CHAPTER - 6

Shariah-Compliant Equity, Funds and Derivative Products in Islamic Financial Market

The phenomenal growth of the Islamic financial industry undoubtedly has also had positive effect on the investment in equity market. In fact the tradition of practice of Islamic finance as Musharaka and Murabaha are most similar to practice that goes in present day stock exchange. Started at the first decade of this century, Islamic finance industry has diversified widely. The industry expanded from being banking–based industry to wider areas incorporating financial market based products and practices. As aftermath of the recent global financial crisis, the Islamic equity market is segment of the industry that has been receiving much attention. As the conventional equity market remains in doldrums due to the prolonged effects of the global financial crisis at the time, the demand for the Islamic equity market, Sukuk Islamic fund and other Islamic financial products are expected to increase further in tandem with the sustained rapid growth of the Islamic banking and finance industry. As a result, Islamic financial markets have become one of the fastest growing sectors in the Islamic banking and finance industry. In addition to the Sukuk, Shariah-Compliant equity and funds are yet another important products in Islamic financial market.

1 Arab Banking Corporation, “Islamic Equity Funds” Institute of Islamic Banking and Insurance, (London: Retrieved june 18, 2007)
6.1. Shariah-Compliant Stock

According to Kevin Rothwell, the concept of share market was first introduced in France in the thirteenth century when the Dutch East India Company was the first company to issue shares on the Amsterdam stock exchange in 1602. It has been claimed that the concept of Mudarabah which in some way resembles to the modern stock market concept was found in the age of Prophet Muhammad. However, all stock that has prevalence in modern stock market is not pure Shariah-Compliant since most of the business corporations contain elements of Shariah- inconsistent in their business nature or financial structure. Since the term Shariah-Compliant Stock refers to equity stock those conform to Islamic Law of investment, therefore Shariah-Compliant Stock is only equity that passes Islamic criteria set out by Islamic jurisprudences.

In order to study the growth of Shariah compliant equity market, one can observe the growth of market by looking at the size of Shariah compliant stock in total equity market. Although, the exact size of Shariah-Compliant Stock are not possible to measure and estimate the size of it is variance among index providers, however the trend of the market can be measured by scrutiny of one particular index. In this study, Dow Jones Islamic Market Indexes are used as the data base to estimate the size of Shariah compliant equity market as it is one of prominent and widely accepted index provider that started to provide Islamic index since 1999. This Data base covers the global universe of investable equities that have been screened for Shariah compliance consistent with Dow Jones Indexes’

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proprietary methodology. The selection universe for the DJIM indexes is the same as the universe for the Dow Jones World Index, a broad-market index that seeks to the universe for the DJIM Index includes the components of 56 country-level benchmark indexes worldwide, each of which covers approximately 95 per cent of the float-adjusted market capitalization of the underlying market. The information available has been up to August 2011. According to Fact Sheet of Dow Jones Islamic Market Index the size of Islamic stock market can be depicted as figure below:

Figure 6.1: Market Capitalization of Shariah-Compliant Stock by Global and Regional Indexes

<table>
<thead>
<tr>
<th>Index</th>
<th>Component Number</th>
<th>Market Capitalization (Billion US dollar)</th>
<th>Float-Adjusted (^5) (Billion US dollar)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dow Jones Islamic Market World Index</td>
<td>2591</td>
<td>19,995.5</td>
<td>13,278.3</td>
</tr>
<tr>
<td>Dow Jones Islamic Market Asia/Pacific Index</td>
<td>1255</td>
<td>4,195.9</td>
<td>2,562.6</td>
</tr>
<tr>
<td>Dow Jones Islamic Market Asia/Pacific ex-Japan Index</td>
<td>1030</td>
<td>3,308.6</td>
<td>1,842.4</td>
</tr>
<tr>
<td>Dow Jones Islamic Market ASEAN Index</td>
<td>260</td>
<td>523.4</td>
<td>195.9</td>
</tr>
<tr>
<td>Dow Jones Islamic Market Developed Markets Index</td>
<td>1576</td>
<td>13,000.8</td>
<td>11,366.9</td>
</tr>
<tr>
<td>Dow Jones Islamic Market Developed Markets ex-Japan Index</td>
<td>1351</td>
<td>12,113.5</td>
<td>10,646.7</td>
</tr>
<tr>
<td>Dow Jones Islamic Market Emerging Markets Index</td>
<td>1015</td>
<td>6,994.8</td>
<td>1,911.4</td>
</tr>
<tr>
<td>Dow Jones Islamic Market Europe Index</td>
<td>276</td>
<td>3,238.2</td>
<td>2,604.7</td>
</tr>
<tr>
<td>Dow Jones Islamic Market GCC Index</td>
<td>113</td>
<td>290.0</td>
<td>80.4</td>
</tr>
</tbody>
</table>

\(^4\) Dow Jones Islamic Market Indexes SM Methodology,

\(^5\) The number of shares actually available for purchase by the public on open markets. It is calculated by subtracting restricted shares such as those held by company insiders from outstanding shares.
According to Dow Jones Islamic Market World Index which started working on May 24, 1999, the size of Shariah-compliant stock on August 2011 was 19,995.5 billion US dollars with 2591 companies being listed on the Dow Jones World Index passing the Shariah-screen. However, as float-adjusted market show, the real Shariah-compliant stock that available for investors to trade was 13,278.3 billion US dollars.7

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6 The index covers Bahrain, Egypt, Jordan, Kuwait, Morocco, Oman, Qatar, Saudi Arabia, Tunisia and the United Arab Emirates.

