



PSE Guidelines on Screening of Securities for Shariah Compliance

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GUIDELINES ON SCREENING OF PSE SECURITIES FOR SHARIAH-COMPLIANCE

1. Overview, Scope and Limitations

The Philippine Stock Exchange (PSE) is one with the National Commission on Muslim Filipinos (NCMF) in its quest to increase the participation of Muslim Filipinos in nation building. Through its headship, the NCMF, together with the PSE and other capital market participants and regulatory agencies, discussed the framework by which Islamic finance may play a stronger role in Philippine capital market development.

For PSE to pave the way for Islamic equity investment opportunities, the listed equity securities must first be screened for Shariah-compliance as is practiced in other markets. Shariah law specifies the moral conduct by which Islamic followers are to engage in investments. Shariah-compliant equities are listed companies which activities conform to the Shariah doctrines. By PSE publishing the list of Shariah-compliant securities in its PSE website, Islamic investors are provided with easy access to research and assurance with respect to their compliance concerns.

These guidelines detail the process and basis by which PSE, through a reputable international screening institution, screens its securities for Shariah-compliance. PSE engaged the services of a firm with expertise in Islamic finance and specialty in Shariah securities screening, as evidenced by its screening of about 40,000 securities in over 25 countries.

PSE emphasizes that the inclusion of a security as Shariah-compliant neither constitutes a financial or investment advice from the PSE, nor a recommendation or endorsement to buy or sell any such security. Moreover, parties interested in creating subsequent Islamic products from PSE's Shariah-compliant list must obtain PSE's prior approval. Such parties shall further take responsibility for ensuring its Islamic investment product conforms to Shariah law.

PSE provides the list of Shariah-compliant securities as a guide to Islamic investors on potential investible securities that comply with Shariah law. However, the Islamic investor should note that its conduct and compliance with other rules governing Shariah are not covered by the Exchange.

2. **Screening of securities for Shariah compliance**

- 2.1 Only common shares of listed companies at the Exchange will be screened. Shariah disallows investments in preferred shares¹ and warrants².
- 2.2 Suspension of companies or securities traded at the Exchange is not a factor included in Shariah-screening. It is thus possible for a suspended security to be included in the list of Shariah-compliant securities.
- 2.3 As a rule, the Shariah screening firm shall use all financial statements and disclosures issued by the listed company, news and research to assess compliance. Direct communications with the listed company are few and far between unless clarifications on the company's announcements are needed.
- 2.4 Screening of securities for Shariah- compliance shall observe the methodology stipulated by the Accounting and Auditing Organization for Islamic Finance Institutions³ (AAOIFI), an independent Islamic international non-profit organization tasked with the standardization and harmonization of international Islamic finance practices and financial reporting in accordance to Shariah. The following are the screening procedures to be employed by the screening firm engaged by PSE in accordance with AAOIFI standards:

2.4.1 Business Screening

The company's activity, industry and product are evaluated. Nature of primary business must not be involved in prohibited business activities in accordance with Islam such as adult entertainment, alcohol, cinema, defense & weapons, financial services (insurance, conventional banking, conventional financial institutions, derivatives, mortgage, etc.), gambling, gold and silver hedging, interest-bearing investments, music, pork, and tobacco.

When a company's primary business is not any of the prohibited activities listed above, the total revenues derived by the company from

¹ AAOIFI, "Shari'ah Standard No. 21: Financial Paper (Shares and Bonds)," November 2017, Section 2/6, p. 561 and Appendix B. Issuance of Shares, p. 572 (bullet point 3).

² AAOIFI, "Shari'ah Standard No. 21: Financial Paper (Shares and Bonds)," November 2017, Appendix B p. 575, (bullet point 3). The nature of warrants is deemed similar to that of options.

