Understanding Shariah Compliant Indexing

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Introduction

Islamic finance is a rapidly developing sector, servicing a global and growing Muslim population of around 1.9bn people.

With around US$4tn in assets, Islamic finance represents only one percent of the conventional financial system and is forecast to grow at double-digit rates over the coming years. This fast rate of expansion reflects the growing demand from an increasingly savings-rich client base and the increasing sophistication of Islamic financial and investment products.

In this paper, we introduce the central ideas of Islamic finance, before looking at recent market trends and noting the role of the UK and the London Stock Exchange Group (LSEG) in this important industry. We then explore the ways Islamic equity and bond indices are constructed, using the FTSE Russell benchmark range, including those we run in partnership with our Shariah screening partners. A recent report by LSEG FX showed how Islamic finance assets have grown steadily since 2015 across all the market segments. With the ever-changing macro-economic environment, we also offer some insight into what the markets might hold for Islamic finance over the short / medium term, and whether the prevailing environment is one of growth or contraction.

The paper ends with a glossary of important Islamic finance terms.

I hope it will serve as a helpful introduction to anyone interested in this increasingly important part of the world’s financial markets, and set out why the established principles of Islamic finance can align with modern financial approaches such as indexing.
Islamic finance (also known as Shariah-compliant finance) is finance that conforms to the moral precepts of Islam.

Islamic finance differs from conventional (Western) finance in its approach to money: it is based on the belief that money doesn’t have any intrinsic value. Instead, according to Islamic scholars, money should be seen just as a medium for exchanging products and services. Linked to this idea is a ban in Islamic finance on making money from money in the form of interest.

Islamic finance also prohibits investment in goods or services seen as harmful. This prohibition covers activities such as the production and sale of alcohol, tobacco and gambling.

Another principle in Islamic finance is that of partnership between the provider of finance and the entity receiving it. This means that the profits and risks of a business venture should be shared as far as possible, rather than one party claiming most or all of the upside or bearing the full risk of loss. In the Islamic finance partnership, losses and profits are often shared according to a pre-agreed ratio.

Activities seen as permissible and desirable within Islamic finance are called ‘halal’ and those seen as prohibited are called ‘haram’. These interpretations are made by Islamic scholars on the basis of three primary sources: the Qur’an, the Hadith (the sayings of the Prophet Muhammad) and the Sunnah (the practice and traditions of the Prophet Muhammad).
Size of Islamic Finance

Islamic finance is a rapidly growing part of the global financial markets. According to LSEG FX, global Islamic finance assets grew from $2.17trn in 2015 to $3.96trn in 2021, and are forecast to increase to nearly $6trn by 2025 (see Figure 1).

![Figure 1: the growth of Islamic finance](image)

Global Islamic Finance industry landscape

Islamic Finance Assets Growth (2015 - 2021, USD Billion)

- 2015: $2.17trn
- 2016: $2.23trn
- 2017: $2.50trn
- 2018: $2.60trn
- 2019: $2.86trn
- 2020: $3.39trn
- 2021: $3.96trn
- 2022 (Projected): $5.00trn

Islamic Finance Assets Distribution (2020, USD Billion)

- Islamic Banking: $2.765bn
- Sukuk: $713bn
- Islamic Funds: $169bn
- Other IFIs: $73bn
- Takaful: $238bn

Source: LSEG FX, Islamic Finance Development Report 2022

These assets are held largely by the Islamic banking system (70 percent of the total) and in Sukuk (Shariah-compliant bonds). Islamic funds, other Islamic financial institutions and Takaful (a Shariah-compliant alternative to conventional insurance), make up the remaining 12 percent of the total assets in Islamic finance.
What is the role of the UK and LSEG in Islamic Finance?

The UK’s financial markets play a prominent role in this industry. According to TheCityUK¹, the UK is one of the leading centres for Islamic finance outside the Muslim world.

This hub includes a vibrant Shariah-compliant banking sector, with four Islamic banks authorised to operate in the UK. The UK is also a key venue for the issuance of Sukuk, with more than $50bn raised through 68 Sukuk issues on the London Stock Exchange between 2015 and 2021.