If one is looking at more particular market region the detail can be shows as:

**Shariah-compliant stock in Asia-Pacific market:** the countries market index including in this market index are Japan, Australia, Taiwan, India, South Korea, China, Hong Kong, Singapore, Malaysia, Indonesia, Thailand, New Zealand, Philippines, and Sri Lanka. The magnitude of Shariah-compliant stock was 4,195.9 billion US dollars with 1255 companies listed on conventional index qualified to Shariah-compliant stock list and only 56 per cent or 2,562.6 billion US dollars of total Shariah-compliant stock was available for trade.\(^8\)

![Figure 6.3: Pattern of Sector Allocation of Shariah-compliant stock in Asian-Pacific Market](chart)

**Shariah-compliant stock in ASEAN market:** As the index list represents component companies in the ASEAN (Association of Southeast Asian Nations) region that pass rules-based screening for Shariah compliance. The index covers Shariah-Compliant market in

\(^8\) Dow Jones Islamic Market Asia/Pacific Index℠ Fact Sheet http://www.djindexes.com/mdsidx/downloads/fact_info/Dow_Jones_Islamic_Market_Asia_Pacific_Index_Fact_Sheet.pdf [19 Sep. 11]
Indonesia, Malaysia, Philippines, Singapore, Thailand and Vietnam. Index Universe are selected for the DJIM ASEAN Index comprises the component companies of the Dow Jones Indonesia Index, Dow Jones Malaysia Index, Dow Jones Philippines Index, Dow Jones Singapore Index, Dow Jones Thailand Index and Dow Jones Vietnam Index. According to this index, the full market capitalization of the ASEAN market was 523.4 billion US dollars with 260 companies listed in this index. However, 195.9 billion US dollars were the Float-adjusted market capitalization or 37 per cent of total stock in this list as being traded.9

**Figure 6.4: Pattern of Sector Allocation of Shariah-Compliant Stock in ASEAN Market**

<table>
<thead>
<tr>
<th>Sector</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Telecommunications</td>
<td>26.93%</td>
</tr>
<tr>
<td>Industrials</td>
<td>17.23%</td>
</tr>
<tr>
<td>Oil &amp; Gas</td>
<td>14.77%</td>
</tr>
<tr>
<td>Basic Materials</td>
<td>13.30%</td>
</tr>
<tr>
<td>Consumer Goods</td>
<td>12.51%</td>
</tr>
<tr>
<td>Consumer Services</td>
<td>5.46%</td>
</tr>
<tr>
<td>Utilities</td>
<td>3.64%</td>
</tr>
<tr>
<td>Health Care</td>
<td>2.84%</td>
</tr>
<tr>
<td>Financials</td>
<td>2.55%</td>
</tr>
<tr>
<td>Technology</td>
<td>0.76%</td>
</tr>
</tbody>
</table>

**Shariah-compliant stock in European market:** Dow Jones Islamic Market Europe Index represents the Shariah-compliant stocks that pass its Shariah-screen in European market. The index covers those stocks which are available to foreign investment. The

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9 Dow Jones Islamic Market ASEAN Index℠ Fact Sheet
indexes represent the countries such as Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and U.K.\textsuperscript{10} According to this index, the full market capitalization of the European market was 3,238.2 billion US dollars with 276 companies listed in this index. The float-adjusted market capitalization was 2,604.7 billion US dollars. It means that 80.4 per cent of Shariah-compliant stocks in this market were available for trade.\textsuperscript{11}

\textbf{Shariah-compliant stock in GCC market:} The market covers Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates. According to Dow Jones Islamic Market GCC Index, the full market capitalization of the GCC market was 290 billion US dollars with

\textsuperscript{10} Dow Jones Europe Indexes SM Fact Sheet

\textsuperscript{11} Dow Jones Islamic Market Europe Index SM Fact Sheet
113 companies listed in this index. The Float-adjusted market capitalization was 80.4 billion US dollars. It means that 27.7 per cent of Shariah-compliant stocks in this market were available for trading.\textsuperscript{12}

\begin{figure}
\centering
\includegraphics[width=\textwidth]{figure66.png}
\caption{Pattern of Sector Allocation of Shariah-Compliant Stock in GCC Market}
\end{figure}

If one categorizes the market into the developed and emerging market the detail can be shown as:

**Shariah-compliant stock in developed markets:** The market includes 25 country-market as Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Iceland, Ireland, Israel, Italy, Japan, New Zealand, Netherlands, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, United Kingdom, and United States.\textsuperscript{13}

\textsuperscript{12} Dow Jones Islamic Market GCC Index\textsuperscript{SM} Fact Sheet

\textsuperscript{13} Guide to the Dow Jones Global Indexes \textsuperscript{SM}, August 2011, p3
According to Dow Jones Islamic Market Developed Markets Index, the full market capitalization of the developed market was 13,000.8 billion US dollars with 1576 companies listed in this index. The Float-adjusted market capitalization was 11,366.9 billion US dollars. It means that 87.4 per cent of Shariah-compliant stocks in this market were available for trading.\(^\text{14}\)

**Figure 6.7: Pattern of Sector Allocation of Shariah-Compliant Stock in Developed Market**

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**Shariah-compliant stock in emerging markets:** The market include Brazil, Chile, China Offshore, Czech Republic, Hungary, India, Indonesia, Malaysia, Mexico, Philippines, Poland, Russia, South Africa, South Korea, Taiwan, Thailand, and Turkey.\(^\text{15}\) According to this


index, the full market capitalization of Shariah-compliant stock in the emerging markets was 6,994.8 billion US dollars with 1015 companies listed in this index. The Float-adjusted market capitalization was 1,911.4 billion US dollars. It means that 27.3 per cent of Shariah-compliant stocks in this market were available for trade.\textsuperscript{16}

![Figure 6.8: Pattern of Shariah-Compliant Stock in Emerging Market](image)

6.1.2. Islamic Shariah-compliant Stock Index and screening process

Islam as a religion guides all aspects of the lives of its followers. Hence, Muslims are required to conduct their economic affairs in accordance with the teachings of Islam. The concept of companies screening before making investments in them is derived from the Shariah principle that Muslims should not partake in an activity that does not comply with the teachings of Islam. Increased awareness of Muslim investors about opportunities

\textsuperscript{16} Dow Jones Islamic Market Emerging Markets Index\textsuperscript{SM} Fact Sheet
offered by the foreign stock markets played an important role in the development of Shariah screening methodology.

When Islamic and Muslim investors investing in any Stocks and equity fund, in case of investment in equities traded on the stock exchanges, Islamic investors need to take into account not only the structure of the transaction but also the nature of the counter party. Thus the investor needs to consider further issues of the company itself being involved in Shariah non-compliant financing and structuring. Due to this, initially Shariah scholars tended to completely rule out investment in listed equities.\(^\text{17}\)

Before investing in shares of any business corporation, an Islamic investor needs to take into consideration the various aspects about the corporation to define that whether the share of corporation is investable in the view of Shariah or not. Generally, these considerations can broadly be categorised into the following aspects:

- Activities of the business corporation: The criterion or guidelines regarding the activities of the corporations are there to prevent an Islamic investor becoming a part of something which is impermissible in Shariah view such as alcohol, gambling or pornography business. It is not concerned only with main activities but also includes ancillary activities. Some time, a more extreme view, is regarding that any hint of a haram activity is sufficient to deem the investment unacceptable. However, some scholars have taken a more relaxed view in allowing a minimal amount of haram activity, as if it is not the primary business of

the business corporation and it is unavoidable in the conditions in which the company operates such as interest-based borrowing for working capital.

