

Gold in Islamic Finance

Andrew Naylor, Director, Central Banks and Public Policy | May 2018

About the World Gold Council

The World Gold Council is the market development organisation for the gold industry – working to stimulate and sustain demand for gold.

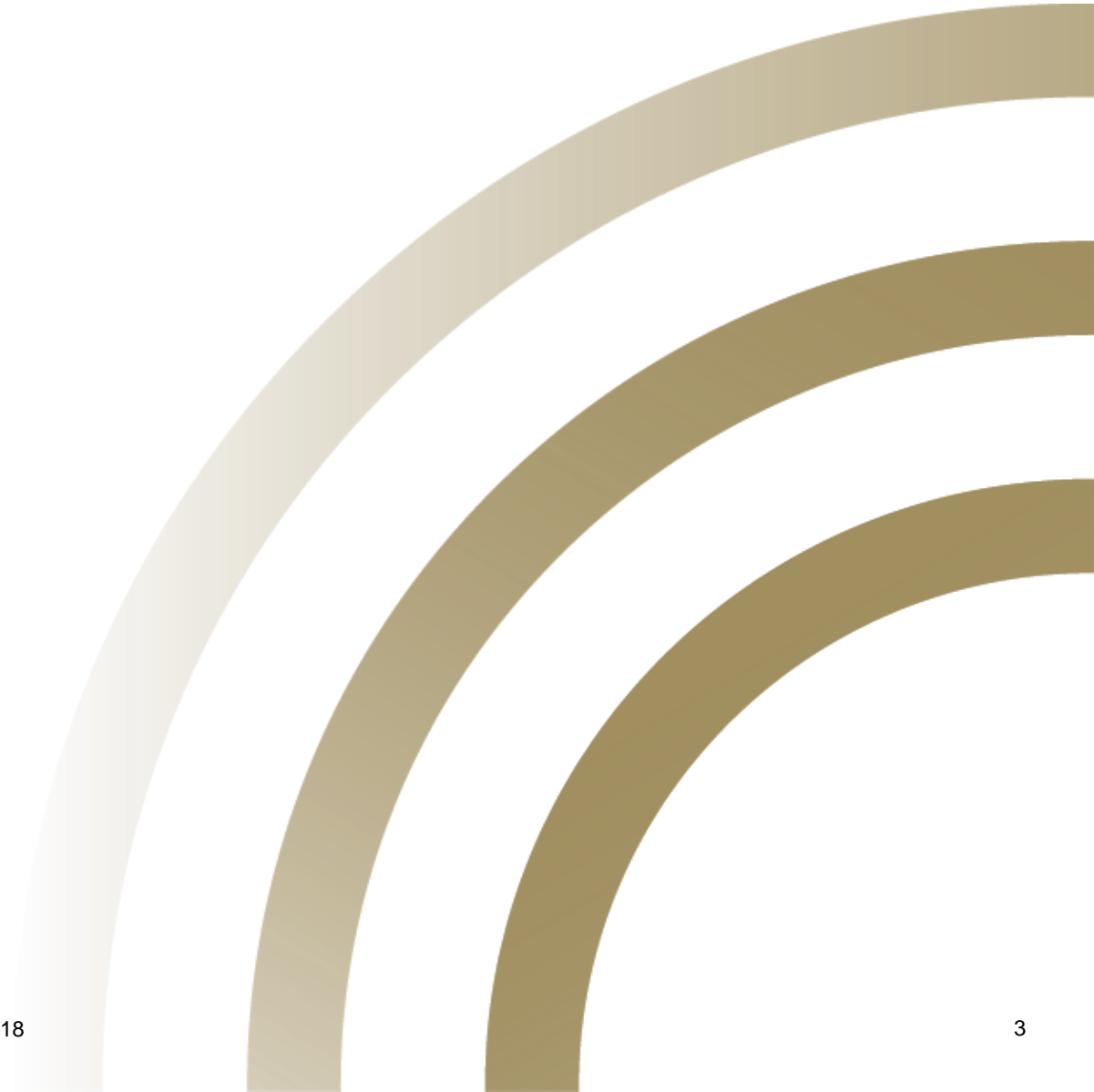
We develop gold-backed solutions, services and products, based on authoritative market insight and we work with a range of partners to put our ideas into action.

As a neutral and unbiased authority on gold, we provide insights into the international gold markets, helping people to understand the wealth preservation qualities of gold and its role in meeting the social and environmental needs of society.

The membership of the World Gold Council includes the world's leading and most forward thinking gold mining companies.

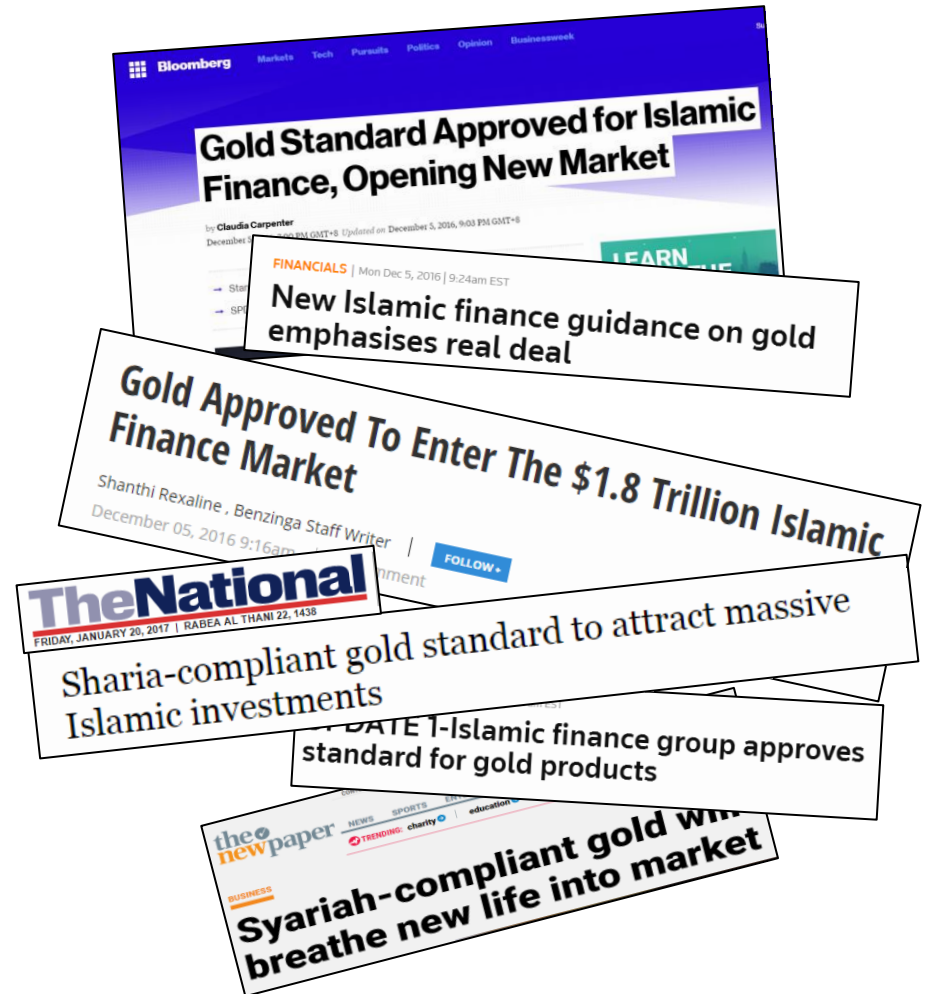
www.gold.org

AAOIFI Shari'ah Standard on Gold



AAOIFI Shari'ah Standard on Gold

- The World Gold Council worked with AAOIFI (Accounting and Auditing Organisation for Islamic Finance Institutions) on the launch in 2016 of a Shari'ah Standard for the gold market.
- IFSB Financial Stability Report 2017: AAOIFI Standard on Gold sets a “precedent that initially contradictory opinions can converge and finally allow a collective Fatwa”
- New Shari'ah-compliant investment products are now available.
- Available online at www.shariahgold.com



Why was a Standard needed?

- Gold has a long history as a currency in Islam, but its use as a commodity was less certain.
- Whilst some banks offer Shari'ah-compliant gold, there was a lack of international consensus on the Shari'ah treatment of contemporary gold products
- This “grey area” status means that the gold market has failed to develop in the same way as conventional markets.
- For Islamic finance to reach its full potential, new products are needed to meet contemporary financial needs.
- The AAOIFI Shari'ah Standard on Gold means that more sophisticated gold products can now be developed.

