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Stock Markets and Shariah Screening Methodologies

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Dr. Shariq Nisar delivered a public lecture on ‘Stock Markets and Shariah Screening Methodologies’ at The Center for Islamic Economics and Finance, Qatar Faculty of Islamic Studies, Hamad bin Khalifa University on Sunday, 29th of March, 2015. Dr. Shariq Nisar, who has pioneered Shariah Screening in India has been associated with many landmark Shariah compliant transactions in the country. He is currently the director of India’s premier Shariah Advisory firm, TASIS.

Dr. Shariq Nisar started the lecture with an Introduction about Shariah screening. He emphasized on the need for such screening processes and the difficulties involved in finding sufficient Shariah compliant stocks for making a viable portfolio. The speaker stressed on the point of stocks being the best available option for investment on Islamic principles.

“Stocks are the best available option for investments on Islamic principles by individuals, portfolio managers, Islamic banks, insurance and reinsurance companies, pension funds and other financial institutions.”

He explained the ‘Shariah Screening Process’ and how business and products of a company is filtered in order to identify whether it is suitable for a Shariah compliant investor. The Islamic Shariah has clearly mentioned the activities in which Muslims are not allowed to be involved such as Riba (Interest), consumption of alcohol, pork, etc. Muslims are not allowed to invest in such businesses whose earnings are from such activities. He also spoke at length about the need for financial screening and its various processes. He discussed these aspects through the real life examples of Shariah Screening processes followed in different parts of the world:

AAOIFI (Bahrain)

Business Screening: AAOIFI’s business screening norms specify that an investment is permitted only if the objective for which the corporation was created is lawful as per the Shariah.

Financial Screening: The fundamental rule of AAOIFI’s financial screening involves prohibition of acquiring and trading in shares of corporations which indulges in transactions involving Riba and other prohibited activities even when their primary activity is lawful. There are certain exemptions to this statement as under:

- The Memorandum of Association does not mention that one of its objectives is against the Shariah.
- Total borrowings and debt does not exceed over 33% of its market cap.
- The total income generated from prohibited component does not exceed 5% of the total income of the corporation.

QE AL Rayan Islamic Index (Qatar)

Business Screening: QE AL Rayan Islamic Index excludes those businesses which involves in transactions of conventional Financial Services, Pork related products, Alcohol, Tobacco, Weapons, Gambling, Music, cinema, Adult entertainment, Hotels (except Shariah compliant hotels).

Financial Screening: QE AL Rayan Islamic Index accepts those businesses to be Shariah compliant where:

- Total borrowings are less than 33.33% of Total Assets.
- Cash plus Interest bearing securities are less than 33.33% of Total Assets.
- Account Receivables and Cash are less than 33.33% of Total Assets.

National Commercial Bank (Saudi Arabia)

Business Screening: NCB excludes those corporations which has one of its business objectives in conflict with the Shariah. Investment is not permitted in any company which engages in alcohol, pork, tobacco, conventional finance, etc.

Financial Screening: NCB accepts those businesses to be Shariah compliant where:

- Total Debt is less than 33.33% of Market Cap.
- Interest Income is less than 5% of Total Income.
- Debt plus liquid fund is less than 50% of Market Cap.

S&P Shariah Index

Business screening: S&P screens the annual report of companies. All those activities which are in conflict to Shariah are screened out.

Financial Screening: S&P assumes the following businesses to be Shariah compliant whose:

- Total Debt is less than 33% of Average Market Value (36 months)
- Accounts Receivables is less than 49% of Average Market Value (36 months)
- Cash plus Interest bearing securities are less than 33% of Average Market Value (36 months)
- Non-compliant income (other than interest) is less than 5% of total income.

National Stock Exchange (NSE) Shariah Index (India)

Business Screening: TESIS screens companies on the basis of their business activities and products and all those businesses which are in conflict with the Shariah are screened out such as alcohol, pork, tobacco, etc.

Financial Screening: TESIS assumes following businesses to be Shariah compliant whose:

- Borrowings/Debts are less than 25% of Total Assets.
- Interest Income plus returns (8%) from all non-compliant investments are less than 3% of Total Income.
- Cash Plus Receivables are less than 90% of Total Assets.

Dr. Shariq Nisar also explained the Shariah screening methodology followed by other institutions like Dow Jones, FTSE (London), MSCI, Karachi Meezan Islamic Index and SEC Malaysia. He then went on to conduct SWOT Analysis if these Shariah screening norms:

Strengths: The most important strength is the partnership approach which is closest to the ethos of shariah. Secondly, it brings large number of activities under its cover such as venture capital, private equity, pension funds etc. According to Dr Shariah this is one area where Shariah scholars and financial professionals share their views and thoughts which has greatly facilitated the growth of this segment.

Weaknesses: Lack of proper understanding of the true basics of Shariah screening and the absence of standard shariah screening norms often lead to confusion. Certain screening norms differ quite widely with each other in certain respects. More importantly some institutions have changed their norms when it did not suit their business and commercial interests.

Opportunities: Stock markets assume important position in the financial world and its importance increases for Islamic finance as conventional money markets products are prohibited. Islamic finance can operate in major areas of finance such as mutual funds, pension funds and insurance. Capital markets provide bright prospects to Islamic finance as it provides liquidity, diversification, scalability, governance and expertise.

Threats: According to Dr Shariq slow growth and development of stock markets in Muslim world and lack of credible institutions in Muslim countries is the biggest threat to the development of Islamic capital market. Hence it is essential that Muslim countries make concerted efforts to develop Islamic capital market. According to him poor representation of Muslim institutions in this field is not going to be helpful.

Dr. Shariq Nisar concluded his presentation by highlighting the **Major Issues and Challenges** faced in the shariah screening process. These include the calculation and purging of impure income non-availability of shariah compliance related information in the balance sheet of the companies and low exposure of Shariah scholars to the Capital markets. He also highlighted the conflict of interest situation between indexes service providers and shariah compliance. The application of one-third as “rule of thumb” for shariah screening process also got the critical attention during his presentation.

The program ended after a lively questions and answers and reactions of the participants on the key issues highlighted during the lecture.