

Creating a Shariah-compliant Investment Portfolio



1st Ethical
1st Ethical Charitable Trust

www.1stethical.com

OUTLINE

- Key Shariah Restrictions & Investment Criteria
- FSA guidelines & requirements
- Construction of a balanced-risk portfolio in the UK
- Trusts and Tax efficiency in investment
- Summary

SHARIAH RULES

1. No Interest (Riba) involved in transaction
2. No 'unethical' concerns
3. No contractual deficiencies eg
Uncertainty

RIBA (USURY)

The Shariah defines usury as ‘

'any payment received above the principal loaned'*

* Last Sermon of Prophet Mohammed (SAW)

Unethical Concerns

1. Gambling Outlets and Businesses
2. Tobacconist Concerns
3. Pornographic Concerns
4. Banks & Insurance Firms
5. Alcoholic Manufacturers, distributors etc
6. Organisations whose principal activity is not the above, however derive > 10% of income from above activities.
7. Highly leveraged companies (>33%)
8. Companies involved in activities prejudicial to the Interests of the Shariah.

Contractual Deficiencies

1. Core Elements of a valid contract under English Law – Offer, Acceptance, Consideration, Capacity, Form etc
2. Core Elements of a valid Islamic contract – Offer, Acceptance, Consideration, Capacity, Form, **Existence and availability of subject Matter, legitimacy of subject matter (in eyes of shariah), absence of uncertainty (Gharar) in key components of contract, absence of Gambling (Maysir) and Qimar (games of chance). Also unfair penalty clauses, ensuring no contract within a contract and ensuring rights and responsibilities of all parties are properly aligned.**

FSA GUIDELINES

1. Imparting investment advice without being authorised by FSA is a criminal offence – similar model followed to that of GP and pharmacist
2. Risk - KYC requirements necessitate comprehensive understanding of investor risk profile. Risk is inextricably linked to reward but can also result in a loss. This criteria sits alongside all other Shariah criteria when structuring balanced client portfolio.