Benefits of the Standard:

Ensures
Shari'ah
Compliance

Increases
Product
Innovation

Opens up a
\$2trn Market

New Hedging
Opportunities

A Safe Haven
for Islamic
Finance

Key principles

1. Gold must be **traded on a spot basis** (hand-to-hand). Conventional forwards and futures are not permissible.
2. Gold can be **owned on a physical or a constructive basis**. This very important as it allows gold products to be structured.
3. In the case of constructive possession, **gold has to be fully allocated**. Unallocated gold is not permissible.
4. Allocation can occur through either T+0 settlement OR the receipt of a certificate/email **specifying bar ownership**.
5. It is **permissible to own gold jointly**, where each partner owns an undivided beneficial interest in a trust. This is important for structuring purposes, such as for some physical gold ETFs.

Shari'ah Compliant Gold Products

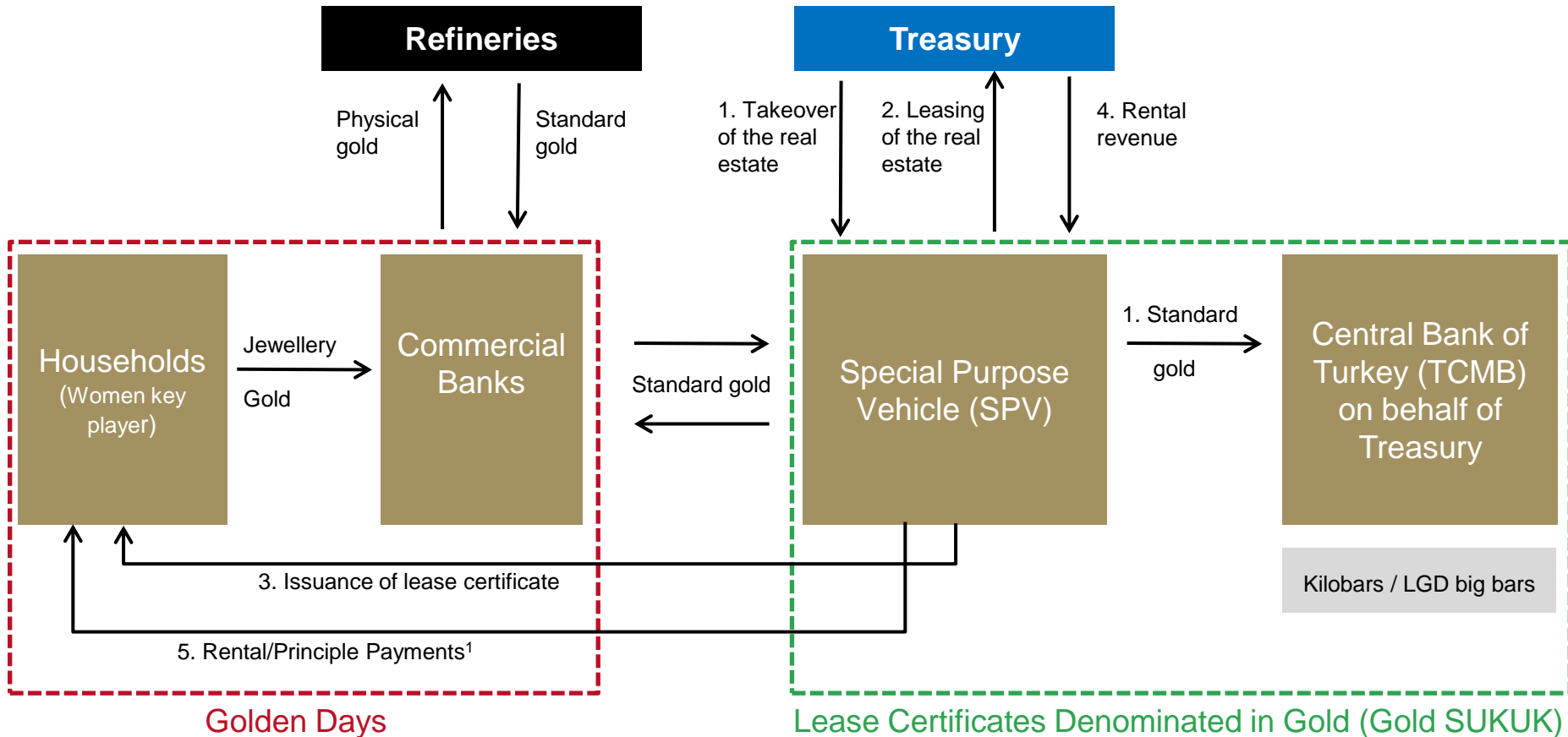


Key products

1. **Gold investment accounts** - ad hoc purchases of gold, vaulted on the investor's behalf
2. **Gold savings plans** - regular purchases of gold, vaulted on the investor's behalf
3. **Gold certificate programmes** – ad hoc or regular purchases of gold, evidenced through the issuance of a certificate
4. **Physical gold ETFs** - fully-backed gold funds traded on an exchange
5. **Gold spot contracts** – exchange traded contracts
6. *In addition there are a number of other transactions and uses of gold covered by the Standard, including gold as capital (Salam), gold leasing (Ijarah), gold collateral (Rahn), security deposits (Hamish Jiddiyyah), unilateral promises (Wa'd)*

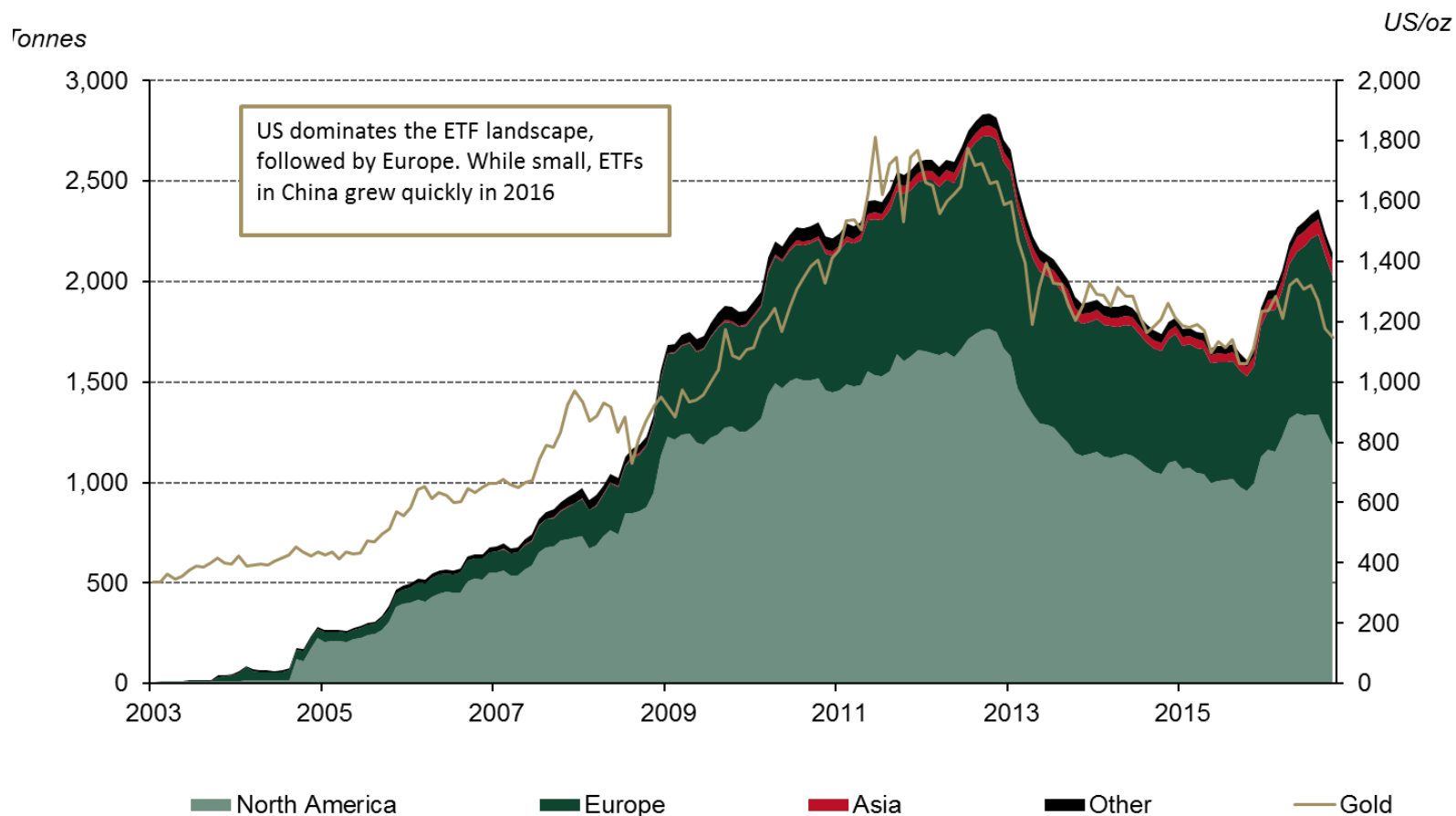
Key products – Gold Sukuk

Turkish Treasury launched a gold backed Sukuk (Ijara) in 2017 to mobilise 2200 tonnes of household gold:



¹Rental payments in TL indexed to gold prices; principle payments in standard gold (options: most liquid Turkish gold coin - Ceyrek - or kilobar)

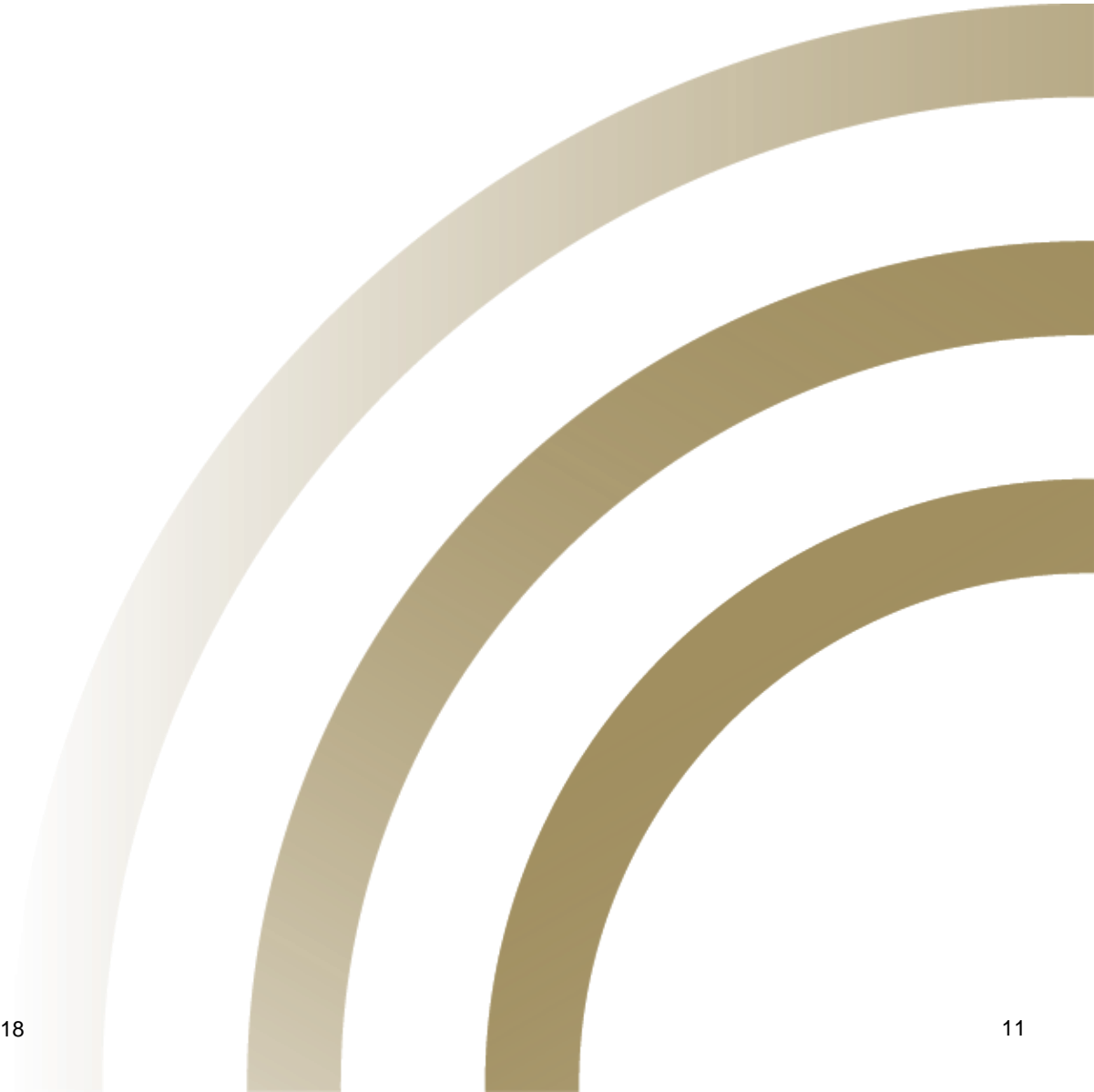
Key products – Gold ETFs



Sources: Respective ETP providers, Bloomberg, LBMA, World Gold Council

Note: Gold holdings are as reported by the ETF/ETC issuers. Where data is unavailable, holdings have been calculated using reported AUM numbers.