The UK is a leading centre of Islamic finance education and training, with four internationally recognised professional institutions offering qualifications and certifications in the subject.

London is home to over 200 international law firms, and TheCityUK estimated in 2022 that at least 16 of these firms have dedicated Islamic finance sections. The majority of cross-border Islamic contracts are governed by English law.

The London Stock Exchange Group (LSEG) plays a prominent role in the Islamic finance sector through its dedicated Sukuk and Islamic funds platforms.

FTSE Russell, the LSEG subsidiary that produces, maintains, licenses and markets indices, has a rapidly growing range of Islamic equity and bond indices, which are described in further detail in the remainder of this paper.

Notable LSEG achievements in Islamic Finance

- In 2015, LSEG launched a dedicated Sukuk segment on its fixed income markets to help facilitate liquidity
- $50bn+ has been raised through 68 Sukuk issues between 2015 and 2021
- LSEG issued the first sovereign green Sukuk in 2018
- LSEG is home to 4 Shariah ETFs with combined assets of c. $650m as at 31 May 2022
- FTSE Russell offers Shariah-compliant equity and Sukuk indices to a growing number of clients

¹ https://www.thecityuk.com/media/1tbbofqr/islamic-finance-global-trends-and-the-uk-market.pdf
Creating an Islamic equity index

An Islamic equity index is one that is built with the main precepts of Islamic finance in mind. FTSE Russell's Islamic equity indices are built using a two-stage process.

Stage 1
Business activity screening
At this first stage, companies involved in specified areas of business activity are excluded from the starting set of securities for the equity index. The threshold for index inclusion is typically that the total sum of non-permissible income should not exceed 5 percent of a company's total revenue and interest income.

The non-permissible business activities are specified in the relevant index's ground rules, but typically cover:

- Conventional finance (non-Islamic banking, finance, insurance)
- Alcohol
- Pork-related products and non-halal food production, packaging and processing
- Tobacco
- Weapons, arms and defence manufacturing
- Entertainment (casinos, gambling, cinema, adult entertainment)

Stage 2
Financial screening
At this second stage, the remaining companies are screened on a financial basis and must meet certain ratios to be considered Shariah-compliant. Typically, these financial ratios are set as follows:

- The total sum of interest-bearing debts should not exceed a third of total assets or average market capitalisation
- The total sum of interest-bearing cash and investments should not exceed a third of total assets or average market capitalisation
- The sum of trade receivables and long-term notes receivable should not exceed half of the total assets or market capitalisation of the company
Dividend purification

As an additional index design step, the dividends from the remaining equities may be ‘purified’. This reflects the fact that companies inevitably still derive some of their total income from interest income or prohibited activities. Dividend purification means that a fixed percentage of the dividends received from the index constituents is deducted from the dividend paid out to shareholders and given to charity.

Approaches to index construction

Although the approaches of different Islamic equity index providers are broadly similar in terms of the business activity and financial screens, there may be nuances in the way indices are constructed.

For example, calculating the financial screen on the basis of a company’s market capitalisation can lead to more volatile results, even when a long-term average is used. Using a company’s total assets for the financial screen implies a closer relationship with balance sheet data, but with a potential lag from the company’s current conditions.

FTSE Russell uses both market-capitalisation-based and asset-based financial screening approaches in its Islamic equity index range. In our FTSE Global Equity Shariah Index Series, for example, we screen on a financial basis using companies’ assets while in our other Shariah equity offering, we screen using companies’ market capitalisation (averaged over the previous 24 months).

Measuring Shariah-compliance

Screening for Shariah-compliance across FTSE Russell’s Islamic equity indices is undertaken by specialist Shariah screening partners; we have two providers that we work with to deliver our shariah equity solutions.

The screening providers certify the indices as Shariah-compliant through the issue of a Fatwa (Islamic legal opinion) by specialist Shariah scholars.