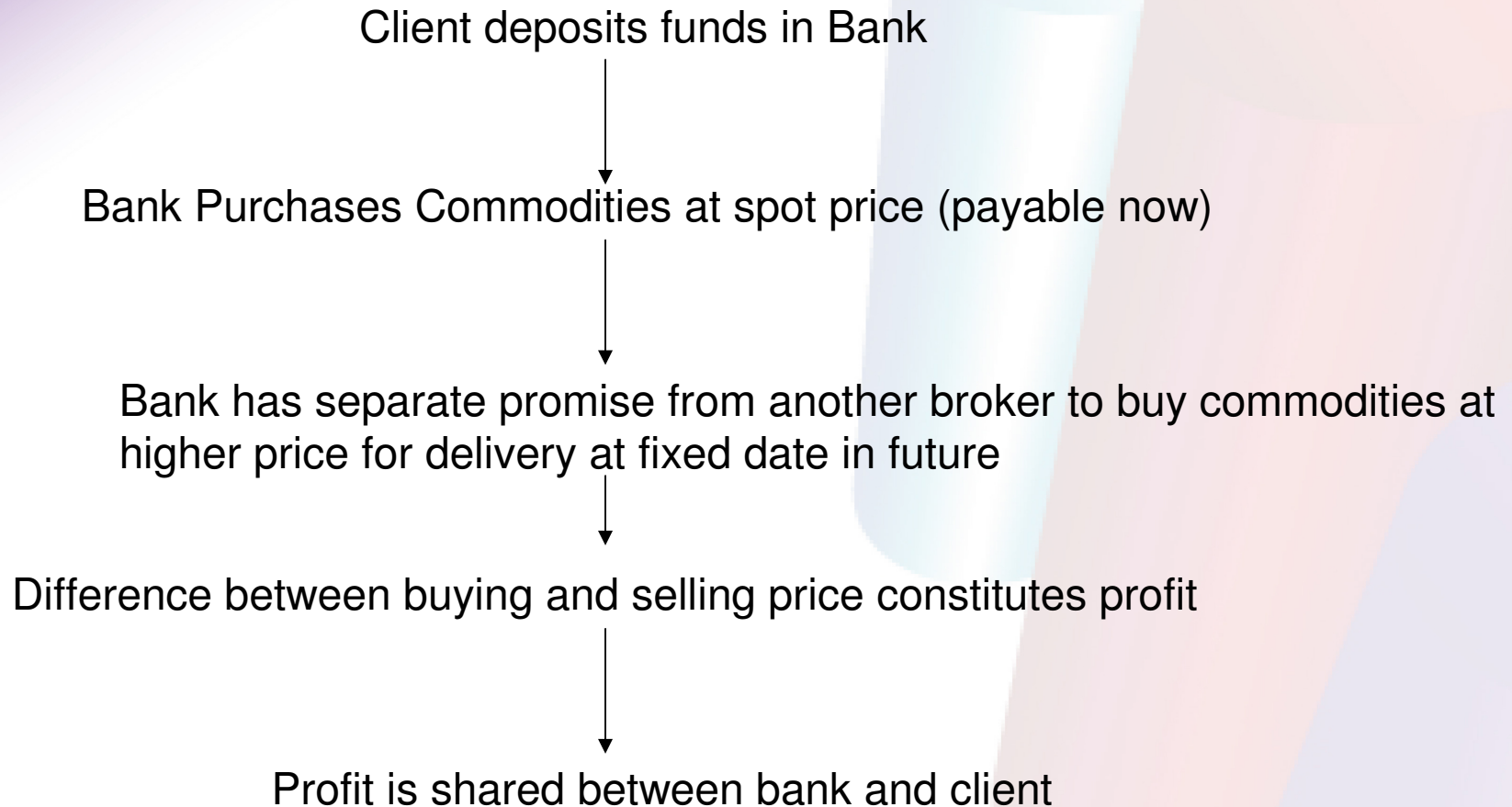
LOW RISK

ISLAMIC BANK ACCOUNTS
PROPERTY INVESTMENTS

ISLAMIC BANK ACCOUNTS

1. HSBC – *Funds Ring-fenced, No Return*
2. Lloyds TSB – *Funds Ring-fenced, No Return*
3. Islamic Bank of Britain (IBB) – Return based on Commodity Murabaha

