



Please can the Al Qalam panel advise whether the criteria adopted by Dow Jones Islamic Indices is acceptable. If one was to adopt these criteria, certain practical questions arise, on which clarification is required.

In essence these criteria propose to permit investments in quoted companies, as long as the company in question has a debt gearing of less than one third market capitalization, and secondly has annual sales of less than 5% of annual turnover in impermissible activities (banking, insurance, alcohol, gambling etc.) A review of the market valuations, debt ratios, and sales levels of impermissible activities should occur once a quarter, with only those companies meeting the criteria to be invested in. If a company subsequently fails to meet the criteria, after initially meeting and therefore having monies invested, then the violation should occur for two consecutive quarters, after which the shares should be sold and the monies reinvested in permissible companies.

Please clarify how the cleansing of the fund takes place. With regards to the impermissible activities of less than 5%, is it permissible for the same amount of dividend and capital growth to be given in charity. I know scholars differ over whether to give the capital growth to charity, and the more cautious view is to give both. The issue is whether a % of turnover is adequate as the precise amount of haram profit may well be different. It would be extremely difficult to calculate the exact amount - is a % of turnover acceptable.

Secondly, the permissible companies would be both earning some minimal amount of interest on their cash deposits as well as paying interest on their cash loans of less than 1/3 market capitalization. There is really no way I can think of as to how to accurately cleanse the interest earned, and you cannot cleanse interest paid to the bank! I therefore presume it would be adequate to cleanse as a %, the same amount of total profit as the % of turnover which relates to impermissible activities. Please confirm the same and also clarify if and how cleansing should occur if a company declines in any given year to issue a dividend, and / or generates a loss on share price during the same period.

1st Safar 1429
8th February 2008



AL QALAM

الجواب حامدًا و مطليًا و مسلمًا و منه الصدق و الصواب

Firstly, I am able confirm that the criteria adopted by the Dow Jones Islamic Indices is acceptable to members of the Al-Qalam Shariah Panel.

Secondly, with regards to the impermissible activities of less than 5%, I can also confirm that while capital growth does not require purification in our view, it is more cautious to give the capital growth to charity as well as the dividend. However, it is not correct to assume that the cleansing of impermissible activities as a percentage of turnover is adequate. Rather, the actual amount of non-compliant income earned by the investee company must be calculated. This is clearly stated in the following Screening Criteria agreed by the Al-Qalam Shariah Panel members on 27th January 2008.

Screening Criteria for Investment in Stocks / Shares

1. Business of the investee company

The business of the investee company should be lawful. Accordingly, investment in shares of conventional banks, insurance companies, leasing companies, companies dealing in alcohol etc are not permissible.

2. Debt to total assets

The total debt of the investee company should not exceed 33%¹ of the total assets. The debt here includes all interest-based debt & interest based financing.

3. Illiquid to total assets

The total illiquid assets of the investee company as a percentage of the total assets should also be at least 33%².

4. Investment in non-Shariah compliant activities and income from non-Shariah compliant investments

The following two conditions must be observed for share screening purposes:

¹ The figure of 33% is based on one third being considered 'abundant' in the *hadith* reported by al-Tirmidhi.

² Some scholars have said 51%, as - للاكثر حكم الكل - the majority deserves to be treaded as the whole. Others have said 33% as one third is considered abundant. According to the *banafiyah* there is no specific ratio. The only conditions are that the liquid part must not be negligible, and the price of the combination of the liquid and illiquid assets must be more than the value of the liquid assets.

- The total investment of the investee company in non-Shariah compliant business should not exceed 33% of the total assets.
- The income from Non-Shariah Compliant Investment ³ should not exceed 5%⁴ of the gross revenue. (Gross revenue means net sales plus other income). Subsequently, giving the proportionate portion of non-compliant income to charity is required to purify the dividend income from these stocks. However, capital gain on these stocks needs not to be purified.

5. Net liquid assets versus share price

The net liquid assets [**Net Liquid Assets = Total Assets – (Tangible Fixed Assets + Inventory) - Liabilities**] per share should be less than the market price of the share.

Thus, if a company satisfies the above criteria it will be permissible to invest in such a company and any income earned from impermissible activities must be cleansed accordingly.

E.g. "ABC Company", whose non-compliant income (NCI) to gross revenue (GR) ratio is say 4% and its non-compliant investments (NCIn) to total assets (TA) ratio is 25%, and it is also in compliance with the remaining criteria. Based on these screening criteria the company is Shariah compliant for investment purposes. Now "ABC Company" declares dividend for its share holders of say 20 pence per share and your investments in that company are of 1000 shares.

The dividend purification process is that this total amount of dividend received (1000 shares x 20 pence per share dividend) £200 is multiplied with the percentage of non-compliant income received by the company (which in this case is 4%)

The dividend purification amount is: £200 x 4% = £8. Thus, £8 will be given in charity on account of dividend purification.

With regards to the cleansing of interest earned, if accurate information is not available one must make an informed approximation based on prevalent market rate. Notwithstanding, it would be more precautionary to give more than the resultant approximation to charity.

If a company declines in any given year to issue a dividend, and / or generates a loss on share price during the same period, one is still required to

³ Non Compliant Income (NCI) refers to the ACTUAL AMOUNT of NCI earned by the investee company, and not the % of NCI to turnover, divided by the Total Gross Revenue of that company.

⁴ This figure of 5% is based on the collective opinion of contemporary *'ulama*.

apply the cleansing process to the actual amount of income earned from impermissible activities as described above.

And Allah knows best.

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