Transparency & Accountability: Dow Jones Islamic Market Index

The International Islamic Finance Forum

Dusit Hotel, Dubai, UAE
March 17-19, 2002

Presented By
A. Rushdi Siddiqui
+609-520-4681
rushdi.siddiqui@dowjones.com
Presentation Overview

- Islamic Investing
  - Religious Sentiment & Prods/Perform?
- Transparency & Accountability
- Standardization
- DJIM vs. FTSE Islamic
- Licensees & Their Demands
- DJIMs vs. Conventional Counterparts
Pre-DJIM Launch (Feb. 9, 1999):

- About 44 Islamic Funds globally (over 100 today)
  - www.Failaka.com
  - 50% from Middle East & 50% SE Asia
- TII Euro Small Cap Index (TII & HSBC) launched in 1998
- MSCI (World) ex. Financial
  - Sin Industries & Highly leveraged companies included
- Internal Islamic Equity Benchmarks
  - WMC, Citi, UBS, etc.
  - Appearance of Impropriety & conventional investors accept?
Transparency & Accountability

- Islamic (Shariah Compliant) Index
- The DJIM index was the first Islamic equity benchmark index created by an independent index provider.
- DJIM is a 'low debt, non-financial, social-ethical index' in the broad sense.
- Measure relative performance to a benchmark
  - Commonplace amongst conventional investors
- Market’s way of Rewarding and Punishing fund managers
  - Monitoring flow of asset accumulation & redemption
- Advertising campaign for fund sponsors
- Marketing: Proud to be in the DJIM
Transparency & Accountability

- Need for Peer Review:
  - In US, we have Morningstar’s 5 Star System
  - Name & Shame

- 36/100 Islamic funds are global equity

- Make it easy for Islamic investors to rely on rating
  - May not read or understand Islamic fund prospectus

- Morningstar’s Rating system (1-5 stars) results in flow of assets into 5 Star (rated) funds.

- www.Failaka.com (coverage not rating/ranking)

- Reuter’s Lipper units covers 16 Malaysian Funds
  - Ranking methodology
  - interest should expand into Gulf, Europe, or US/Canada
Islamic Funds (Courtesy of Failaka.com)

- **Largest Islamic Funds**
  - Al-Ahli Global Trading (NCB) $503M
  - Alfanar/SEDCO (Permal) $171M
  - Al-Ahli Small Cap (NCB) $171M

- **Largest Islamic Managers**
  - Wellington Mgmt (Boston) $727M
  - Permal (New York) $336M
  - Deutsche Asset Mgmt (EU) $134M

- **Largest Islamic Sponsors**
  - NCB (Saudi Arabia) $935M
  - SEDCO (Saudi Arabia) $336M
  - Keppel Insurance (Singapore) $98M
Islamic Funds  (Courtesy of Failaka.com)

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Funds</th>
<th>Assets ($M)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>29</td>
<td>$800</td>
</tr>
<tr>
<td>2000e</td>
<td>98</td>
<td>$5,000</td>
</tr>
<tr>
<td>2002</td>
<td>100+</td>
<td>$3,300</td>
</tr>
</tbody>
</table>

- 34% decline in asset under management from 2000 to 2002!
- What Happened?
Islamic Funds (Courtesy of Failaka.com)

Times Are Changing:

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Funds</th>
<th>Type of Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>23</td>
<td>8 GE &amp; 5CP/B</td>
</tr>
<tr>
<td>2002</td>
<td>11</td>
<td>1 GE &amp; 5CP/B</td>
</tr>
</tbody>
</table>

• What Does This Mean?
# Islamic Funds
(Courtesy of Failaka.com)

<table>
<thead>
<tr>
<th>15 Largest Funds</th>
<th>15 Smallest Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>– 1 has $25,000 min.</td>
<td>– 3 have $25,000 min.</td>
</tr>
<tr>
<td>– 3 with up-front load</td>
<td>– 9 with up-front load</td>
</tr>
<tr>
<td>• 1 has &gt;2% Load</td>
<td>• 6 have &gt;5%</td>
</tr>
<tr>
<td>– 1 has &gt;2% fees</td>
<td>– 6 have &gt;2% Fees</td>
</tr>
<tr>
<td>– $108 M ave size</td>
<td>– $4.4 M ave size</td>
</tr>
</tbody>
</table>
DJIM vs. FTSE Global Islamic Index
Interim Tolerance Parameters

- DJIM- 2/9/99
- DJI’s Shariah Board (5)
- Shks. Usmani, Abu-Ghuddah, Yaquby, Elgari, DeLorenzo
  - D/MC <33%
  - C + IBS/MC <33%
  - AR/Assets <45%
- DJI Calculates/Maintains
- 1640 stocks, 34 countries, $9 Trillion
- Quarterly review
- 30 Islamic Indexes
- Nearly 30 licensees