COMMODITY MURABAHA IN ACTION



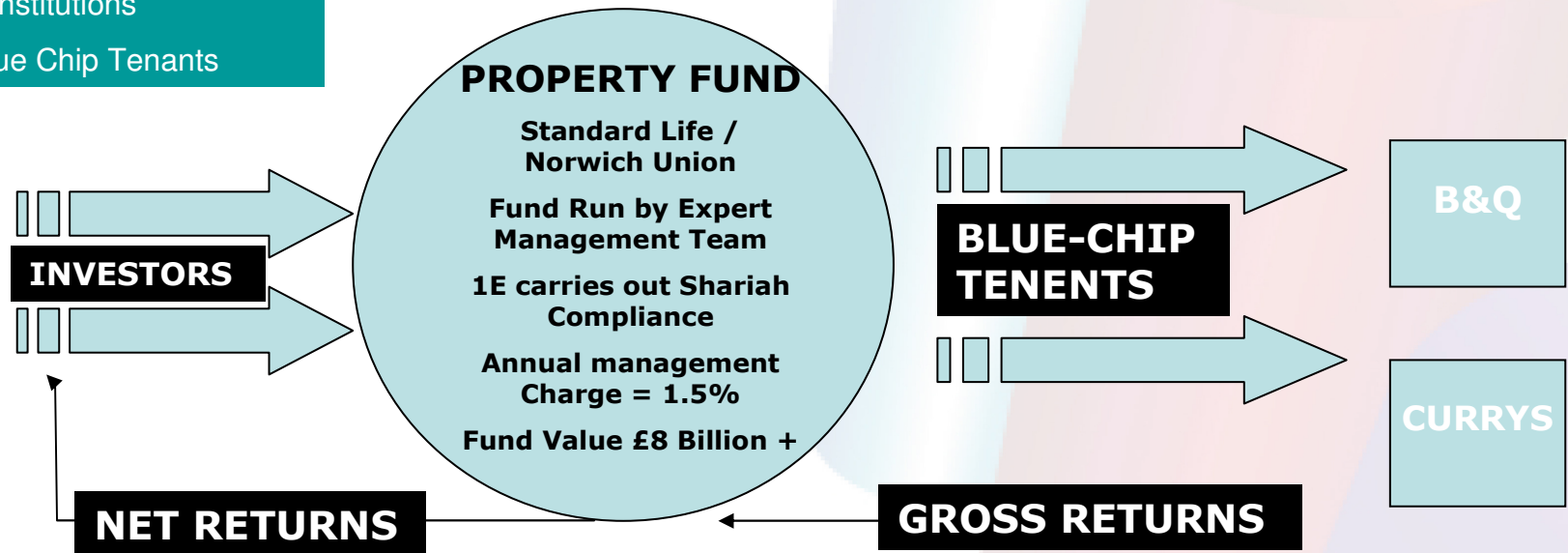
Property Funds

SAFETY / SECURITY

- Established Institutions
- Low-Risk Blue Chip Tenants

SHARIAH COMPLIANCE

- High Cash content in Funds
- Investment in non Shariah Compliant properties
- Zakat Calculations / Interest Cleansing