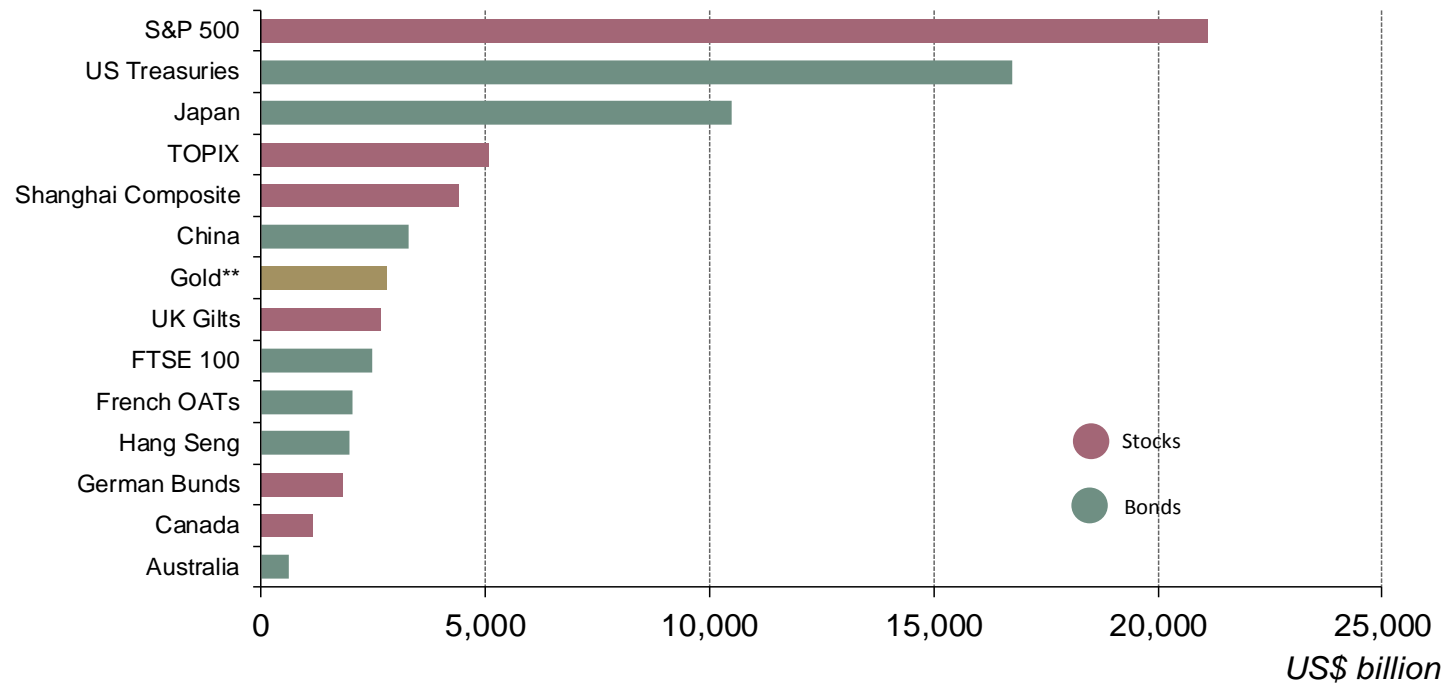
Case for Gold in Islamic Finance



Gold is a mainstream asset that is as liquid as other major financial securities

Gold market larger than many major stock and bond markets

Market size of major global financial assets in US\$*



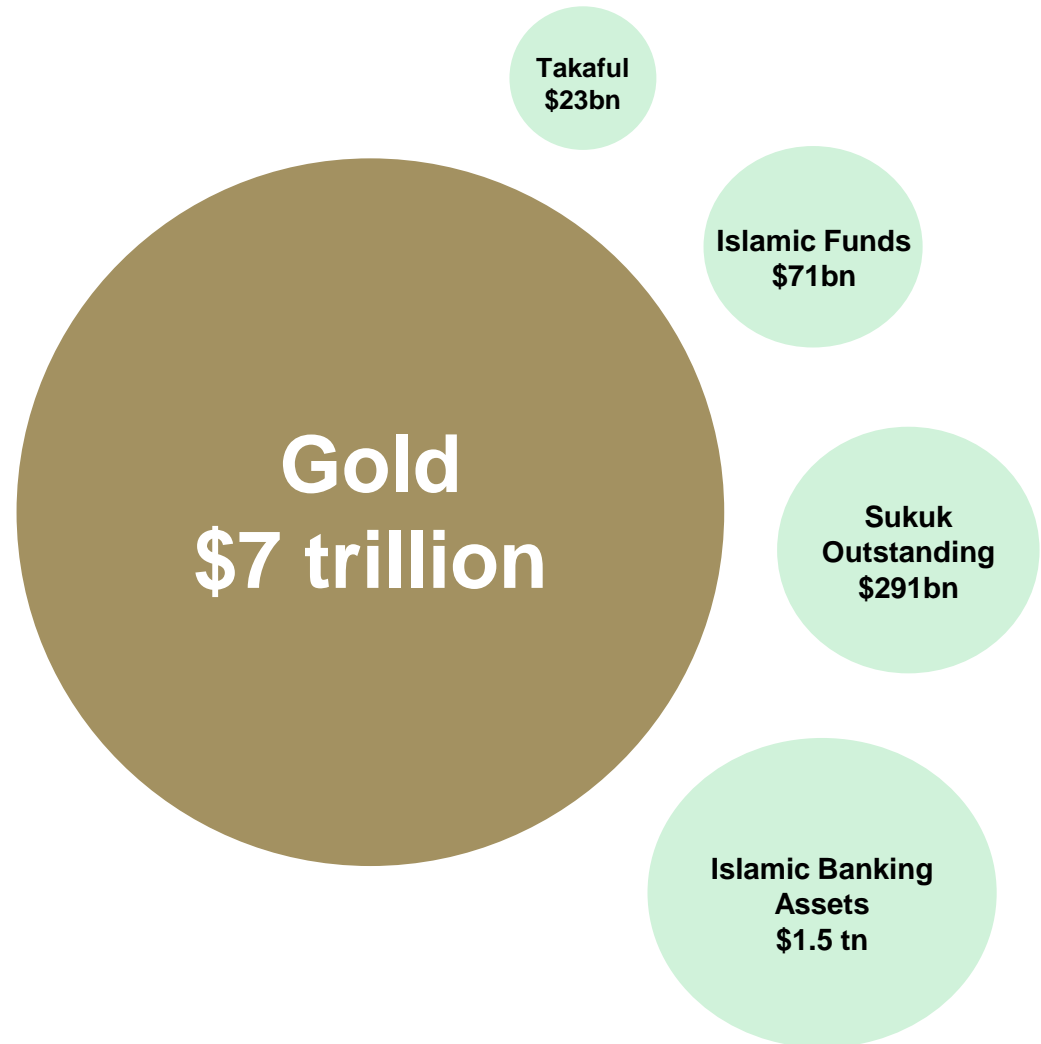
*As of 31 March 2017 where available, otherwise most recent data published.

**Includes bars, coins, gold-backed exchange-traded products and official sector holdings.

Source: World Gold Council; BIS, Bloomberg, Thomson Reuters GFMS, ICE Benchmark Administration

The gold market is larger and more liquid than major Islamic asset classes

- Gold has a market capitalisation of \$7 trillion* - 24 times larger than the outstanding volume of sukuk
- Average daily turnover on the London OTC market is \$240 billion, making it more liquid than both the German and UK sovereign bond markets
- New gold products have improved investor access to gold, boosting the size and liquidity of the global gold market

