusion perspective?

CS: Tailored investment solutions are crucial for securing the long-term financial well-being of all members, including those of Islamic faith. Census data shows that only 45% of Muslims live in owner-occupied households, compared to 63% of the general population. This suggests that Muslims might face additional financial pressures in retirement, making it even more important to ensure their pension investments are working for them.

Not all Muslim employees are currently saving into workplace pensions, which may be due to more complex cultural or economic factors. In the past, one of these barriers may have been a lack of suitable investment options. We are working to ensure that this is no longer the case in future — with Muslim employees already able to access a range of Shariah-compliant investments from Standard Life that align with their values.

How does governance work on these funds?

IH: All our Shariah-compliant funds must be independently verified by a board of Islamic scholars, who ensure that the investment objectives and strategy adhere to Shariah law and provide ongoing monitoring of portfolio holdings.

We also screen for over a 150 Shariah standards to produce a Shariah Compliance Score for each Sukuk that is standardised and transparent. Many Sukuk funds finance projects in Islamic countries, adding an ethical dimension to these investments that may appeal to Muslim savers who value the societal impact of their portfolios. ■