PERFORMANCE

- Average Return Rate – 8%
- Long-Term positive Prospects



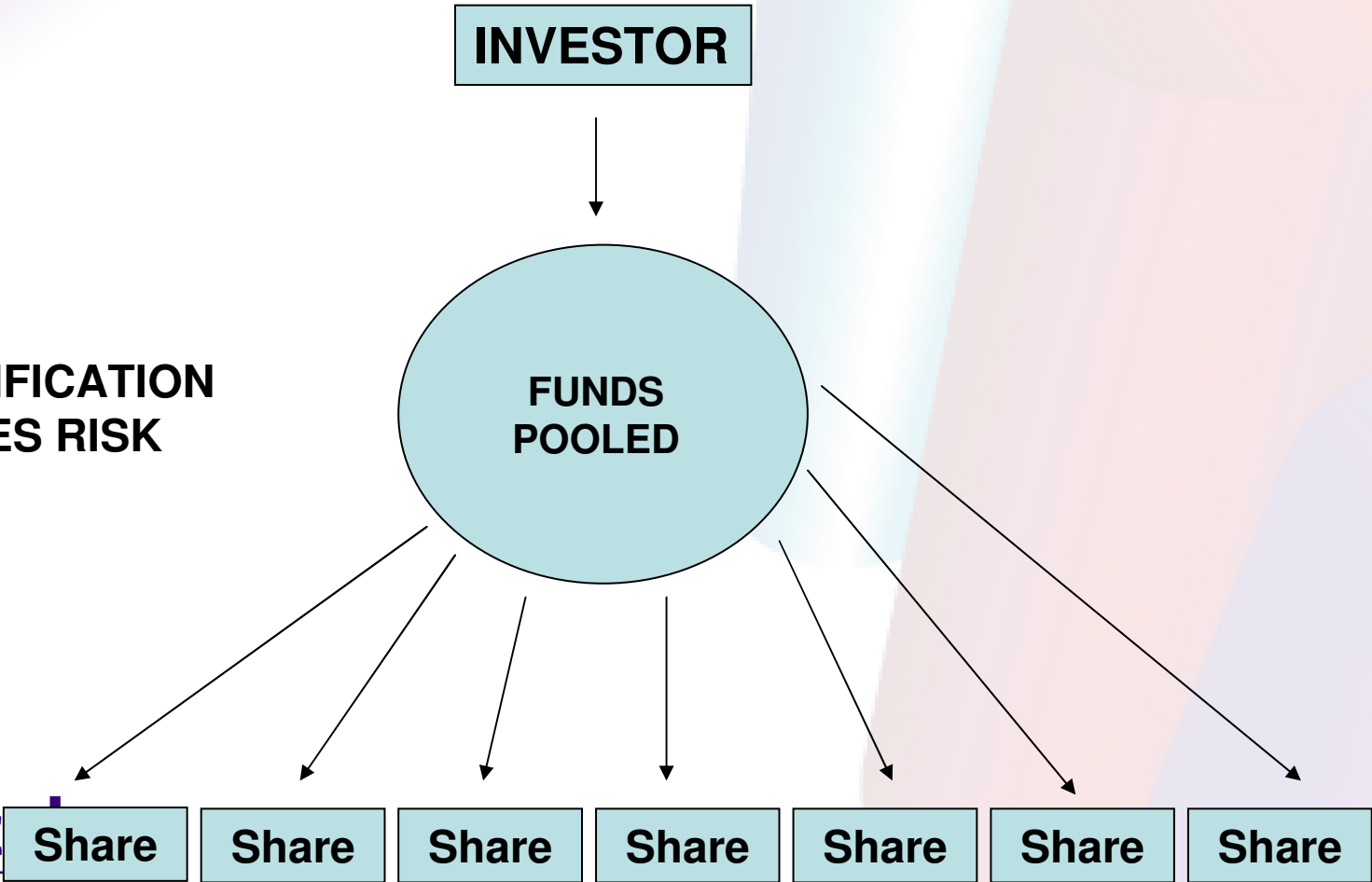
MEDIUM - RISK

MEDIUM RISK

1. Ethical Unit Trusts (Friends Prov, NPi, SWiD)
2. HSBC Amaanah Equity Unit Trust

UNIT TRUSTS

**DIVERSIFICATION
REDUCES RISK**



DOW JONES ISLAMIC INDEX

- The Dow Jones Islamic Market Indexes were introduced in 1999 as the first benchmarks to represent Islamic-compliant portfolios. Today the series encompasses more than 70 indexes and remains the most comprehensive family of Islamic market measures.
- The indexes are maintained based on a stringent and published methodology. An independent [Shari`ah Supervisory Board](#) counsels Dow Jones Indexes on matters related to the compliance of index-eligible companies.
- Excluded from the indexes are producers of alcohol and pork-related products, providers of conventional financial services (banking, insurance, etc.) and providers of entertainment services (hotels, casinos/gambling, cinema, pornography, music, etc.). Tobacco manufacturers and defense and weapons companies, although not strictly forbidden for investment under Islamic Law, are excluded from the indexes as well.
- Stocks are subjected to a series of financial-ratio screens to remove companies based on debt and interest income levels.
- Quarterly reviews are carried out to ensure criteria are met on an ongoing basis and also to cleanse the fund of haram monies by donating to charity.