• Capital Structure: This criterion focuses on the capital structure of the business corporation to examine the ratio of Riba or non Shariah-compliant finance in corporation’s assets and liabilities. The purpose of the criteria regarding the capital structure of the company is also to investigate corporation’s leverage ratios. A corporation should not be over-leveraged and this is judged by either its debt-to-equity ratio or its debt-to-assets ratio.

• Tradability: in this criterion focus is on the level of liquid and financial assets. The purpose of the tradability restrictions is to avoid assets of corporations that the majority of their assets represent either financial assets or cash, which cannot be traded unless the trade complies with special Islamic currency exchange rules and debt transfer rules. The liquid and debt assets, cash or receivables, are considered to be cash-equivalent. Although, there is a difference of opinion amongst scholars however the majority view is that obligations on counterparties cannot be traded, except at par. Therefore, the shares of a corporation can be traded at varying prices depending on a number of factors. A corporation whose majority assets comprise of cash or debt assets cannot be traded according to Shariah.

• Unlawful Income: Apart from income from main business of corporation, the unlawful income criterion is meant to ensure that any impermissible income, either
from interest or other impermissible activities, is reduced into a minimum ratio required by Shariah law.\textsuperscript{18}

In short, the criterion of screening process aimed at the formation of investment portfolios from common stocks of listed international companies which ideally satisfy three basic criteria: legitimate field of economic activity, interest-free dealings in both assets and liabilities, and the dominance of real assets. Therefore in order to pass screening process a corporation must not be engaged in the production of illegitimate goods. It must not deal with interest rate financing as a means to leverage its capital structure through fixed debt liabilities, or generate interest income from investment securities; and since a company’s shares represent equity rights in its assets, the latter should be real assets, not liquid money or receivable debt as they cannot be sold freely at a profit like real goods, real estate and machinery.

\textbf{6.1.2.1. Evolution of Shariah Screening}

Under the Shariah, the ownership of shares in a company is considered a proportionate ownership of the company’s business and assets. Muslim investors therefore cannot own a company that is involved in non-Shariah compliant activity. The Non-Shariah compliant activities range from having a line of business that is considered impermissible to dealing with “interest” while managing the financial affairs of a company. Due to the prevalence of the interest-based conventional banking system, most of the companies today end up dealing with interest even though it is not part of their major business activities. These companies would not qualify for Shariah–compliant investments. Such a

\textsuperscript{18} Oxford Islamic Finance and Dar Al Istithmar, A Universal Platform for Shari’a Compliant Equity Screening, white paper 7-7-2009, p.4.
development kept the majority of Muslim investors away from the stock markets for a long time.

It needs to separate Shariah-Compliant Stock out of the total stock that is traded in the market. Many institutions and organization around the world have stated to develop and provide their own Islamic Shariah-compliant Stock Index, to establish clear guidance on the types of equities that comply with Shariah requirements. Malaysia for example, the Bank Islam Malaysia Bhd was first initiator that made efforts to provide a list of Shariah-compliant stocks in 1983. The effort was followed by the introduction of a list of Shariah-compliant stocks by the Securities Commission of Malaysia in June 1997. However, the implementation of a process to identify Shariah-compliant stocks facilitates the establishment of Islamic indices. The first Islamic equity index was introduced in Malaysia by RHB Unit Trust Management Bhd in May 1996. This was followed by the launching of the Dow Jones Islamic Market Index (DJIM) by Dow Jones &Company in February 1999, the Kuala Lumpur Shariah Index (KLSI) by Bursa Malaysia in April 1999 and the FTSE Global Islamic Index Series by the FTSE Group in October 1999, Kuala Lumpur Shariah Index (KLSI) in April 1999, and Financial Times Stock Exchange Global Islamic Index (FTSE-GII). Since then, various specific Islamic index have been introduced at global, regional, and country level.\(^\text{20}\)


6.1.2.2. Criteria of Shariah Screening process

The developments of Shariah Screening process create a stringent set of criteria for investment, specially to facilitate Muslim and Islamic investors to investments in the various stock markets around the world. These criteria represent part of the screening process to identify companies which business performances do comply with a minimum requirement of Shariah-compliant standard. The criteria involves tests at the level of a company’s primary business and at the level of its financial or capital structure. In the more recent decade, such Shariah “screens” have been adopted by the major international index providers to establish specialized Islamic market indices. Some of prominent Islamic index are as follow;

Dow Jones Islamic Index

Dow Jones Indexes was the first initiator who launched Shariah-compliant indexes in 1999 in Bahrain. It was the first index created for investors seeking investments in compliance with Muslim Sharia law. The Dow Jones Islamic Market Index (DJIM SM) was the first attempt by any global index provider to create a measurement tool for Shariah-compliant investors. As it claim, the unique of DJIM SM is that it has its own Shariah Supervisory board for the purpose of advising on the DJIM Indexes, unlike other global index providers the outsource Shariah screening to pre-existing Shariah boards to minimize expenses. As of August 2011, The Dow Jones Islamic Market Index family involve 69

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indexes in country-level around the world. DJIM screens have since been adopted by the Auditing & Accounting organization of Islamic Financial Institutions [AAOIFI]-Standard 21.

**Dow Jones Islamic Index Screening Criteria**

Companies that will be included in Dow Jones Islamic Market Index must qualify the following criterion.

**Screen Criteria of Business Activities:** For DIMI SM, activities of the companies should not be inconsistent with Shariah precepts. Therefore, if any company has business activities that consider as the Shariah inconsistent industries, it is excluded from the Islamic index universe. The Shariah inconsistent industries in consideration of DJIMI Shariah Supervisory Board can be broadly categorised as:

- Alcohol products and related activities
- Pork related products
- Conventional financial services industries
- Entertainment industries include hotels, casinos, gambling, cinema, pornography, music, etc.
- Tobacco industries, and
- Weapons and defence industries.

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23 Dow Jones Indexes, Guide to The Dow Jones Islamic Market Indexes SM, p.3


24 Dow Jones, N.22.
Screen Criteria for Acceptable Financial Ratios: the companies that qualify in business activities will be tested by financial ratios screen to remove companies with unacceptable levels of debt or impure (interest) income by applying the following screens:

Debt to Market Cap: the companies that Total Debt \( \div \) Trailing Twelve Four Month Average Market Capitalization (TTMAMC) is greater than or equal to 33 per cent, will be excluded (Note: Total Debt = Short-Term Debt + Current Portion of Long-Term Debt + Long-Term Debt).

