Shariah compliant investing is a part of the Responsible Investing family.
Responsible Investment screening became more specialized as AUM grew

Current AUM: $ 33 Trillion

Shariah compliant investment screening is also becoming increasingly specialized with growth in AUM

Current AUM: $ 62 Billion
Growth of SRI assets (in US) and Evolution of screening methodologies

- **1960's**: Had simple negative screens: avoided investments in 'sin industries'.
- **1980's**: Avoided invst in South Africa: screened out Co's having 'discriminatory labour practices'.
- **1995**: Detailed screening: 'Specific industries' were screened out - tobacco, alcohol, weapons & gambling.

**Source**: US SIF & RI Research
Evolution of Shariah screening

First Shariah Screened Index - Dow Jones Islamic Market

- Used internationally accepted sector classification systems like ICB to screen stocks

Drawbacks:

- Companies having revenues from non-permissible businesses apart from dealing in its core compliant business sector, were classified as compliant

<table>
<thead>
<tr>
<th>Period</th>
<th>: till 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industry AUM</td>
<td>: less than $ 50 billion</td>
</tr>
<tr>
<td>No. of Funds</td>
<td>: 576</td>
</tr>
</tbody>
</table>
Evolution of Shariah screening

Revenue Segment based screening introduced – S&P Shariah indices launched

- Studied the revenue segments of each company
- Companies having more than 5% income from non-permissible business activities were eliminated
- Interest income not part of the 5% non-permissible income threshold

Advantages:

- Companies were screened based on actual business income derived rather than their broad sector classification

<table>
<thead>
<tr>
<th>Period</th>
<th>2007 - 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industry AUM</td>
<td>$50 - $60 billion</td>
</tr>
<tr>
<td>No. of Funds</td>
<td>795</td>
</tr>
</tbody>
</table>
Evolution of Shariah screening

*Refined* Shariah screening Criteria—defined Islamic Banks/Insurance Cos

- Islamic banks and Insurance companies were defined and included in the compliant universe
- Leverage compliance was computed without Islamic debt component, hence promoting Islamic borrowing instruments
- Companies which carried all its business and financial activities in accordance with Shariah principles were exempt from financial ratio screens.

**Advantages:**

- These screening methodology improvements added credibility to the screening process

<table>
<thead>
<tr>
<th>Period</th>
<th>2010 - 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industry AUM</td>
<td><em>above $60 billion</em></td>
</tr>
<tr>
<td>No. of Funds</td>
<td>971</td>
</tr>
</tbody>
</table>
Evolution of Shariah screening

*Sector specific* Shariah screening Criteria – defined screening criteria for Real estate companies …

- Certain industry sectors needed a specialised screening criteria.
- Companies such as Real Estate firms, payment processing companies, Conventional financial institutions in the process of getting converted to fully Islamic companies…, required specific screening methodology approvals from the Shariah committee due to the peculiar nature of their business.

*Advantages:*

- Improved the accuracy of the screened universe

<table>
<thead>
<tr>
<th>Period</th>
<th>beyond 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industry AUM</td>
<td>above $60 billion</td>
</tr>
<tr>
<td>No. of Funds</td>
<td>1065</td>
</tr>
</tbody>
</table>
Growth of Shariah assets and Evolution of screening methodologies

**Simple Computer aided screen:**
Co’s having non-permissible ICBs were eliminated

**Revenue Segment based screening:**
Compliances assigned based on revenue derived from permissible sectors

**Refined Shariah criteria:**
- use of Islamic debt, defined Islamic banks & Insurance Cos.

**Sector Specific Shariah criteria:**
- Real Estate Cos.
- Payment processing Cos.
- Cos in transition to becoming Islamic.

Source: RI Research

YEARS

AUM in Billions of USD

YEARS

Source: RI Research
Islamic Investments Industry - Issues

- Geographically concentrated:
  70% of Islamic investments are domiciled in:
  - Saudi Arabia
  - Malaysia
  - Luxemburg (mostly GCC investors)

- Lack of Institutional money:
  Composition of institutional investors:
  - Islamic Funds: 20%
  - Conventional Funds: 70%

- Top 10 Islamic funds account for more than 50% of total Islamic AUMs

- Problem of scaling up:
  Only 80 Islamic funds have AUM in excess of $100 million.
Challenges in Shariah Equity screening

- Non-Standardized disclosures:
  - There is no uniform disclosure mechanism for Shariah sensitive information by companies

- Non disclosure of Shariah sensitive information:
  - There is no mandatory statute which bounds a company to disclose Shariah sensitive information
  - Leads to potential misclassification.
  - AAOIFI has issued standards, but their application is voluntary.

- Absence of a regulated mechanism for Shariah supervision and audit of Islamic instruments and Companies.

- Absence of a corporate culture of internal/external Shariah review and guidance
… positive outlook

- Investor relation teams more interactive:
  - Companies are becoming increasingly responsive through their IR’s on responding to Shariah sensitive queries.

- Better disclosure of Shariah sensitive information:
  - Certain companies, especially in the GCC, have begun disclosing Shariah sensitive information in their financial statements which aids in accurate Shariah classification.

- Shariah compliance in financial decisions:
  - There is a trend in the GCC to replace existing conventional debts by borrowing in a Shariah compliant manner.

- More number of Financial institutions in the GCC are seeking to offer Shariah compliant instruments
Questions?
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Dr. Shah has a PHD in Financial Econometrics & Asset Pricing from the London School of Economics. He also holds a MPHIL., in Economics from Cambridge University. Mushtaq Shah has many years experience in hedge fund trading, economics and analysis and is the co-founding partner of Quantmetrics Capital Management, a billion dollar hedge fund company. Prior to founding Quantmetrics, Mushtaq was Head of Research for Equinox Capital Management, prior to which he was Head of European Convertible and Quantitative trading at Credit Suisse First Boston. Previously he was a Senior Equity Strategist and Executive Director, Goldman Sachs International within the number one rated pan-European Equity Strategy Unit. Mushtaq has also held positions as European Currency Economist, UBS, and Head of Proprietary Equity trading, Bank of America.

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