Depending on the methodology used, different companies might be included in our two Shariah offerings.
The different methodologies employed may also result in different securities being included in each index. This is best showcased using two well known companies as a case study:

Case Study 1: Multinational Technology Conglomerate

**IdealRatings vs Yasaar rulebook**

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<tr>
<th>CHALLENGE</th>
<th>Multinational Technology Conglomerate</th>
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<tr>
<td><strong>Finance Screening</strong></td>
<td>FTSE IdealRatings Islamic Index Series (IR):</td>
<td>FTSE Global Equity Shariah Index Series (Yasaar):</td>
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<tr>
<td>IdealRatings</td>
<td>- Business Pass</td>
<td>- Business Pass</td>
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<tr>
<td></td>
<td>- Financials Pass</td>
<td>- Financials Fail</td>
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<tr>
<td></td>
<td>- Overall Shariah Compliance Pass</td>
<td>- Overall Shariah Compliance Fail</td>
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**FTSE IdealRatings Islamic Index Series (IR):**
- Business Pass
- Financials Pass
- Overall Shariah Compliance Pass

**FTSE Global Equity Shariah Index Series (Yasaar):**
- Business Pass
- Financials Fail
- Overall Shariah Compliance Fail

**Non-compliant based on FTSE Yasaar mandates due to the Investment ratios exceeding financial thresholds (Total Assets).**

Due to Company 1’s market cap not exceeding 33% of average daily market cap, the company passes FTSE IdealRatings’ mandate.

**FINANCIAL SCREENING**
- Debt over average daily market cap not exceeds 33%
- Cash and short term interest bearing securities over average daily market cap not exceeds 33%
- Non permissible income generated from conventional interest income and any non compliant activities should not exceed 5% of the total income

**Yasaar**
- Debt is less than 33.333% of total assets
- Cash and interest bearing items are less than 33.333% of total assets
- Accounts receivable and cash are less than 50% of total assets
- Total interest and non compliant activities income should not exceed 5% of total revenue

Case Study 2: Multinational Technology Corporation

**IdealRatings vs Yasaar rulebook**

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<th>CHALLENGE</th>
<th>Multinational Technology Corporation</th>
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<tr>
<td><strong>Finance Screening</strong></td>
<td>FTSE IdealRatings Islamic Index Series (IR):</td>
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</tr>
<tr>
<td></td>
<td>- Financials Fail</td>
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</tr>
<tr>
<td></td>
<td>- Overall Shariah Compliance Fail</td>
<td>- Overall Shariah Compliance Pass</td>
</tr>
</tbody>
</table>

**FTSE IdealRatings Islamic Index Series (IR):**
- Business Pass
- Financials Fail
- Overall Shariah Compliance Fail

**FTSE Global Equity Shariah Index Series (Yasaar):**
- Business Pass
- Financials Pass
- Overall Shariah Compliance Pass

**Non-compliant based on FTSE IdealRatings rulebook, however the company passes FTSE Yasaar Shariah screening.**

**FINANCIAL SCREENING**
- Debt over average daily market cap not exceeds 33%
- Cash and short term interest bearing securities over average daily market cap not exceeds 33%
- Non permissible income generated from conventional interest income and any non compliant activities should not exceed 5% of the total income

**Yasaar**
- Debt is less than 33.333% of total assets
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- Total interest and non compliant activities income should not exceed 5% of total revenue
Creating an Islamic bond index

A Sukuk is an Islamic financial certificate that complies with Shariah law. Sukus fall into a number of different categories, depending on the nature of the underlying business activity being financed.

For example:

- Sukuk al-ijara, the most commonly used structure, is a sale and leaseback agreement most suitable if the issuing company has unencumbered assets that are commercially leasable, such as real estate, ships or aircraft;
- Sukuk al-wakala is used if the assets available supporting the issuance of the Sukuk comprise a portfolio of assets or investments, rather than a tangible asset or assets;
- Sukuk al-mudaraba are commonly used for development financing, as this structure is connected to a project’s profitability;
- Sukuk al-murabaha is used to acquire commodities as trustee on behalf of the Sukuk holders and to sell those commodities to the originator on deferred payment terms;
- Sukuk al-tawarruq is used to buy an asset, typically a freely tradeable commodity, and immediately sell it to a customer on a deferred payment basis.

In a typical Sukuk index, a research methodology is applied to assess a Sukuk’s eligibility for index inclusion.

Standards often fall into two main categories:

- General Shariah standards – a set of general standards that are applied to all Sukuk structures;
- Structure-specific standards – standards for each Sukuk structure, such as ijara, mudaraba and Murabaha.