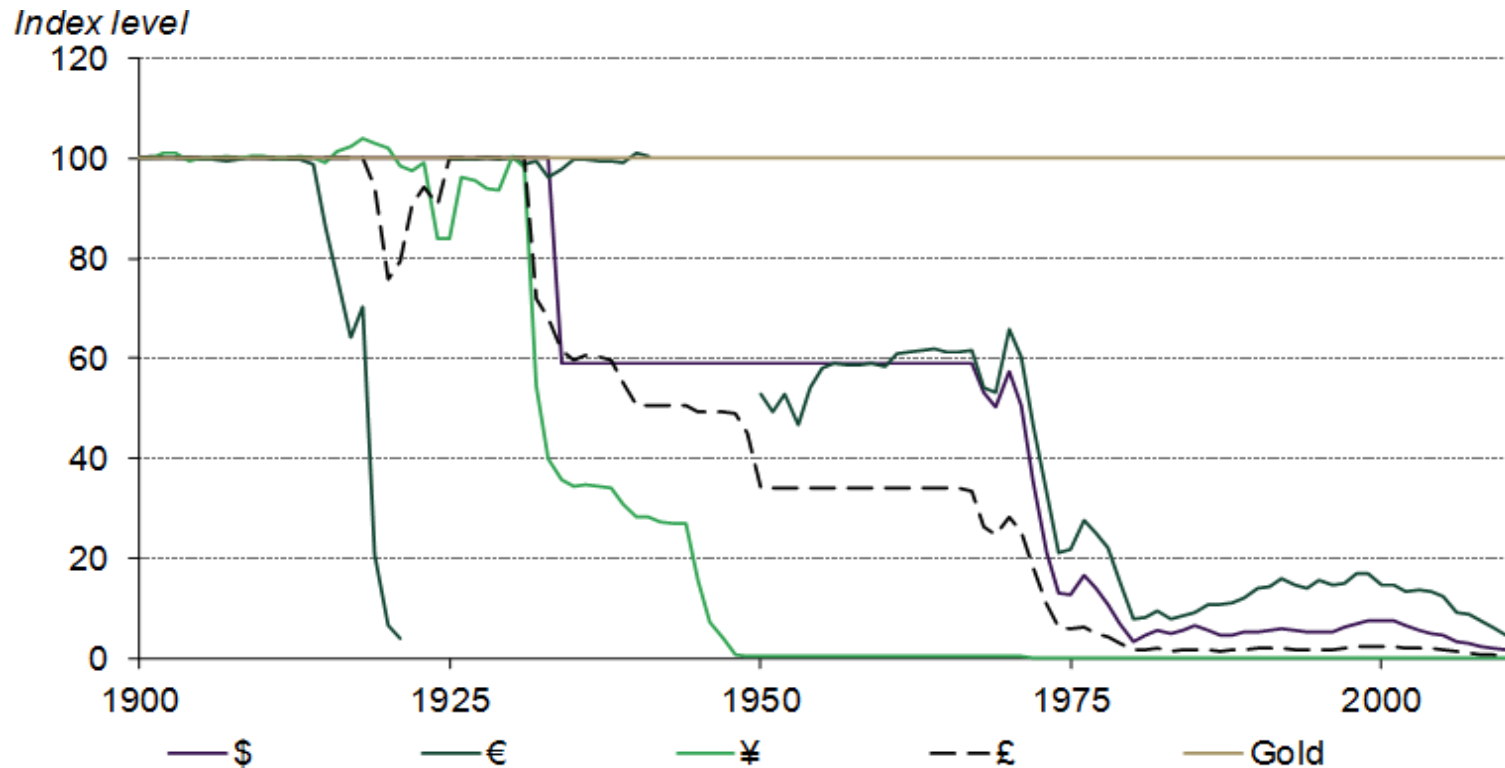


*Includes jewellery

Source: World Gold Council; IFSB

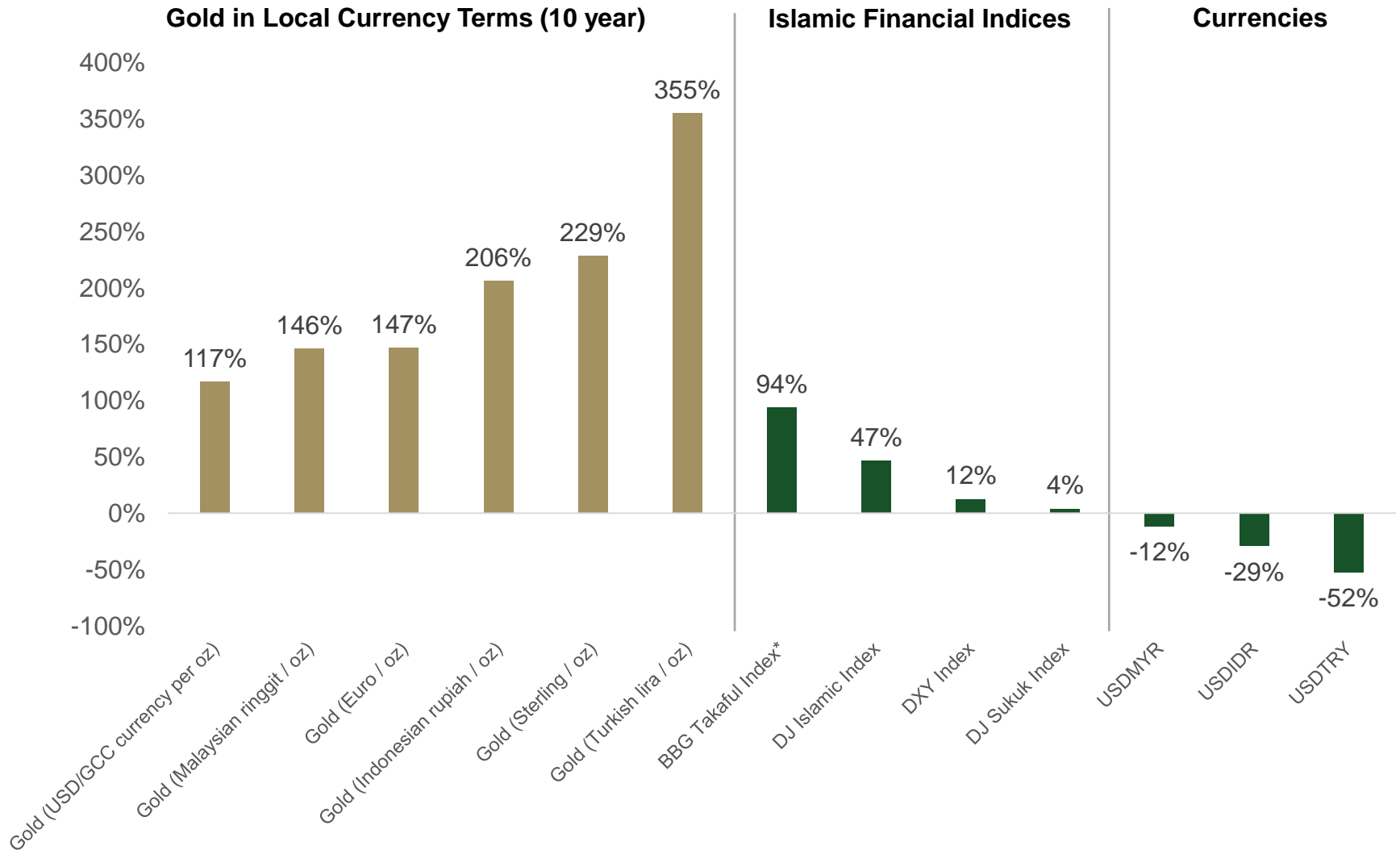
A long-term wealth preservation tool

Gold vs. Major World Currencies (1900-Present)



Source: World Gold Council; Bloomberg

Gold outperforms other Islamic asset classes



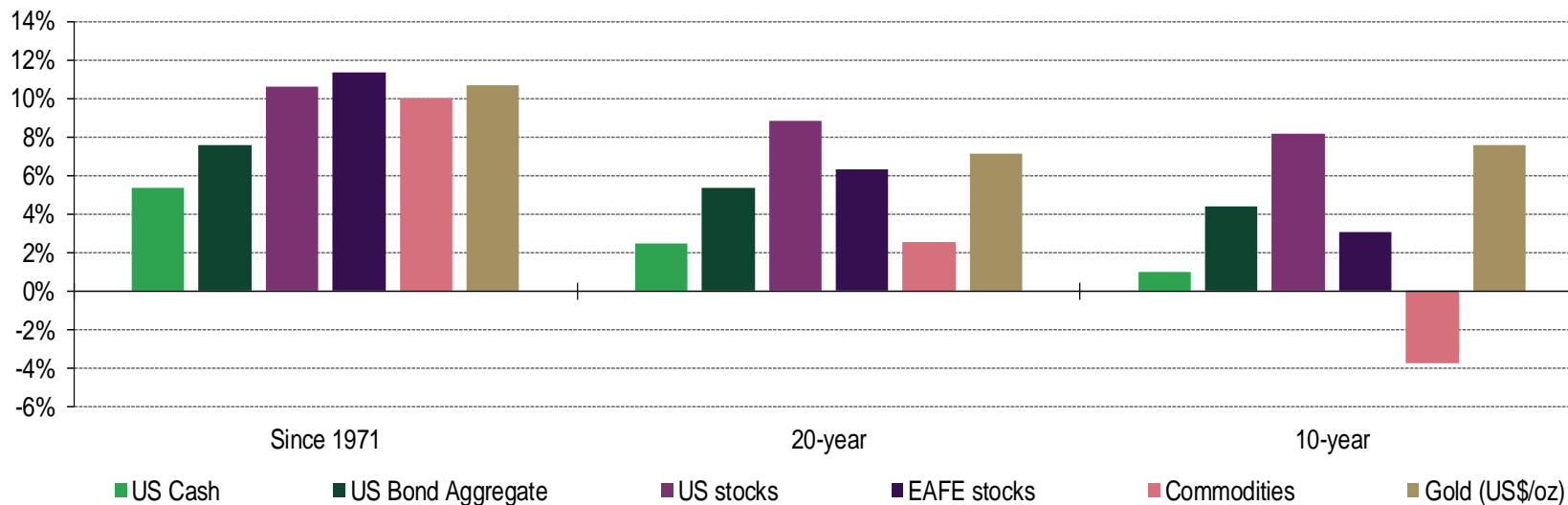
Sources: World Gold Council; Bloomberg

Gold provides returns

- Gold can be a **source of return** for investors' portfolios – it is not useful only in periods of higher uncertainty
- Gold has delivered **comparable returns to US stocks over the long run**
- **Income growth increases demand for gold** in the form of jewellery and long-term savings

Gold's long-term performance compared to other financial assets*

Avg. annual return

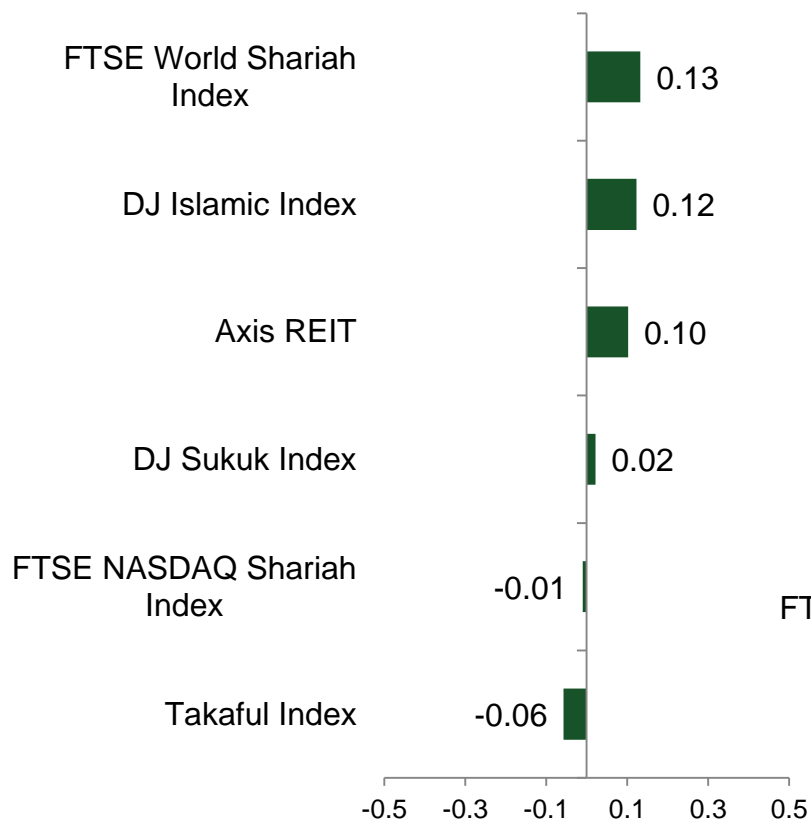


*Based on total returns indices including MSCI US, MSCI ACQI ex US, JPMorgan 3-month US cash, BarCap US Bond Aggregate, Bloomberg Commodity for the 10- and 20-year average, and S&P Goldman Sachs Commodity since 1971 due to data availability. Gold performance based on the LBMA Gold Price. Data between January 1971 and December 2016.