Liquid Assets to Market Cap: the companies that the (sum of Cash + Interest-Bearing Securities) \( \div \) TTMAMC is greater than or equal to 33 per cent, will be excluded.

Receivables to Market Cap:

the companies that Accounts Receivables \( \div \) TTMAMC is greater than or equal to 33 per cent, will be excluded. (Note: Accounts Receivables = Current Receivables + Long-Term Receivables).\(^{25}\)

Corporations passing the above screens criteria are qualified to be included as components of the Dow Jones Islamic Market Index.

**Standard & Poor’s Shariah Index**

Standard & Poor’s (S&P) is a United States-based financial services company that is well known for its stock-market indices. S & P introduced its first Shariah indices in 2006. As Standard & Poor’s applied Shariah screens to its three major indices – the S&P 500, the S&P Europe 350 and the S&P Japan 500. The results are the S&P 500 Shariah, the S&P Europe

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\(^{25}\) Dow Jones Indexes, N.23, pp.4-5.

Shariah and the S&P Japan 500 Shariah indices. To meet the demand for a benchmark Shariah product in GCC and Asia regions, Standard & Poor’s launched the S&P GCC Shariah Indices and the S&P Pan Asia Shariah Index in 2007. Subsequently several other regions have been targeted, including the GCC, the Pan Asia large-cap sector, global property markets, the Middle East & North Africa (MENA) and the Emerging markets, using the relevant Standard & Poor's underlying benchmark indices. Some of S&P Shariah Index series such as

- S&P 500 Shariah. (U.S.),
- S&P Europe 350 Shariah (17 European markets),
- S&P Japan 500 Shariah. (Japan),
- S&P/TOPIX 150 Shariah. (Japan)
- S&P/IFCI Large-Mid Cap Shariah (23 Emerging markets),
- S&P GCC Shariah (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and U.A.E.),
- S&P Pan Arab Shariah (11 Pan Arab countries) and ,
- S&P Pan Asia Shariah (China, Hong Kong, India, Indonesia, Malaysia, Philippines, Singapore, South Korea, Taiwan, and Thailand)\(^\text{26}\)

Standard & Poor’s has contracted with Ratings Intelligence Partners (RI) to provide the Shariah screens and filter the stocks based on these screens. Ratings Intelligence Partners is a London/Kuwait-based consulting company specializing in solutions for the

\(^{26}\) Standard & Poor’s, S&P Global Investable Shariah Index Series,

http://www2.standardandpoors.com/spf/pdf/index/SP_Global_Investable_Shariah_Index_Series_Factsheet.pdf [16 Sep. 11]
global Islamic investment market. S &P criterion of Shariah screening process can be shown as following;

Sector-Based Screens: by S &P Shariah screen, business activities unacceptable or non-compliant business refer to corporation that offer products and services related to Pork, Alcohol, Gambling, Conventional Financial service, Advertising and Media (newspapers are allowed, sub-industries are analysed individually), Pornography, Tobacco, Trading of gold and silver as cash on deferred basis are screened out.

Accounting-Based Screens: After a company pass Sector-Based Screens, certain company financial ratios has to be measured in three focus areas as leverage, cash, and the share of revenues derived from non-compliant business activities.

Leverage Compliance: leverage level of a corporation must be less than 33 per cent of total equity market value. This financial ratio measure as Debt / Market Value of Equity (12 Month average)

Cash Compliance: these ratio references to cash holdings. These are:

- Accounts Receivables \div Market value of Equity (12 Month average) must less than 49 per cent

- (Cash + Interest Bearing Securities) \div Market value of Equity (12 Month average) must less than 33 per cent

Revenue Share from Non-Compliant Activities: a corporation’s income from non-compliant activities must be less than 5 per cent of total revenues; (Non-Permissible Income other than Interest Income) \div Revenue is less than 5 per cent.
Dividend Purification Ratio: this ratio is provided to investors for purification purposes, it is calculated as Dividends \times \frac{\text{Non Permissible Revenue}}{\text{Total Revenue}}^{27}

The Securities and Exchange Commission (SEC) Malaysia index

In Malaysia, the central level of Screening for Shariah compliant stocks is done by the Shariah Advisory Council (SAC) of the Securities and Exchange Commission (SEC). List of Shariah compliant stocks would be announced by SAC twice a year. In screening criteria of SEC, it is interesting to note that in financial screening, criteria is not to examine the ratio of debt or liquidity as there are no restrictions on the proportion of debt or proportion of liquid assets in total assets in Shariah stock screening criteria of SEC. Thus screening will require income statements but not the balance sheets of the business corporations.

Screening Criteria of SEC Malaysia

Screening Criteria of SEC can be discussed in detail as following:

Core Activities: The main business of the corporation should not be Shariah incompatible. Therefore corporations that their main business involve with following activities are excluded:

- Financial services based on Riba (interest)
- Conventional insurance
- Gambling
- Manufacture or sale of non-halal products or related products

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27 Standard & Poor, S&P Shariah Indices Methodology, 2007, pp. 6-7 [16 Sep. 11]
- Entertainment activities that are non-permissible according to Shariah
- Manufacture or sale of tobacco-based products or related products;
- Stockbroking or share trading in Shariah non-approved securities, and
- Other activities deemed non-permissible according to Shariah

Mixed Activities: For corporations whose business comprises both permissible and non-permissible elements, the SAC considers two additional criteria:

1) The public perception or image of the corporations must be good.

2) The core activities of the corporation are important and considered as maslaha (public interest) to the Muslim ummah (nation) and the country. The non-permissible element must be very small and involves matters such as Umum Balwa (common plight and difficult to avoid), uruf (custom) and the rights of the non-Muslim community which are accepted by Islam.

Benchmarks of Tolerance: although SEC permits the business corporation that dealing in both Shariah and non-Shariah activities, however, the certain ratio of revenue of non-Shariah is defined by the Benchmarks of Tolerance. Therefore, if profit before tax from non-Shariah activities of the business corporations exceeds the benchmark ratio, the stock of the business corporations will be excluded from the list. The benchmarks are:
a) The 5 per cent benchmark: in case of the activities that are clearly prohibited by Shariah law such as Riba transaction, gambling, liquor and pork. The total contributions revenue combine by these activities must not exceed 5 per cent of company total revenue.

b) The 10 per cent benchmark: in case of the business that involve the activities that involve the element of ‘umum balwa” which is a prohibited element affecting most people and difficult to avoid such as interest income from fixed deposits in conventional banks. The total contribution of revenue combine by these activities must not exceed 10 per cent of company total revenue.

c) The 25-percent benchmark: in case of the business that are generally permissible according to Shariah and have an element of Maslaha (public interest), but there are other elements that may affect the Shariah status of these activities such as hotel and resort operations, share trading. As this kind of business activities might involve other activities that are deemed non-permissible according to the Shariah. The mixed contributions from these activities must not exceed 25 per cent of corporation’s total revenue.

