

# REVISED SHARIAH SCREENING METHODOLOGY

## -Dialogue Session with Public Listed Companies



**20-21 February 2013**

# Objectives

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- To provide an overview of the revised Shariah screening methodology to be adopted by the Shariah Advisory Council (SAC) of the Securities Commission Malaysia

# Background

1995	The SAC introduced 4 activity-based screening benchmarks.
1997	The SC announced the official list of Shariah-compliant stocks/securities listed on Bursa Malaysia.
1998	The list of Shariah compliant securities announced twice yearly
1999	Bursa Malaysia launched the Kuala Lumpur Shariah index.
2000	Announcement streamlined to April and October
2004	<ul style="list-style-type: none"> <li>• The SC disclosed the benchmarks applied in the screening of Shariah-compliant securities.</li> <li>• Shariah-compliant review at pre-IPO stage undertaken by the SAC upon application by issuer (voluntarily)</li> </ul>
2007	<ul style="list-style-type: none"> <li>• Announcement changed to May and November</li> <li>• Bursa Malaysia and FTSE launched two Shariah indices.</li> </ul>

# Existing Shariah Screening Methodology

## Dual Approach of Screening



### **1. Quantitative**

Compute the contribution of non-permissible activities and compare with group revenue and group profit before tax:

- 5%
- 10%
- 20%
- 25%

### **2. Qualitative**

- Public perception or image
- Maslahah

# Revised Shariah Screening Methodology

## Dual Approach of Screening

### 1. Quantitative

Compute the contribution of non-permissible activities and compare with group revenue and group profit before tax:

- 5%
- 20%

Compute the financial ratios (<33%):

- Debt/Total Assets; and
- Cash and Cash Equivalent/Total Assets






### 2. Qualitative

- Public perception or image

### Revised

- 1) Streamlined current activity benchmarks
- 2) Introducing financial ratio test

# Streamlined Current Activity Benchmarks

Current	Revised
<p><u>5% benchmark</u></p> <ul style="list-style-type: none"> <li>• Conventional banking</li> <li>• Conventional insurance</li> <li>• Gambling</li> <li>• Liquor and liquor-related activities</li> <li>• Pork and pork-related activities</li> <li>• Non-halal food and beverages</li> <li>• Shariah non-compliant entertainment</li> </ul>	<p><u>5% benchmark</u></p> <ul style="list-style-type: none"> <li>• Conventional banking</li> <li>• Conventional insurance</li> <li>• Gambling</li> <li>• Liquor and liquor-related activities</li> <li>• Pork and pork-related activities</li> <li>• non-halal food and beverages</li> <li>• Shariah non-compliant entertainment</li> <li>• Interest income from conventional accounts and instruments</li> <li>• Tobacco and tobacco-related activities; and</li> <li>• Any other activities as determined Shariah non-compliant by the SAC</li> </ul>
<p><u>10% benchmark</u></p> <ul style="list-style-type: none"> <li>• Interest income from conventional accounts and instruments </li> <li>• Tobacco and tobacco-related activities </li> </ul>	<p><u>20% benchmark</u></p> <ul style="list-style-type: none"> <li>• Hotel and resort operations</li> <li>• Share trading</li> <li>• Stockbroking business</li> <li>• Rental received from Shariah non-compliant activities</li> <li>• Any other activities as determined Shariah non-compliant by the SAC</li> </ul>
<p><u>20% benchmark</u></p> <ul style="list-style-type: none"> <li>• Rental received from Shariah non-compliant activities</li> </ul>	
<p><u>25% benchmark</u></p> <ul style="list-style-type: none"> <li>• Hotel and resort operations </li> <li>• Share trading </li> <li>• Stockbroking business </li> </ul>	

# Newly Introduced Financial Ratios

## i) Cash over Total Assets [Cash ratio]

Cash will only include cash placed in conventional accounts and instruments, whereas cash placed in Islamic accounts and instruments will be excluded from the calculation

## ii) Debt over Total Assets [Debt ratio]

Debt will only include interest-bearing debt whereas Islamic debt/financing or sukuk will be excluded from the calculation.

Both ratios, which are intended to measure riba and riba-based elements within a company's balance sheet, **must be lower than 33%**.

# How does the revised methodology affect the Shariah-compliant status of listed companies?

The Shariah-compliant status of the company may be affected in the following manner:

- i) Companies with mixed activities which are currently assessed under the 10% or 25% benchmarks may be affected because their activities are now assessed under the 5% or 20% benchmarks

Example:

Company A	Shariah non-compliant activity	Current methodology [ 10% benchmark]	Revised methodology [ 5% benchmark]
Business activity : Property development, trading of building materials and <b>manufacture and distribution of cigarettes (tobacco)</b>	Tobacco's revenue / Group revenue= 9%	Status : <b>Shariah-compliant</b>	Status : <b>Shariah non-compliant</b>



# Con't...

ii) Companies with high level of conventional debt may be affected as currently there is no screening based on the total conventional debt of the company

Example:

Company A	Level of conventional debt	Current methodology	Revised methodology [ 33% benchmark]
Business activity : Property development, trading of building materials and construction works	Total conventional debt / group total assets = 39% n.a	Not applicable  Status : <b>Shariah-compliant</b>	Status : <b>Shariah non-compliant</b>

# How We Do the Screening?

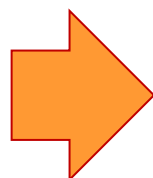
Public listed companies

Screening?

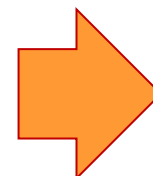
Status

**Core Activity:**

- Gambling
- conventional banking
- Conventional insurance
- Manufacturing of liquor
- etc



No need



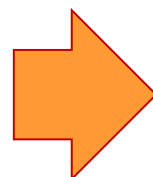
Shariah non-compliant

**Core Activity:**

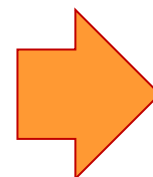
- Construction
- Plantation
- Etc

**Subsidiaries involved in:**

- Tobacco
- Gambling
- Insurance
- Conventional banking



Yes



Could be Shariah-compliant or otherwise

How?

# Example – ABCD Berhad

Activity	Group Fin. Information	Non-compliant information
Core: Construction	TO : RM20 mln PBT: RM12 mln	Interest income from fixed deposits : RM 0.9 mln
Other activities: Distribute liquor	Total Asset : RM80 mln Total cash: RM 20 mln Total debt : RM 40 mln	TO liquor : RM 0.5 mln PBT liquor : RM 0.2 mln

	Test	Result
1) Activity	Interest income/Group TO = 4.5% TO liquor/TO Group = 2.5% PBT liquor/ PBT Group = 1.7%	Compliant (<5%) Compliant (<5%) Compliant (<5%)
2) Financial ratio	Cash <sup>^</sup> Ratio = 25% Debt <sup>^</sup> Ratio = 50%	Compliant (<33%) <b>Non-compliant</b> <b>(&gt;33%)</b>

<sup>^</sup> refers to conventional cash and conventional debt

**Overall result : Securities of ABC Berhad is Shariah non-compliant**

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**Thank You**

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# **Q & A**