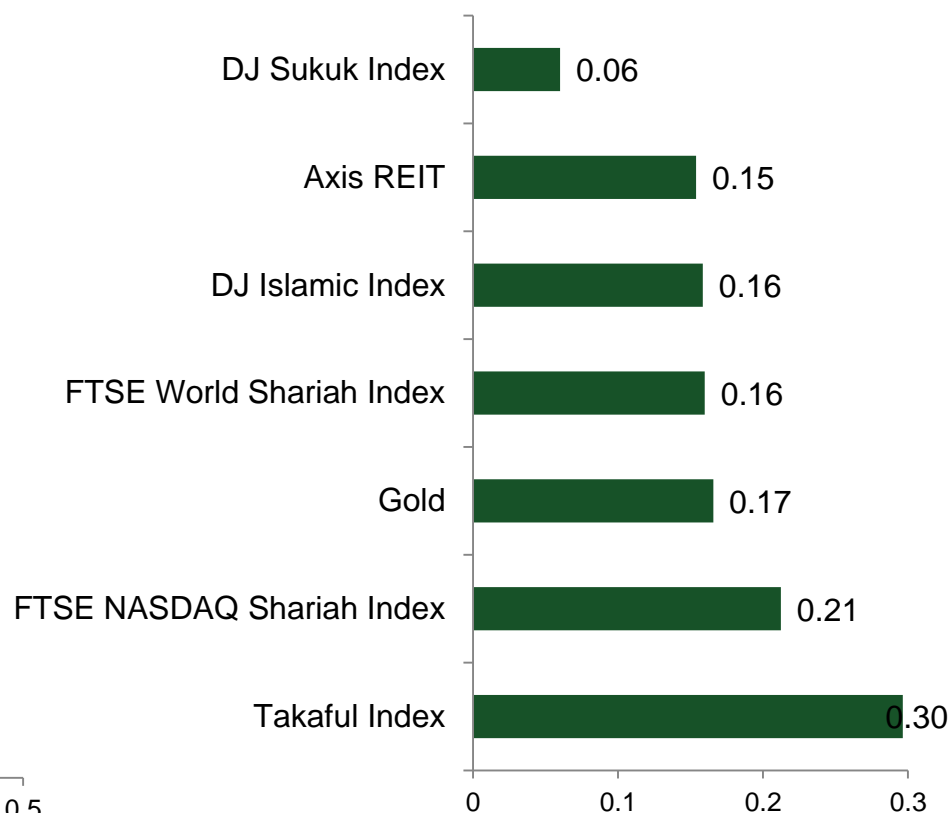
Sources: World Gold Council; Bloomberg, NBER, ICE Benchmark Administration

Gold is a powerful diversifier

Islamic Asset Classes Correlation to Gold (8 Year)



Annualized Volatility of Islamic Assets and Gold (8 Year)

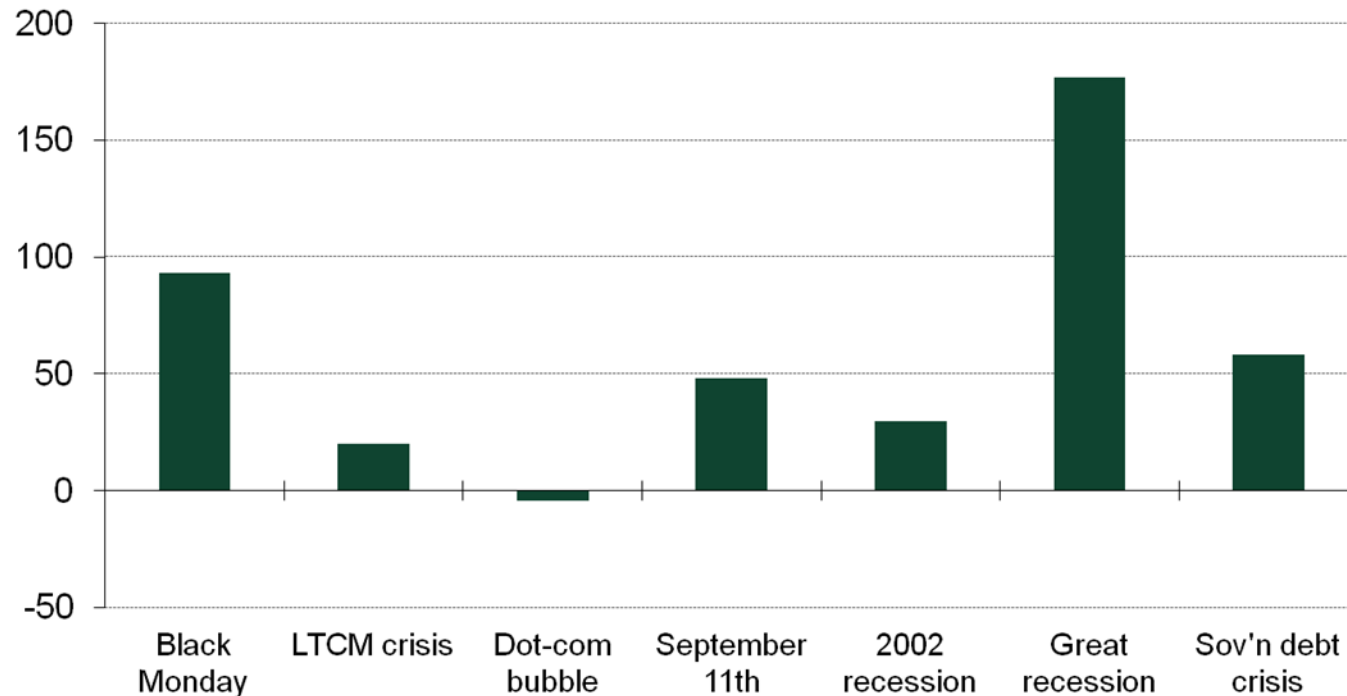


Source: World Gold Council; Bloomberg. 8-year returns and correlations used due to limitations on data availability for Islamic assets

Ultimate safe haven asset for Islamic investors

Impact of a 4% allocation to gold in a standard portfolio during crises*

Basis points



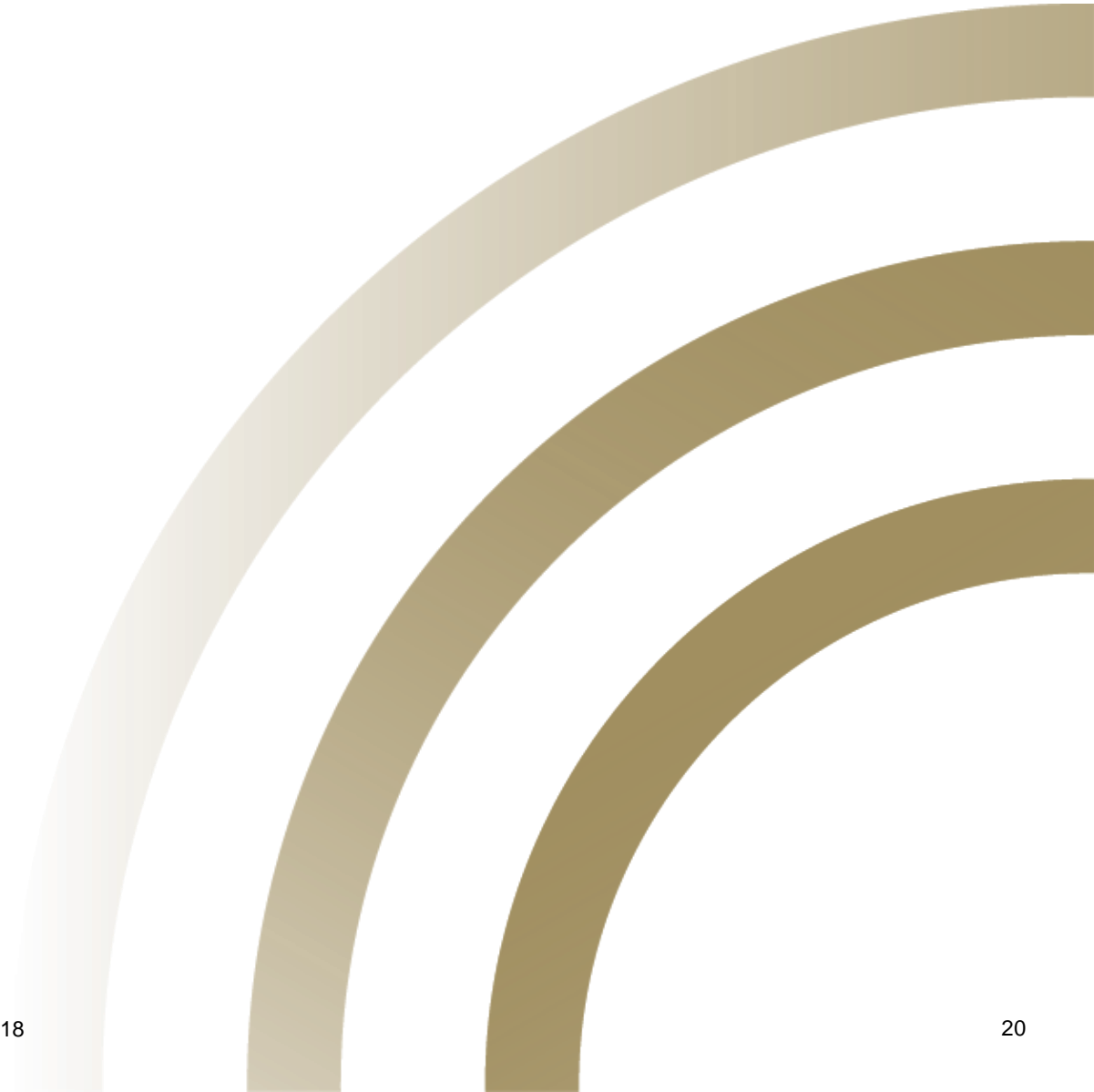
*Standard portfolio defined as having 55% equities, 25% fixed income and at most 5% cash with the remaining weights optimally allocated in alternative assets including real estate, private equity, gold and hedge funds. Black Monday: 9/87-11/87, LTCM: 8/98, Dot-com: 3/00-3/01, Sept 11th: 9/01, 2002 recession: 3/02-7/02, Great recession: 10/07-2/09, Sov'n debt crisis I: 1/10-5/10.