4. Debt and Liquidity: No restrictions on the proportion of debt or proportion of liquid assets in total assets.28

**KMI-30 index**

KMI-30 is Country level index of Pakistan. It was created by coordination between The Karachi Stock Exchange (KSE) and Al-Meezan Investment Management Limited. This index was first introduced on 1 September 2008. It objectives to provide a relevant

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benchmark to Islamic equity funds for comparing their performance, returns on Shariah Compliant equity investments, and help Shariah conscious people choose the profitable stocks which are Shariah Compliant. Al Meezan Investments provide its Shariah expertise, guidelines, skills and stocks screening towards the activities with regard to launching and continuation process of the Index. On the contrary, KSE provides maintenance and support for the index. The screening criterion of KMI-30 can be described in detail as below:

To qualify as Shariah compliant under KMI-30, a stock must meet all the six key requirement

1. Business of Company: main business of the company must be halal. Hence, investment in securities of any company dealing in haram activity such as conventional banking, conventional insurance, alcoholic drinks, tobacco, pork production, arms manufacturing, pornography or related activities is not permissible.

2. Debt to Total Assets: Debt to Asset ratio should be less than 40 per cent. Debt, in this case, is classified as any interest bearing debts. Zero coupon bonds and preference shares are included.

3. Non-compliant Investments to Total Assets: The ratio of non-compliant investments to total assets should be less than 33 per cent. The non-compliant investments that calculated in this ratio is also including any investment in non-compliant security.

4. Non-complaint Income to total revenue – Purification of Non-compliant income: The ratio of non-compliant income to total revenue should be less than 5 per cent. Total
revenue includes Gross revenue plus any other income earned by the company. This amount is cleansed out as charity as a pro rata ratio of dividends issued by the company.

5. Illiquid Assets to Total Assets: The ratio of illiquid assets to total assets should be at least 20 per cent. Illiquid asset in this criterion refer to asset that Shariah permits to be traded at value other than the par.

6. Net Liquid Assets to Share Price: The market price per share should be greater than the net liquid assets per share calculated as: (Total Assets – Illiquid Assets – Total Liabilities) divided by number of shares

6.2. Islamic Funds

Shariah-compliant funds started to appear during 1990s as equity investment was widely accepted by Shariah scholars in the early 1990s. This acceptance paved the way to launch mutual funds that operate in compliance with the Islamic Law. Moreover, recent launch of reliable equity benchmarks by various global index providers such as the Dow Jones, S & P and other regional and country level index providers have been a turning point for the Shariah-compliant fund industry. As this industry continues to grow and being more sophisticated, Shariah-compliant funds are not being only a halal investment alternative available for Muslim investors but now the funds also respond to the specific need for

more liquid investment tools. Growth of Shariah-Compliant Funds have increased in number and size as it started from 13 funds in 1996 to 150 in 2000. The industry had grown at approximately 22 per cent per annual between 2000 and 2005. The number of funds reached 400 by 2006. Recently research made by Ernst & Young in 2011, estimating that assets of Islamic funds are growing up to 58 billion US dollars. Event reflected in a slowdown in the number of new funds launched in 2007 to 2009 from 173, 78, 29 respectively, the total number of funds has reached up to around 760 at the end of 2010. The total assets under their management have reached 58 billion US dollars.

Figure 6.9: Islamic Fund worldwide

![Bar Chart](chart.png)


Fund management refers to investors pooling their resources to invest in Shariah-compliant business activities through any manager collectively, thus they could not invest individually. At present, there are about 800 Shariah-compliant investment funds facilities to investors in various parts of the world. These mutual funds of various categories are providing low risk/moderate return, balanced risk/return and high risk/high return. The major segment of the funds are equity funds while a number of hybrid funds are managing leasing, real estate, Takaful and other funds.

Generally, Islamic funds are managed and conducted on two basis methods

1. Mudarabah basis and,

2. Agency basis

In case of funds that be carried out on Mudarabah principle, the fund manager would get per-greed percentage of the realized profit. While, manager of a fund that is built on agency principle would get a fee on agreed terms that could be any specified amount of cash or percentage of the net asset value of the fund. Following are Islamic investment fund described by Shaikh Taqi Usmani:

1. Equity funds, the proceeds of which are invested in shares of joint stock companies, and returns in the form of capital gains and dividends are distributed on a pro rata basis among the investors.

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34 Muhammad Ayub, *Understanding Islamic finance* (West Sussex: John Wiley & Sons Ltd, 2007) p.201

35 Muhammad Taqi Usmani is a Hanafi Islamic scholar from Pakistan who was born in 1943. He served as a judge on the Federal Shariat Court of Pakistan from 1981 to 1982 and the Shari'a Appellate Bench of the Supreme Court of Pakistan from 1982 to 2002. He is an expert in the fields of Islamic Jurisprudence (fiqh), economics and hadith. He also held a number of positions on the Shariah Boards of prestigious Islamic institutions, and is one of the most influential Islamic authors outside the Middle East.
2. Ijarah funds: The capitals of such funds are used to purchase the assets for the purpose of leasing. Rentals received from the user are distributed among subscribers of the fund. Ijarah fund certificate can be traded in the secondary market on the basis of market forces. Anyone who purchases these certificates replaces the sellers in the pro rata ownership of the relevant assets and all the rights and obligations of the original subscriber are passed on to him.

3. Commodity funds: in which the subscription capitals are used to invest in different commodities for the purpose of resale. The profits generated by the sales are distributed among the subscribers.

4. Murabaha funds: Any fund created for Murabaha sale should be a closed-end fund; its units cannot be negotiable in a secondary market as an Islamic bank’s portfolio of Murabaha does not own any tangible assets.