- FTSE 11/99
- TII Shariah Board (4)
- Shks. Al-Yaseen, Faidhulla, Al-Madhkur, Al-Sharif
  - D/A <33.33%
  - Purify all impermissible income
- FTSE Calculates/Maintains
- 944 stocks
- Semi-annual review
- 5 Islamic Indexes
Need For Standardization

- RHB Malaysia (24 companies in DJIM)
- RHB Indonesia (4 companies in DJIM)
- Confidence in the market (GAAP compliance)
- Grow the market
- AAOFI (Bahrain) and Malaysian counterpart
- Will Standards result in eliminating need Shariah Boards/Advisors?
  - Purification methodology
  - Fund/Portfolio management (documentation)
  - Use of Derivative Instruments
# Top 10 DJIM Holdings

<table>
<thead>
<tr>
<th>April 2001</th>
<th>August 2001</th>
<th>January 2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cisco System</td>
<td>Microsoft</td>
<td>Microsoft</td>
</tr>
<tr>
<td>Intel</td>
<td>Exxon Mobil</td>
<td>Exxon Mobil</td>
</tr>
<tr>
<td>Exxon Mobil</td>
<td>Pfizer</td>
<td>Pfizer</td>
</tr>
<tr>
<td>Pfizer</td>
<td>Intel</td>
<td>Intel</td>
</tr>
<tr>
<td>IBM</td>
<td>BP Amoco</td>
<td>IBM</td>
</tr>
<tr>
<td>BP Amoco</td>
<td>Glaxo SmithKline</td>
<td>Johnson &amp; Johnson</td>
</tr>
<tr>
<td>Vodafone Group</td>
<td>Johnson &amp; Johnson</td>
<td>BP PLC</td>
</tr>
<tr>
<td>Glaxo SmithKline</td>
<td>Merck</td>
<td>Vodafone</td>
</tr>
<tr>
<td>Merck</td>
<td>SBC Communication</td>
<td>Glaxo SmithKline</td>
</tr>
<tr>
<td>Microsoft</td>
<td>Cisco Systems</td>
<td>Cisco Systems</td>
</tr>
</tbody>
</table>
Sample DJIM Licensees

- Permal Asset Management (SEDCO)
- Abu Dhabi Islamic Bank
- Brown Brothers Harriman
- Rockefeller Group
- Samba Capital Management International
- UBS Asset Management
- HSBC Investment Bank (UK)
- Al-Tawfeek Co. for Investments
- iHilal.com
- Bank Al-Jazira
- Al Bank Al Saudi Al Fransi
- Schroders
- Allied Irish Bank
Reasons Licensees Terminate Contract

- Never got the seed money
- Did not raise enough assets
- Had poor performance
- High Net-worth or Institution pulled out
- Distribution problems
- Wanted to do their own screening
Demands of Fund Managers

- DJIM universe in Format
- Performance Monthly Files:
  - Country breakdown
  - Global sector breakdown
  - Regional/Country sector breakdown:
    - Americas
    - N. America
    - Europe
    - UK
    - Japan
<table>
<thead>
<tr>
<th>Index</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>DJIM</td>
<td>-18</td>
</tr>
<tr>
<td>MSCI</td>
<td>-17</td>
</tr>
<tr>
<td>US</td>
<td>-16</td>
</tr>
<tr>
<td>S&amp;P</td>
<td>-13</td>
</tr>
<tr>
<td>Tech</td>
<td>-33</td>
</tr>
<tr>
<td>QQQ</td>
<td>-32</td>
</tr>
<tr>
<td>Can</td>
<td>-8.7</td>
</tr>
<tr>
<td>A/P</td>
<td>-23</td>
</tr>
<tr>
<td>JAP</td>
<td>-30</td>
</tr>
<tr>
<td>ENE</td>
<td>-9</td>
</tr>
<tr>
<td>TSE</td>
<td>-13</td>
</tr>
<tr>
<td>N 225</td>
<td>-23</td>
</tr>
<tr>
<td>D ENE</td>
<td>-4</td>
</tr>
<tr>
<td>TLS</td>
<td>-18</td>
</tr>
<tr>
<td>HCR</td>
<td>-14</td>
</tr>
<tr>
<td>DW x US</td>
<td>-26</td>
</tr>
<tr>
<td>EM</td>
<td>+5</td>
</tr>
<tr>
<td>FT 100</td>
<td>-16</td>
</tr>
<tr>
<td>EM</td>
<td>+5</td>
</tr>
<tr>
<td>US</td>
<td>L,M,S</td>
</tr>
<tr>
<td>EU</td>
<td>L,M,S</td>
</tr>
<tr>
<td>Euro</td>
<td>L,M,S</td>
</tr>
</tbody>
</table>
Products off of Islamic Index

- Sector Based Investing (28 DJIMs)
- Islamic ETF
- Islamic Index Linked CD
- On-line investing
- Folios
- ECN for DJIM companies
Dow Jones Indexes

The markets’ measure.