Source: World Gold Council; Barclays Capital; Bloomberg; Hedge Fund Research; J. P. Morgan; Thomson Reuters

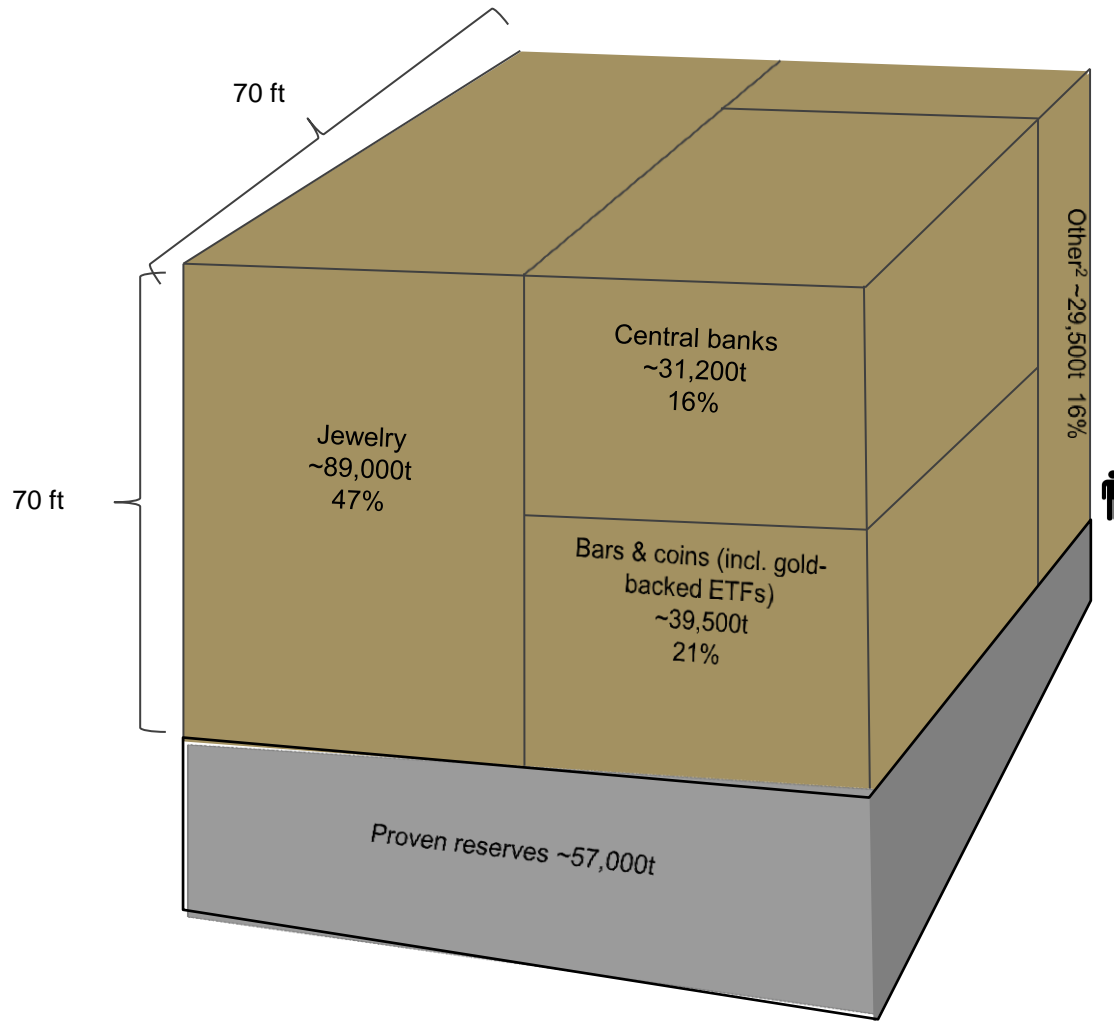
What you need to know

- **Gold is driven by many factors**, not just US investment demand
- **Gold is one of the most effective diversifiers**
- **Gold provides returns** – its returns remain competitive compared to major financial assets in both conventional and Islamic finance
- **Gold is well-established** – forms part of more portfolios, trades ~US\$200bn/daily, its market is larger than many major stock, bond and sukuk markets
- **Gold improves risk-adjusted returns** – due to its low correlations, downside protections and positive performance

Gold Demand Dynamics



How Much Gold is There?



The majority of the world's gold has already been mined. The above ground gold stock would form a cube that is 21m³, filling about three Olympic-sized swimming pools

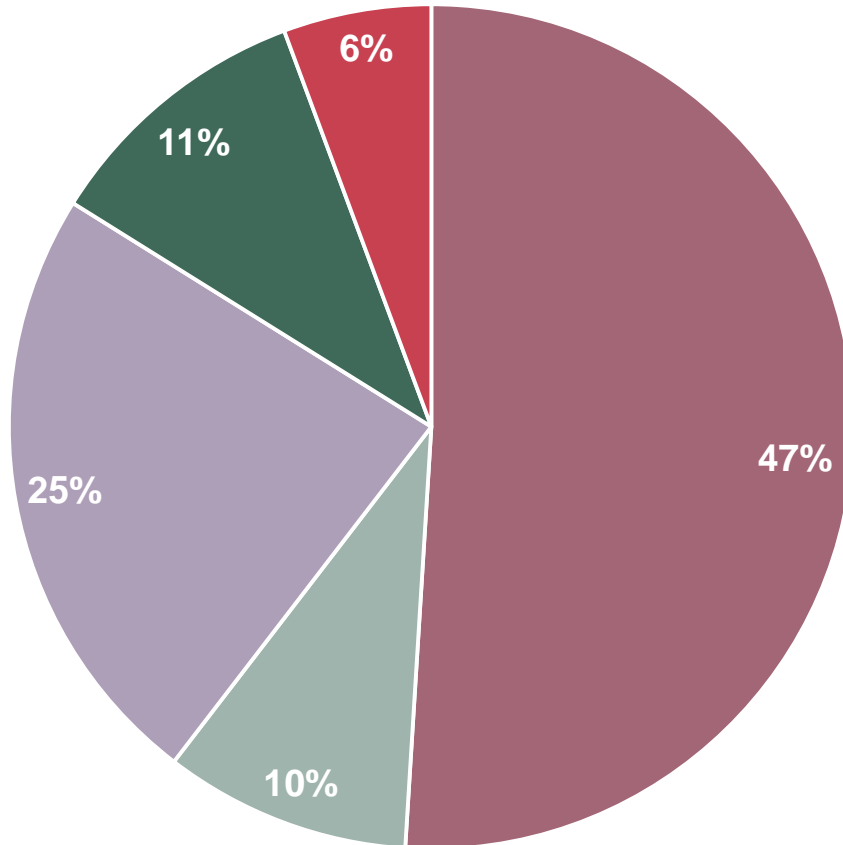
Total above ground stocks
~ 189,000 tonnes
(US\$7.5 trillion)

