

# FTSE SGX Shariah Index Series – Shariah Compliance & Screening

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## Shariah Indices

FTSE Group and Singapore Exchange (SGX) have launched the FTSE SGX Asia Shariah 100 Index to respond to the rising demand for Shariah compliant investment opportunities. The constituents within the index are screened by a panel of expert Shariah Scholars, in accordance with Shariah Law. The Yasaar Scholars include:

- Sheikh Yusuf T. DeLorenzo - US
- Sheikh Dr Mohd Daud Bakar - Malaysia
- Sheikh Essam Ishaq – Bahrain
- Sheikh Muhammad Nurullah Shikder - Dubai

## Shariah Overview

The Shariah is the Arabic term for Islamic Canon Law – a divinely revealed system of rules that is derived from the Quran and the Sunnah. According to the Islamic faith, money is not considered an end in itself but a means to higher values. If it is earned, invested and spent according to the guidelines set out by the Shariah, the individual, the family and society as a whole will be rewarded.

## Islamic Financial Market Overview

Islamic investing is faith-based and, as such, a core component of the Islamic system of financial management is the requirement to invest in compliance with Shariah principles and precepts. These include, most notably, the prohibition of riba (including interest) and gharar (intentional or incomplete disclosure or uncertainty) and the avoidance of revenues from prohibited sources.

The Yasaar panel of Scholars abide by internationally accepted standards in allowing or disallowing investments in today's markets. The potential for Shariah-based products is significant and growing as many choose a faith-based approach to investing.

## Islamic Index Funds

The increased desire for a faith-based approach to investment decision making has led to the development of Shariah-compliant indices and the development of investment funds which track those indices. From an Islamic perspective, the design of these indices and funds are based around a few guiding principles:

- The use of a Shariah Advisory Board to oversee the fund's compliance with the principles of Islam
- Screening the underlying investments in the fund for:

- Compliance in terms of business activity
- Compliance with regard to the financial position of a company so as to fit with the modern day financial environment and to adhere to Shariah principles under a current day interpretation by the Shariah Advisory Board
- Subjecting the fund's returns to a purification process. This is prescribed in order to deal with issues surrounding the portion of Haram or impure income.

## Shariah Compliance

To qualify as a Shariah-compliant company, an organisation is required to conform to a number of criteria:

### Business activity constraints

Prohibit investing in companies with primary businesses deriving revenues from:

- Financial services based on interest (conventional banks, finance companies, insurance companies)
- Alcohol
- Gambling
- Night club activities
- Pornography and adult entertainment
- Prostitution
- Tobacco
- Arms manufacturing
- Pork production/packaging/processing

If the primary business is Shariah compliant, while a small percentage of revenue is derived from prohibited sources, then a percentage of the dividend earnings commensurate to the percentage of prohibited revenues must be "purified" or donated to charity.

## A Company's Financial Position - Balance Sheet Analysis

### Company Debt

- According to Shariah law, a company should ideally have no interest-based debt
- However, Scholars have devised a formula to screen the level of a company's debt and thereby exclude companies with excessive leverage (and, by extension, involvement in interest earnings and payments).

### Asset Liquidity Rule

- Accounts receivables and liquid assets (such as bank accounts and marketable securities) to total assets must be below 45% of the company's total assets.

### Cash and Equivalents

- The ratio of cash and equivalents holdings (which generate interest income) to total assets should not exceed 33%.