HIGH - RISK

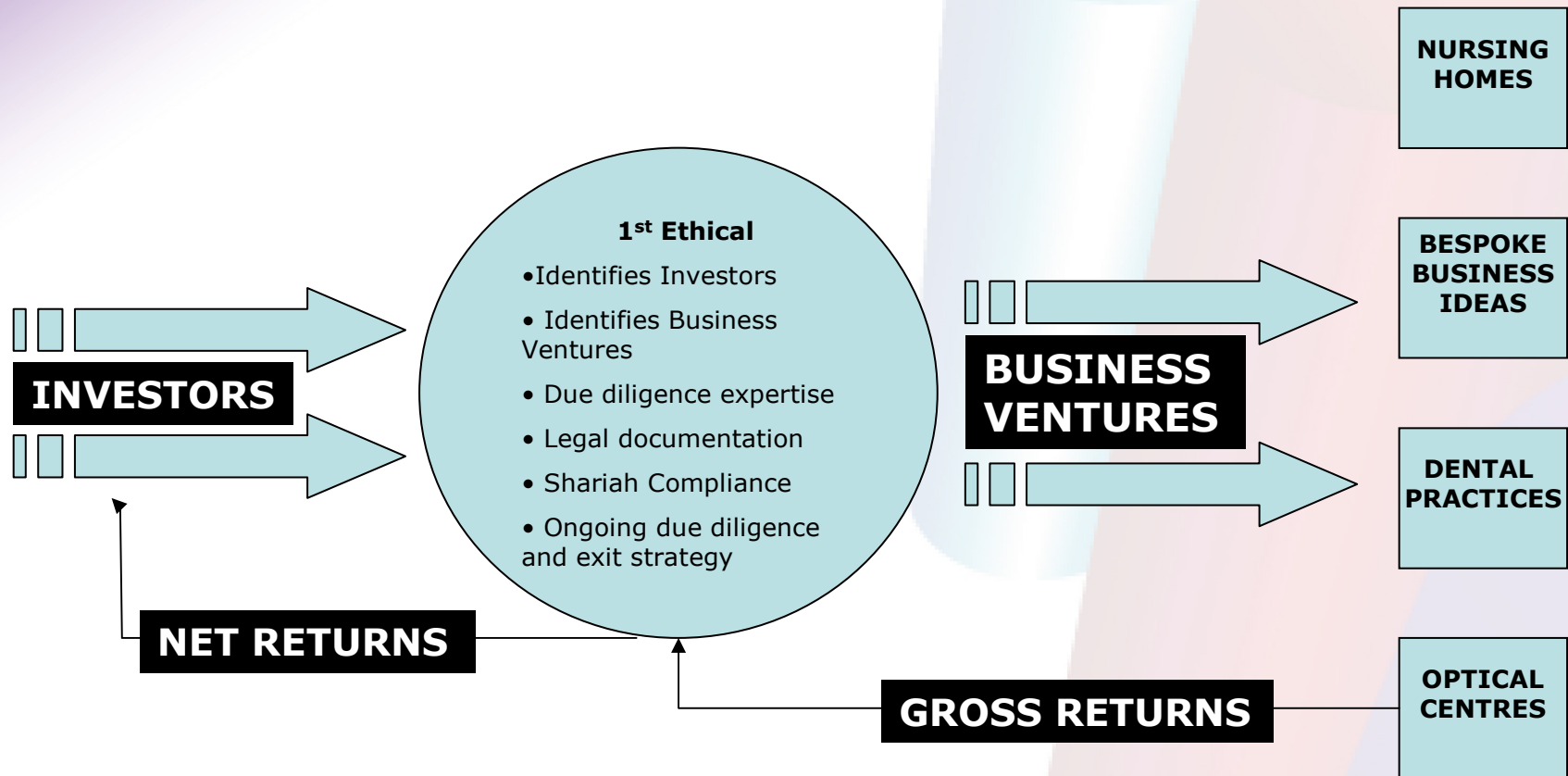
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HIGH RISK

1. Middle-Eastern Islamic Bank equity funds (Islamic Banker)
2. Shariah-Compliant UK equities – Direct Investment – available through TD Waterhouse and through Fysche Crestar.
3. Musharaka Investment – 1st Ethical.

The Musharaka Fund





TAX EFFICIENCY

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Various Options

1. Investment Bond Wrapper – allows higher rate tax payer to save half the tax normally payable
2. ISA – allows up to £7k per annum to be invested and growth to be exempt from income tax
3. Offshore investments – allows no tax to be paid on growth as long as it is not remitted back to UK
4. Discretionary Trust – allows a tax payer to give income to nieces / nephews, siblings and grandchildren who are in a lower tax bracket
5. Pension Trusts – totally tax exempt

TRUSTEES

- Tasked legally with responsibility to safeguard trusts assets
- Hold legal title deed over assets
- Ultimately determine who benefits from assets

DISCRETIONARY TRUST

BENEFICIARIES

- Receive distributions from Trustees (potentially as per letter of wishes)

TAXATION

- Trust Income taxed at 40%
- Reclamations by beneficiaries at their rate.

PROPERTY PURCHASE

Client

PENSION TRUST

COMMERCIAL PROPERTY

PURCHASE
RENTAL

RENTAL INCOME

~~INCOME TAX~~

~~CORPORATION TAX~~

~~CAPITAL GAINS TAX~~

~~INHERITANCE TAX~~

SUMMARY

1. Islam allows wide investment remit as long as interest and unethical concerns are avoided and contracts are acceptable
2. A portfolio must meet the clients risk profile (Risk – Return)
3. Low–Risk – Islamic Bank Account / Property Funds
4. Medium Risk – Ethical / Islamic Unit Trusts
5. High Risk – Direct Investment / Musharaka
6. Provision of investment advice is a regulated activity
7. Effective tax planning can reduce or eliminate payment of tax on profits