Each standard is weighted, with points assigned for passing a given standard and zero points assigned for failed standards. Certain standards are mandatory, and securities that fail such standards will be excluded from the index.

However, the process is not necessarily just a screening procedure. There is an overlap between Islamic finance and sustainable investment. While a lot of the focus in Islamic investment products has been on exclusions - alcohol and gambling for example, observers note that the Qur’an also states that we need to be sensitive to our consumption levels, reduce waste, care for our environment and cultivate sustainable development, for example. Many observers expect the next revolution in Islamic finance will incorporate environmental, social and governance (ESG) characteristics and other sustainability criteria. We have published a blog that explores the convergence of Islamic finance and sustainability in further detail which you can access here.
FTSE Russell’s Shariah index range

Islamic finance on a growth trend
Although Islamic finance assets make up only a small proportion of the global financial system, they are forecast to grow strongly. According to LSEG FX, global Islamic finance assets are forecast to increase to $6tn by 2026 from $4tn in 2021.

Reflecting a rising investment culture amongst savings-rich Islamic countries, the funds sector is forecast to continue its recent above-average growth: it gained assets at a faster rate than any other Islamic finance category during 2021.

Another emerging trend is Islamic sustainable finance, which is also likely to drive demand for indices and benchmarks. LSEG expects more Islamic funds with sustainability or ESG mandates to be launched in the coming years, given the growing issuance of green and sustainable Sukuk.

Greater awareness on ESG issues is attracting retail investors to such funds, while many corporates are seeking more sustainable development paths – and inclusion in the relevant ESG indices – as a response to the rising concerns over climate change.

A third trend is the rise of Islamic fintech, where Shariah compliance is allied with digitally delivered financial solutions. This makes it easier for Muslims to access savings, investments, insurance and mortgages that are in line with the principles of their faith.

How is Islamic finance set up to weather the short to medium term macro-economic market environment?

As part of the key research conducted by LSEG into how the Islamic Finance market performed during the market volatility in 2020, one of the main findings was that global assets for the industry maintained double digit growth, rising 14% versus 2019’s growth of 15%. While the results were down year on year, this was still a notable achievement given the painful year the COVID-19 pandemic inflicted on our communities, societies and economies.

With investors currently understandably concerned about various short-term market events as reported by Zawya, there is a prevailing cautiously optimistic view for the industry over the medium and longer-term, despite negative short-term events. Naturally, inflation and other economic impacts may cause Shariah indices to behave in a similar way to conventional financial indices. For example, despite operating on interest free principals, some Islamic Finance products are still benchmarked to domestic interest rates; therefore changes in interest rates may indirectly impact their performance, leading to returns that might behave similarly to conventional finance.

FTSE Russell offers two Shariah compliant equity solutions which can be viewed on our Shariah suite spotlight page, which provides information on both of our equity offerings as well as our Sukuk and REIT offerings.

2 Refinitiv Islamic Finance Development Report 2022
That said, the market perception that investing in Shariah compliant stocks / benchmarks automatically leads to lower returns, does not necessarily hold true. A look back at the last 10-15 year period shows that the FTSE All-World Shariah Index has outperformed the FTSE All World Index across the majority of time frames (6m, YTD, 12m, 3yr, 5yr, cumulative), with a similar level of volatility. In fact, Shariah/Islamic indices may even perform better during periods of market stress/bear markets (when compared to vanilla indices) due to the omission of conventional finance and highly leveraged companies. The FTSE Global Equity Shariah Index Series has been designed to be used as the basis of Shariah compliant investment products that meet the requirements of Islamic investors globally. While it is true that the underlying objective of a Shariah compliant index is to replicate an ethical perspective, this replication does not automatically result in negative performance.

5-Year performance – total return

(USD)

All these things considered, it is apparent that the demand for indices and benchmarks that embed Islamic investment principles is likely to grow substantially in the coming years, and an investment in such solutions does not mean you have to sacrifice performance. For more information, please speak to your sales representative or contact our sales team.
Glossary of Islamic banking and financial terms

Al Ajr
A commission, fees or wages levied for services.