5. Mixed funds: the subscription capitals are employed in different types of Shariah-compliant investments like equities, leasing, and commodities. For trading of mixed funds, the tangible assets should be more than 51 per cent, while the liquid assets and debts less than 50 per cent.\(^\text{36}\)

For detail, Islamic funds can be categorized into various categories such as realty and property funds, commodity funds, leasing (Ijarah) funds, investment and Murabahah funds. However, the most common type of Islamic funds is equity funds, funds that built on the

\(^{36}\)Muhammad Ayub, N.34, p.201
investment in Shariah-compliant stock.\textsuperscript{37} With Shariah investment guidance in place, the establishment of Islamic investment funds gained momentum. The Amana Income Fund, the first Islamic equity fund to be established in the United States, was formed in June 1986 by members of the North American Islamic Trust (NAIT), an organisation in Indiana, which oversees the funding of mosques in the United States. In 1987, Dallah AlBaraka Group established two companies, namely Al-Tawfeek and Al-Amin, which were specifically dedicated to the development of Islamic equity funds. These companies have successfully launched a number of Islamic funds focusing on such diverse sectors such as real estate as well as international equities.\textsuperscript{38} Recent Islamic equity funds being launched include the Alfanar US Equity Hedge Fund, which was launched in 2003 as the world’s first Islamic hedge fund by the Saudi Economic and Development Company (SEDCO) and the Permal Group.\textsuperscript{39}

Equity funds accounted for the largest segment in Islamic fund, it accounted 39 per cent of total assets management by Islamic funds. Another smaller segment are commodities fund with accounted around 15 per cent, alternative investments and feeder funds 13 per cent, fixed income 12 per cent, real estate 10 per cent, money market 9 per cent and Balanced 2 per cent.\textsuperscript{40}

\textsuperscript{37} Report of The Islamic Capital Market Task Force of The International Organization of Securities Commissions, JULY 2004 Pp.30-31

\textsuperscript{38} Ibid, p.28.

\textsuperscript{39} Ibid, pp.30-31.

\textsuperscript{40} Ernst & Young, N.32,
Ernst & Young's analysis indicated that the bulk of Islamic funds are small scale with 70 per cent of fund managers, 139 out of 201, having less than 100 million US dollars under management, including a third that have less than 25m. Only 22 fund managers or 11 per cent of the total Islamic funds have more than 500 million US dollars assets under management and it is 50 time smaller in size if compared with top 25 conventional fund manager. Achieving scale is even more critical to ensure long term sustainability of Islamic fund market that still not present in present times.
Presently Islamic mutual funds are operating mainly in Saudi Arabia, UAE, Bahrain, Kuwait, Qatar, Pakistan, Malaysia, Brunei, Singapore, Germany, Ireland, UK, USA, Canada, Switzerland and South Africa. Efforts are underway to provide investment facilities through mutual funds in all parts of the world to capture the emerging demand.\textsuperscript{41} Based on number and value, managed in four jurisdictions, Saudi Arabia is the biggest country in term of number of Islamic fund as Saudi Arabia alone contains 181 funds. This is followed by Malaysia Kuwait and UAE. As the country outside Islamic world, USA is another country that shows significant sign in development of Islamic fund as though it contains only 8 funds in the country but the value of fund assets is 2.7 billion US dollars.\textsuperscript{42}

\textsuperscript{41} Muhammad Ayub, N.34, p.201

\textsuperscript{42} TheCityUK, N. 33, p.8
However as recently reported by Ernst & Young in 2011, Islamic funds market are still dependent on few institutional investors as Institutional Funds make up two-thirds of the total new funds launched. Such over dependence is a key structural weakness in Islamic markets globally.\(^{43}\) As the figure 5.13 shows that the market of Islamic funds still depend on institutional investor as more than 50 per cent of total Islamic funds are launched by institutional investors each year. Moreover, this dependence has increased every year as 57 per cent in 2007 to 68 per cent in 2008. In 2009 and 2010 the figure stay at 67 per cent.

The figure pointed out that the over dependence on a few institutional investors is a key structural weakness in Islamic investments markets globally and that achieving scale is even more critical to ensure long term sustainability for the Islamic funds industry worldwide and over 70 per cent of fund managers fall below the estimated break-even AuM level of 100 million US dollars.

6.3. Derivative in Islamic finance market

During recent decades, the investment nature and climate have transformed significantly from a simple and direct investment in typical asset class like real estate, share, equity, and fixed income and another money market instrument into a more demanding and multifaceted instrument. As one can observe that the increase in the usage of index and a more complex derivative instruments, more and more investors work away from direct exposure to the stock but keen toward exposing themselves to the portfolio
investment which the risk return profile can be improved and more manageable. Since then hedge on financial risk become normal practice and financial risk management become essential for any business. With rising of demand of financial tool to maximize portfolio profit and minimize risk, many financial instruments have been developed such as options, future and swaps which stem from debts and involve sale and purchase of debts/liabilities. As a group, such instruments are called derivatives. In short, a derivative is a financial product whose value is a function of the value of another asset, generally takes the form of a contract in which the investor promises to deliver, or take delivery of an underlay asset at a specific date and at a specific price. Although, these financial instrument are regarded very complex and risky contracts however according to Bank for International Settlements it global market size of OTC derivatives market was 596 trillion US Dollars worth in terms of notional amount outstanding at the end of June 2007. The


45 Muhammad Ayub, N. 34, p.209.


47 The value of a derivative's underlying assets at the spot price. In the case of an options or futures contract, this is the number of units of an asset underlying the contract, multiplied by the spot price of the asset. Because of the same assets might be involved in several different derivatives. A derivative is a financial instrument whose value depends on something else such as a share of stock, an interest rate, a foreign currency, or a barrel of oil, for example. One kind of derivative might be a contract that allows you to buy oil at a given price six months from now. But since we don’t yet know how the price of oil will change, the value of that contract can be very hard to estimate. As a result, financial experts have to make an educated guess about the total amount at stake in all these contracts. One method simply adds up the value of the assets the derivatives are based on. For example if contract allows to buy 50 barrels of oil and the current price is 100 US dollars, its "notional value" is said to be 5,000 US dollars. If one make that same calculation for every derivative and add those numbers together, one get something around 596 trillion US dollars, the "notional value" of the world’s over-the-counter derivatives at the end of 2007. However, within that 596 trillion US dollars are derivatives that effectively relate to the same assets, than the "notional amount" isn’t usually a very good representation. An alternative way to measure the size of the derivatives market is to calculate the
global derivatives market size by this measure is four times larger than the combined global equity and bond markets measured by market capitalization. At present, the market is reaching to 708 trillion US dollars in terms of notional amount outstanding by the end of June 2011.