Source: GFMS, Thomson Reuters, US Geological Survey, World Gold Council

Gold Demand is Diverse

Demand by sector

(2015 to 2017 Q2)



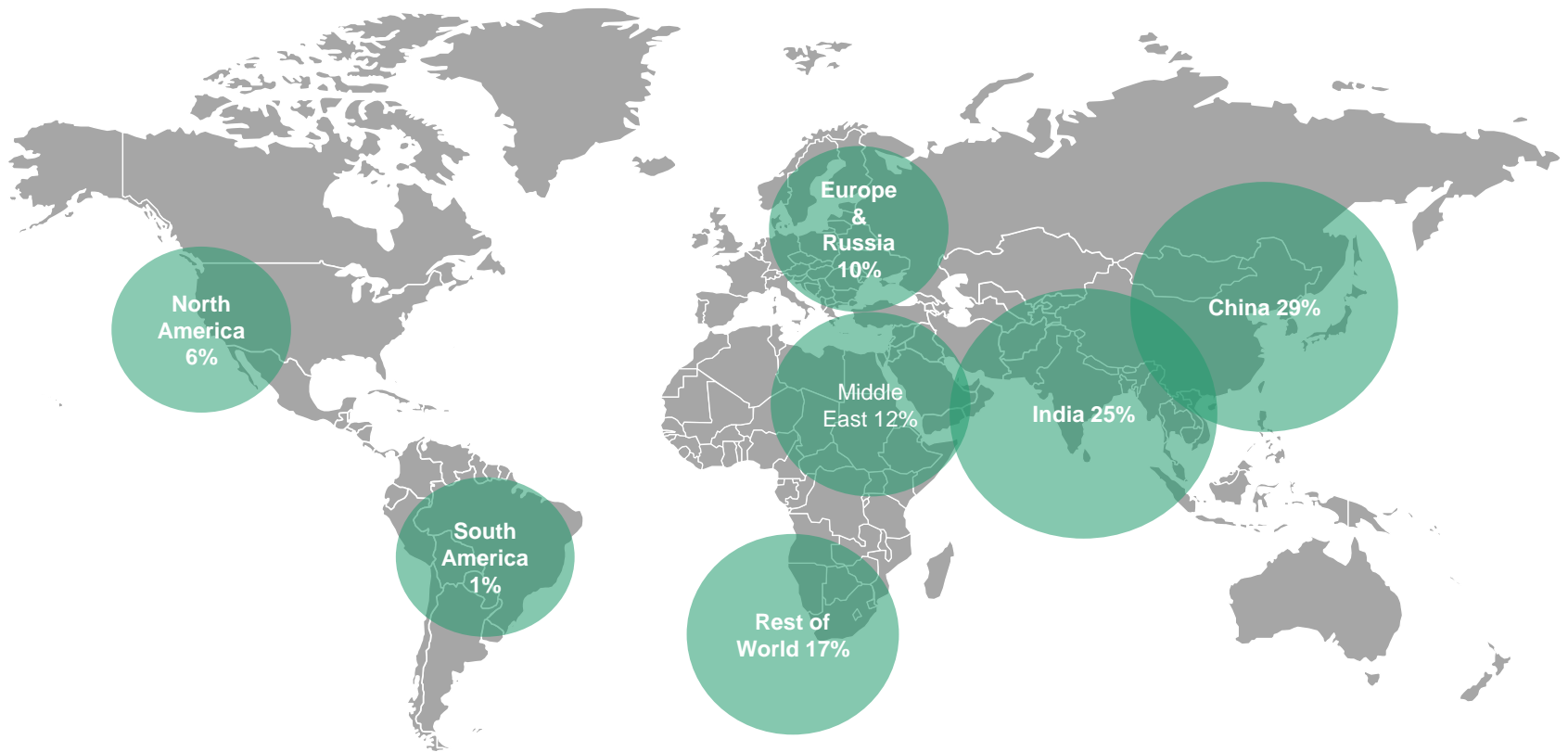
Different people buy gold for different reasons, often influenced by a range of local market conditions or macro economic factors – this diversity of demand underpins gold as an investment asset

- Jewellery
- Technology
- Total Bar and Coin Demand
- ETFs & Similar Products
- Central Banks & Other Inst.

Sources: Metal Focus; Thomson Reuters GFMS; World Gold Council

Gold Demand is Global

More than half of gold demand comes from Asia

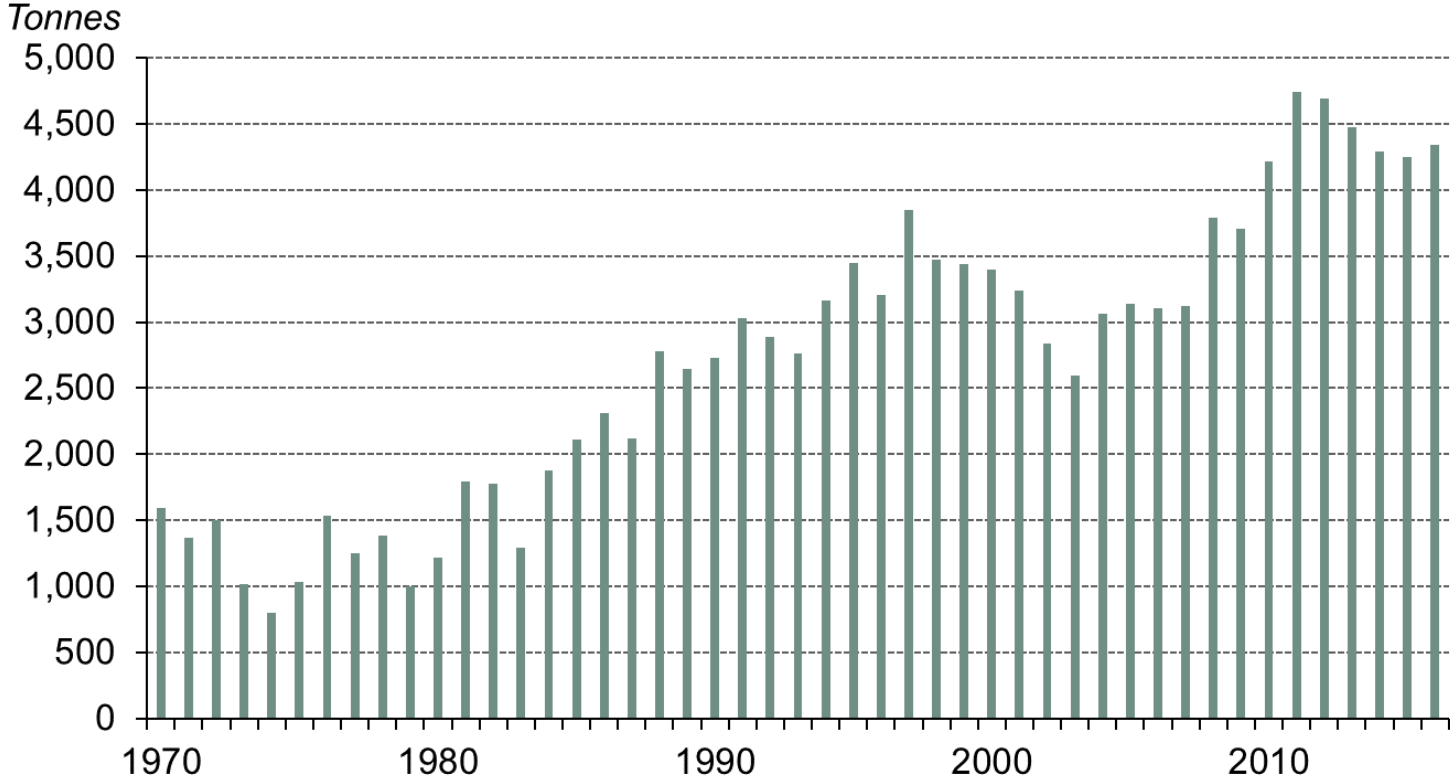


Source: World Gold Council; Metals Focus

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Gold demand increases over time

Annual gold demand



Sources: Metal Focus; Thomson Reuters GFMS; World Gold Council

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