Amana/Amanah
Reliability or trustworthiness. Important value of Islamic society in mutual dealings. It also refers to deposits in trust. A person may hold property in trust for another, sometimes by implication of a contract.

Al Wadia
Resale of goods at a discount to the original cost.

Al Wakala
Absolute power of attorney.

Al Rahn Al
Arrangement where a valuable asset is placed as collateral for a debt. The collateral is disposable in the event of a default.

Al Wadiah
Safe keeping.

Awkaf/Awqaf
A religious foundation set up to assist those in poverty.

Bai Muajjal (Deferred Payment Contract)
A contract involving the sale of goods on a deferred payment basis. The bank or provider of capital buys the goods (assets) on behalf of the business owner. The bank then sells the goods to the client at an agreed price, which will include a mark-up since the bank needs to make a profit. The business owner can pay the total balance at an agreed future date or pay by instalments over a pre-agreed period.

This is similar to a Murabaha contract since it is also a credit sale.

Bai al Dayn Debt financing
The provision of financial resources required for production, commerce and services by way of sale / purchase of trade documents and papers. Bai al-Dayn is a short-term facility with a maturity of not more than a year. Only documents evidencing debts arising from bona fide commercial transactions can be traded.

Bai al Salam
This term refers to advance payment for goods which are to be delivered later. Normally, no sale can be affected unless the goods are in existence at the time of the bargain. But this type of sale forms an exception to the general rule provided the goods are defined and the date of delivery is fixed. One of the conditions of this type of contract is advance payment;
the parties cannot reserve their option of rescinding it but the option of revoking it on account of a defect in the subject matter is allowed. It is usually applied in the agricultural sector, where the bank advances money for various inputs to receive a share in the crop, which the bank sells in the market.

**Bai Bithaman Ajil**

This contract refers to the sale of goods on a deferred payment basis. Equipment or goods requested by the client are bought by the bank, which subsequently sells the goods to the client an agreed price which includes the bank’s markup (profit). The client may be allowed to settle payment by instalments within a pre-agreed period, or in a lump sum. Similar to a Murabaha contract, but with payment on a deferred basis.

**Baitul Mal**

Treasury.

**Fatwah**

A religious decree.

**Fiqh**

Islamic jurisprudence. The science of the Shariah. It is an important source of Islamic economics.

**Gharar Lit**

Uncertainty, hazard, chance or risk. Technically, sale of a thing which is not present at hand; or the sale of a thing whose consequence or outcome is not known; or a sale involving risk or hazard in which one does not know whether it will come to be or not, such as fish in water or a bird in the air. Deception through ignorance by one or more parties to a contract. There are several types of gharar, all of which are haram. The following are some examples:

- Selling goods that the seller is unable to deliver
- Selling known or unknown goods against an unknown price
- Selling goods without proper description
- Selling goods without specifying the price
- Making a contract conditional on an unknown event
- Selling goods on the basis of false description
- Selling goods without allowing the buyer to properly examine the goods

The root Gharar denotes deception. Bay’ al-Gharar is an exchange in which there is an element of deception either through ignorance of the goods, the price, or through faulty description of the goods. Bay’ al-Gharar is an exchange in which one or both parties stand to be deceived through ignorance of an essential element of exchange. Gambling is a form of Gharar because the gambler is ignorant of the result of his gamble.

**Halal**

That which is permissible. In Islam there are activities, professions, contracts and transactions which are explicitly prohibited (haram) by the Qur’an or the Sunnah. Barring them, all other activities, professions, contracts and transactions etc. are halal. An activity may be economically sound but may not be allowed in the Islamic society if it is not permitted by the Shariah.

**Hawala**

Lit: bill of exchange, promissory note, cheque or draft. Technically, a debtor passes on the responsibility of payment of his debt to a third party who owes the former as debt. Thus the responsibility of payment is ultimately shifted to a third party. Hawala is a mechanism for settling international accounts, by book transfers.

**Haram**

Unlawful.