As far as Islamic financial domain is concerned, one can observe that there are many Islamic risk management tools and Islamic derivative products which appeared in the current market such as Islamic profit rate swaps which was an Islamic replication of conventional interest-rate swaps, and The Islamic Cross Currency Swap. There appearing is implicit that the demand of Shariah compliant hedging transactions has increased and hedging of actual risk is recognised as economic necessity by Islamic investor. Although, discussion and debate on the matter of whether derivatives are acceptable from the Shariah perspective has been going on. As for the questions of whether derivatives are clear of wrongful devouring of the properties of others and whether they are concluded through mutual consent of the trading parties or whether derivatives involve speculative risk-taking or Gharar. Many Shariah scholars have accepted the use of derivative hedging as

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a tool of prudence and risk management, but the use of derivatives for speculation is still not acceptable. In conventional derivatives, call and put options, futures, forwards, and swaps are generally used for hedging, arbitrage, and speculation. However, derivative accepted scholars allow using derivatives for the purposes hedging and arbitrage only and ban their use for speculation or gambling (maisir). As long as riba (interest) and gharar (uncertainty) are avoided, the Islamic derivative structure used in hedging and arbitrage enjoys significant freedom of design.\(^5^3\) Since the emerging of this market have evoked divergent responses from the Shariah scholars, many have gone on record to declare them prohibited. However considerable numbers of Shariah scholars have also taken the view that they are permissible. Since there is no consensus over these issues yet, the matter may be said to be still open to further investigation.

Practically, financial derivatives in Islamic financial market grew up considerably with more and more international players such as Deutsche Bank, BNP Parisbas, and the Swiss UBS entering into the market with an aim at affluent investors from Middle East region and worldwide as well as retail markets.\(^5^4\) The market of Islamic derivative market has grown since the early 2000s, but it was slow and bespoke. Various types of derivatives have provided into the markets including Islamic profit rate swap and Islamic hedge funds.\(^5^5\) A notable development was occurring in Malaysia when two Malaysia’s bank, Bank Islam and Bank Muamalat Malaysia,

\(^{53}\) Bala Shanmugam, Zaha Rina Zahari , N.46, p.51.


made agreement to execute a derivative master agreement for documentation of Islamic
derivative transactions in November 2006.\textsuperscript{56} In October 2007, Deutsche Bank executed the first
Islamic Collar Profit Rate swap\textsuperscript{57} with Dubai Islamic Bank (DIB), the transaction was over 500 million
US dollars in notional value.\textsuperscript{58}

The launching of the ISDA/IIFM Tahawwut (Hedging) Master Agreement is the latest
development that is considered as mile stone of Islamic derivative domain. Since, the
increasing application and innovation of the methodologies associated with derivative instruments
have revolutionized the global financial industry over the years. Derivatives have become necessary
tool to the international financial arena. In conventional market, the process of document
standardization in derivative based transactions has reached the point of uniform application. Such
as the ISDA master agreement was published by The International Swaps and Derivatives
Association (ISDA) in 1992 and 2002. Thus huge amount of uncertainty and risk associated with
these types of transactions have been removed. The trend of current Islamic financial market
toward derivative products is also going toward favour of unification and standardization of risk
management instrument and derivative products within Shariah framework. In Islamic financial

\textsuperscript{56} Paul S. Mills, Andreas Jobst, Peter Kunzel, Amadou N. R. Sy, eds, \textit{Islamic Bond Issuance - What Sovereign
Debt Managers Need to Know}, IMF Policy Discussion Paper PDP/08/3, (International Monetary Fund, 2008)
p.12.

\textsuperscript{57} Collar is a protective options strategy that is implemented after a long position in a stock has experienced
substantial gains. It is created by purchasing an out of the money put option while simultaneously writing an
out of the money call option. A collar can be established by holding shares of an underlying stock, purchasing a
protective put and writing a covered call on that stock. The option portions of this strategy are referred to as a
combination. Generally, the put and the call are both out-of-the-money (For a call when an option’s strike
price is higher than the market price of the underlying asset, For a put when the strike price is below the
market price of the underlying asset.) when this combination is established, and have the same expiration
month. Both the buy and the sell sides of this spread are opening transactions, and are always the same
number of contracts. In other words, one collar equals one long put and one written call along with owning
100 shares of the underlying stock. The primary concern in employing a collar is protection of profits accrued
from underlying shares rather than increasing returns on the upside.

\textsuperscript{58} Zamir Iqbal, Abbas Mirakhor, Hossein Askari, \textit{Globalization and Islamic Finance: Convergence, Prospects
domain, the attempt to document standardization is very recently. Although many questions such as permission of Shariah principle on derivative transactions and other speculative instrument or the question that this kind of instrument is really necessary for Islamic finance to deal with Islamic risk management do remain. The International Islamic Financial Market (IIFM) and the International Swaps and Derivatives Association, Inc. (ISDA) launched the ISDA/IIFM Tahawwut (Hedging) Master Agreement on March 1, 2010. The attempt was considered as first important step towards standardisation of Shariah compliant hedging transactions. To ensure that the ISDA/IIFM Tahawwut Master Agreement is consistent with other market standard documentation. The architecture of ISDA/IIFM Tahawwut Master Agreement is very much on the lines of the ISDA Master Agreement. Although, the agreement is based on the structure of the 2002 ISDA Master Agreement however the ISDA/IIFM Tahawwut Master Agreement has many key distinguishing features that aim to bring efficiency, liquidity, and certainty to Islamic financial market as well as to ensure that the derivative instruments are compliant with Shariah order. According to The Master Agreement, the Shariah qualified derivative instrument essentially has to surrender all form of interest provisions embedded within its structure. Therefore no compensation or interest is payable on defaulted or deferred payments or deliveries or on unpaid amounts. In addition an arbitration clause has been inserted and certain events of default and termination events amended to fit the structure of a Shariah-compliant derivative transaction. As the 2002 ISDA, the ISDA/IIFM Tahawwut Master Agreement is a master or framework agreement. The agreement itself does not give rise to any enforceable obligations.

In fact, ISDA and IIFM jointly developed the Tahawwut documentation under the guidance and approval of the IIFM Shariah Advisory Panel and in consultation with market participants. The published document consists of the Tahawwut Master Agreement and an
Explanatory Memorandum, both of which are part of the official Shariah Pronouncement. It provides the structure under which institutions can undertake Islamic hedging transactions such as profit-rate and currency swaps, which represent most of today's Islamic hedging transactions, and is designed to be used between two principal counterparties. Parties understand that no interest shall be payable or receivable and no settlement based on valuation or without tangible assets is allowed. Moreover, the counter parties affirm that they enter into Shariah-compliant transactions only. It is a completely new framework document though the structure of the document is similar to the conventional ISDA Master Agreement. The key mechanisms and provisioning such as early termination events, closeout and netting are developed based on the Islamic Shariah principles.

Although the form of derivatives that have been offered in the present market are various. However types of financial risk management tools and derivative products that claim to be Islamic can be roughly differenced into three groups.

1. Those that are formally being standardized, such as the ISDA/IIFM Tahawwut (Hedging) Master Agreement;

2. Risk management methods directly based on the well-recognized Islamic financing modes and rules; and

3. The possibility to use formal Shariah-compliant mechanisms to replicate conventional risk management products and risk profiles.

However Islamic profit-rate and currency swaps, which fall into first category, represent the most of Islamic hedging transactions at present.60

59 http://www.iifm.net/default.asp?action=article&id=155 [8 February 2012]

60 ISDA Press Releases “IIFM and ISDA Launch Tahawwut (Hedging) Master Agreement” March 1, 2010
The Islamic Profit Rate Swap: A profit rate swap is an analogized hedging transaction of conventional interest rate swap. It is a basic derivative product traded over the counter where two parties agree to exchange future periodic profit cash flows based on predetermined notional amount. It is agreement to exchange profit rates between a fixed rate party and a floating rate party or vice versa implemented through the execution of a series of underlying contracts to trade certain assets under the Shariah contracts. Each party’s payment obligation is computed using a different pricing formula. In Islamic profit rate swap, the notional principal is never exchanged as it is netted off using the Islamic principle of Muqasah. Islamic Profit Rate Swap can be structured based on the Shariah principles such as Murabahah, Bai Bithaman Ajil (BBA), Bai-al-Inah, Al-Wa’ad. An Islamic profit rate swap aims to match funding rates with return rates from investment, achieve lower cost of funding, restructure existing debt profile without raising new finance or altering the balance sheet and manage exposure to interest rate movement. It is also aimed to protect financial institutions from fluctuations in borrowing rates and to provide a risk control mechanism.

61 The discharge of a debt receivable against a debt payable. An example of contemporary application of this contract is Letter of Set-Off.


63 BBA is a sale contract in which the payment of the price, a cost-plus profit, is deferred and payable at a certain particular time in the future.

64 Sale of a commodity on credit and repurchasing it for a lesser amount in cash. It is accepted by Shafie’s Teaching and confined within Malaysia.

65 Al-Wa’ad in Islamic law means promise of a person or a group on a particular subject matter. In this case the promise is to purchase commodity at a certain particular time in the future, at a specific price.

Islamic Cross-currency swaps: Islamic Cross-currency swaps is another prevalent hedging transaction that appeared very recently when Standard Chartered executed the first ever swap transaction of this kind for Bank Muamalat Malaysia in July 2006. This was followed by Citigroup designing a currency swap for the Dubai Investment group (DIB) to hedge the currency risk on DIB’s investment in Bank Islamic Malaysia. The basic structure of an Islamic Cross-currency swap is to match two commodity murabaha sale contracts that generate offsetting cash flows in opposite currencies with maturities desired by the contracting parties.

Obviously, the market of Islamic derivative products is very recent development of Islamic financial markets as it almost started in mid of 2000s. The size of the Islamic derivative market is not known but is quite small. However, with the needs for Halal hedging products of Islamic financial institution and Islamic investors, to optimum their risk management, the potential demand for Shariah compliant risk management products and growth of the markets are very substantial. The new ISDA/IIFM Tahawwut Master Agreement that launched in 2010 is hoped to bring effective risk management to Islamic financial market participants. As the new Master Agreement will facilitate cost-effective entry into transactions as well as assist emergence of new entrants into the market. Currently, active market participants can readily integrate the ISDA/IIFM Tahawwut Master Agreement into their existing documentation platform and there is a potential for increased integration of Shariah-compliant financial products into securities platforms.

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Conclusion

Apart from Sukuk market, Shariah-Compliant Stock, Funds and Derivative Product is other component of Islamic Financial Market which gradually gained attention from market participants. By August 2011, the size of Shariah-compliant stock kicked 19,995.5 billion US dollars in terms of market capitalization and more than 2500 companies were being listed on the Dow Jones Islamic World Index. The Islamic equity market is essentially part of a broader Islamic financial market in which the activities being carried-out are guided by the Islamic law or Shariah. The guidelines governing the Islamic financial markets are establishing basic principles that govern the rights and obligations of the participants in the Islamic financial markets which built on two main sources of Quran and Sunnah. However, some difference of opinion towards particular matter may occur as defined by the respective Shariah scholars. Thus these matter criterions have slight differences in a particular market screen criteria. However, the main difference between the conventional and Islamic financial products is that all the transactions in the Islamic financial market could not involve in Haram activities such as alcohol, tobacco, pork-related products, conventional financial services. Furthermore those elements that could result in exploitation and unfair gains must be avoided or at least minimized to meet the requirement of Shariah law according to particular screen criteria, thus interest (riba), excessive ambiguity (gharar), and gambling (maysir) must be avoided or minimized. Since, considerable numbers of Shariah-Compliant Stock are setting their place on capital market. Shariah-compliant funds started to appear during 1990s as equity investment was widely accepted by Shariah scholars in the early 1990s. The mile stone of development in the
Shariah-compliant fund industry occurred in late 90’s when the reliable equity benchmarks were offered by various global index providers such as the Dow Jones, S & P as well as other regional and national level Index providers entering into the segment. As industry is continuing to grow and getting more sophisticated, Shariah-compliant funds are not only a halal investment alternative available for Muslim investors but now the funds also respond to the specific need for more liquid investment tools. The number of Islamic funds are growing as in 2011 the fund number was estimated to be more than 800 funds. In the domain of Islamic financial market, derivative instruments are very rare experience. It is entirely new segment of Islamic financial market as it first appeared in 2004 in Malaysia. At present, although the debate on Islamic derivatives is going in many aspects, the number of Islamic institution are actively using them as the risk management tool and starting to offer these Shariah compliant derivatives to their clients. The potential growth is expected as the strong acceptance of these instruments is highlighted by the trend toward their worldwide standardization. ISDA/IIFM Tahawwut Master Agreement is expected to be base of development of Islamic derivative and hedging instrument in over-the-counter Shariah compliant derivatives market.