**Ijara (Leasing)**

A contract where the bank or financier buys and leases equipment or other assets to the business owner for a fee. The duration of the lease as well as the fee are set in advance. The bank remains the owner of the assets. This type of contract is a classical Islamic financial product. Leasing is also a lawful method of earning income, according to Islamic law. In this method, tangible assets such as machinery, a car, a ship, a house, can be leased by one person (lessee) to the other (lessor) for a specific period against a specific price. The benefit and cost of the each party are to be clearly spelled out in the contract so that any ambiguity (Gharar) may be avoided.

**Ijarah wa Iqtina (Lease to Purchase)**

This term refers to a mode of financing adopted by Islamic banks. It is a contract under which the Islamic bank finances equipment, a building or other facility for the client against an agreed rental together with an undertaking from the client to purchase the equipment or the facility. The rental as well as the purchase price is fixed in such a manner that the bank gets back its principal sum along with some profit which is usually determined in advance.

**Ijtihad**

Lit: effort, exertion, industry, diligence. Technically, endeavour of a jurist to derive or formulate a rule of law on the basis of evidence found in the sources.

**Istisna (Progressive Financing)**

A contract of acquisition of goods by specification or order where the price is paid progressively in accordance
with the progress of a job. An example would be for the purchase of a house to be constructed, payments are made to the developer or builder according to the stage of work completed. This type of financing along with bai salam are used as purchasing mechanisms, and Murabaha and bai muajjal are for financing sales.

Ju'alal
Lit: stipulated price for performing any service. Technically applied in the model of Islamic banking by some. Bank charges and commission have been interpreted to beju'ala by the jurists and thus considered lawful.

Mudaraba/Modaraba (Trust Financing)
The term refers to a form of business contract in which one party brings capital and the other personal effort. The proportionate share in profit is determined by mutual agreement. But the loss, if any, is borne only by the owner of the capital, in which case the entrepreneur gets nothing for his labour. The financier is known as ‘rab-al-maal’ and the entrepreneur as ‘mudarib’. Mudarib In a mudaraba contract is the person or party who acts as entrepreneur.

Mu'amalah
Lit: economic transaction.

Murabaha/Morabaha (Cost-Plus Financing)
Lit: sale on profit. Technically a contract of sale in which the seller declares his cost and profit. This has been adopted as a mode of financing by a number of Islamic banks. As a financing technique, it involves a request by the client to the bank to purchase a certain item for him. The bank does that for a definite profit over the cost which is agreed in advance. It has been estimated that 80 to 90 percent of financial operations of some Islamic banks belong to this category. There are a number of requirements for this transaction to meet the Islamic standards of a legal sale. The entire transaction is to be completed in two stages and as two separate contracts. In the first stage, the client requests the bank to undertake a Murabaha transaction and promises to buy the commodity specified by him, if the bank acquires the same commodity. In the second stage, the client purchases the good acquired by the bank on a deferred payments basis and agrees to a payment schedule. The Murabaha form of financing is being widely used by the Islamic banks to satisfy various kinds of financing requirements. It is used to provide finance in various and diverse sectors e. g. in consumer finance for purchase of consumer durable such as cars and household appliances, in real estate to provide housing finance, in the production sector to finance the purchase of machinery, equipment and raw material etc.

Musharaka (Venture Capital)
Musharaka is a technique of financing used as a partnership. It is where two or more financiers provide finance for a project. All partners are entitled to a share in the profits resulting from the project in a ratio which is mutually agreed upon. However, the losses, if any, are to be shared exactly in the proportion of capital proportion. All partners have a right to participate in the management of the project. However, they can waive the right of participation in favour of any specific partner or person. There are two main forms of Musharaka: Permanent Musharaka and Diminishing Musharaka. These are briefly explained below:

Permanent Musharaka – In this form of Musharaka an Islamic bank participates in the equity of a project and receives a share of profit on a pro rata basis. The period of contract is not specified. So it can continue so long as the parties concerned wish it to continue. This technique is suitable for financing projects on a longer term where funds are committed over a long period and gestation period of the project may also be protracted.

Diminishing Musharaka – Diminishing Musharaka allows equity participation and sharing of profit on a pro rata basis, but also provides a method through which the equity of the bank keeps on reducing its equity in the project and ultimately transfers the ownership of the asset of the participants. The contract provides for a payment over and above the bank share in the profit for the equity of the project held by the bank. That is the bank gets a dividend on its equity. At the same time the entrepreneur purchases some of its equity. Thus, the equity held by the bank is progressively reduced. After a certain time the equity held by the bank shall come to zero and it shall cease to be a partner. Musharaka form of financing is being increasingly used by the Islamic banks to finance domestic trade, imports, and to issue letters of credit.

Musaqah
A contract in which the owner of the garden shares its produce with another person in return for his services in irrigating the garden.

Muzara’a
A contract in which one person agrees to till the land of the other person in return for a part of the produce of the land.

Qard Hasan (Interest free loans)
Most of the Islamic banks also provide interest free loans (Qard Hasan) to their customers. If this practice is not possible on a significant scale, even then, it is adopted at least to cover some underprivileged people. Islamic view about loan (Qard) is that it should be given to borrower free of charge.

Understanding Shariah Compliant Indexing

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Qimer
Lit: gambling.
Technically, an agreement in which possession of a property is contingent upon the occurrence of an uncertain event.
By implication it applies to those agreements in which there is a definite loss for one party and definite gain for the other without specifying which party will gain and which party will lose.

Rab-al-maal
(In a mudaraba contract) the person who invests the capital.

Riba
This term literally means an increase or addition.
Technically, it denotes any increase or advantage obtained by the lender as a condition of the loan. Any risk-free or "guaranteed" rate of return on a loan or investment is riba.
Riba, in all forms, is prohibited in Islam. In conventional terms, riba and "interest" are used interchangeably.

Sadaqah
Charitable giving.

Shari'ah/Shariah/Shari'a
Islamic canon law derived from 3 Primary sources: the Quran; the Hadith (sayings of the Prophet Muhammad); and the Sunnah (practice and traditions of the Prophet Muhammad), and three Secondary sources: Qiyas (Analogical deductions and reasoning), Ijma (Consensus of Islamic Scholars) and Ijtihad (Legal reasoning).

Shirkah
A contract between two or more persons who launch a business or financial enterprise to make profit. Shirkah = musharaka.

Suftajal
A banking instrument used for the delegation of credit and was used to collect taxes, disburse government dues and transfer funds by merchants. In some cases suftajahs were payable at a future fixed date and in other cases they were payable on sight. Suftajah is distinct from the modern bill of exchange in some respects. Firstly, a sum of money transferred by suftajah had to keep its identity and payment had to be made in the same currency. Exchange of currencies could not take place in this case. Secondly, Suftajah usually involved three persons. 'A' pays a certain sum of money to 'B' for agreeing to give an order to 'C' to pay back to 'A'. Third, a Suftajahs could be endorsed.

Sukuk
A certificate entitling the holder to the benefits of the income stream of the assets backing the certificate. Equivalent to a Fixed income bond.

Takaful
This is a form of Islamic insurance based on the Quranic principle of Ta’awon or mutual assistance. It provides mutual protection of assets and property and offers joint risk sharing in the event of a loss by one of its members. Takaful is similar to mutual insurance in that members are the insurers as well as the insured. Conventional insurance is prohibited in Islam because its dealings contain several haram elements including gharar and riba, as mentioned above.

Waqf
Lit: detention.
Technically, appropriation or tying-up of a property in perpetuity so that no propriety rights can be exercised over the usufruct. The Waqf property can neither be sold nor inherited or donated to anyone. Awaqf consists of religious foundations set up for the benefit of the poor.

Zakah/Zakat
A tax which is prescribed by Islam on all persons having wealth above an exemption limit at a rate fixed by the Shariah.
According to the Islamic belief, Zakah purifies wealth and souls. The objective is to take away a part of the wealth of the wealthy and to distribute it among those who are less fortunate. It is levied on cash, cattle, agricultural produce, minerals, capital invested in industry, and business etc. The distribution of Zakah fund has been laid down in the Qur'an (9:60) and is for the underprivileged, Zakah collectors, new converts to Islam, travelers in difficulty, captives and debtors, etc. It is payable if the owner is a Muslim and of sound mind. Zakah is the third pillar of Islam. It is an obligatory contribution which every wealthy Muslim is required to pay to the Islamic state, in the absence of which individuals are required to distribute the Zakah among those who are less fortunate as prescribed by the Shariah.