³ AAOIFI standards have introduced greater harmonisation of Islamic finance practices across the world covering accounting, auditing, governance, ethics and Shariah standards for Islamic financial institutions and the industry. AAOIFI is supported by institutional members including central banks and regulatory authorities, financial institutions, accounting and auditing firms, and legal firms, from over 45 countries. AAOIFI has gained assuring support for the implementation of its standards, which are adopted in many countries and jurisdictions across the globe such as Bahrain, Jordan, Krygyz Republic, Mauritius, Nigeria, Qatar and Qatar International Financial Centre (QIFC), Oman, Pakistan, Sudan, Syria, United Arab Emirates and Yemen. The relevant authorities in Australia, Indonesia, Malaysia, Pakistan, Kingdom of Saudi Arabia and South Africa have issued guidelines that are based on AAOIFI's standards and pronouncements. Source (Mar 2020): <http://aaoifi.com/about-aaoifi/?lang=en> and <http://aaoifi.com/adoption-of-aaoifi-standards/?lang=en>

such prohibited businesses must not exceed 5% to be Shariah-compliant⁴.

2.4.2 Financials Screening

Islamic Finance provides rules on interest-related activities. It further recognises that too much of leverage/debt in a company makes it less attractive for investments. The AAOIFI's standards stipulate maximum tolerance for financial ratios of the company as a percentage to market capitalization, as follows:

- a. That the interest-bearing debt does not exceed 30% against the 12-month trailing average market capitalization of the company⁵; and
- b. That the total amount of interest-bearing deposits / investments do not exceed 30% against the 12-month trailing average market capitalization of the company⁶.

2.5 The PSE will make the necessary notifications and announcements regarding any change in the standards for screening securities listed and traded in the PSE for Shariah compliance.

3. Reporting

3.1 PSE shall publish the list of Shariah-compliant securities at least quarterly by posting on its website by the 5th trading day of each quarter, as well as other end-of-day reports it appropriately deems to reflect so. PSE, at its sole option, may decide to publish the list more frequently.

3.2 Securities in the list will include companies that pass the AAOIFI rulebook of screening companies for Shariah compliance.

3.3 Newly listed companies will be included at the start of the second quarter following availability of its prospectus or financial statements.

4. Procedures for appeals

4.1 Only companies whose core business is not any of those prohibited by Islam (as listed in Section 2.4.1) may raise to the PSE concerns regarding its exclusion from the Shariah-compliant list by sending an email to PSE Research unit at research@pse.com.ph.

⁴ AAOIFI, "Shari'ah Standard No. 21: Financial Paper (Shares and Bonds)," November 2017, Section 3/4/4, p. 563.

⁵ AAOIFI, "Shari'ah Standard No. 21: Financial Paper (Shares and Bonds)," November 2017, Section 3/4/2, p. 563.

⁶ AAOIFI, "Shari'ah Standard No. 21: Financial Paper (Shares and Bonds)," November 2017, Section 3/4/3, p. 563.

4.2 PSE shall obtain information from the screening agency on rationale behind the company's exclusion and accordingly relay to the company.

4.3 Once a reason for exclusion is provided to a company, PSE shall not entertain subsequent queries on the company's subsequent exclusion unless the latter provides evidence that it has addressed the violation previously cited by PSE and hence, already is compliant with Shariah law.

5. Non-liability of PSE

The PSE, through a reputable international screening institution, screens its securities for Shariah-compliance in accordance with AAOIFI methodology. The PSE, however, does not guarantee the accuracy, completeness or performance of the screening institution. The PSE does not accept any responsibility, on its own or its behalf, for any errors, omissions, or inaccuracies of the screening institution in determining which securities are compliant with the Shariah Law.

The PSE and its affiliates, officers, directors, employees, agents or licensors do not make nor have they made any recommendation regarding any securities determined as Shariah-compliant. THE ADVICE OF PROFESSIONALS, AS APPROPRIATE, REGARDING THE EVALUATION OF ANY SPECIFIC SECURITY, INDEX, REPORT, OPINION, ADVICE OR OTHER CONTENT IS HIGHLY RECOMMENDED.

Further, the inclusion of a security as Shariah-compliant do not constitute an invitation to invest in the said shares or constitute or form a part of any offer for the sale or subscription of, or any invitation to offer to buy or subscribe for, any securities or other financial instruments, nor should it or any part of it form the basis of, or be relied upon in any connection with any contract or commitment whatsoever. No action should be taken or omitted to be taken in reliance upon these guidelines or its results. The PSE does not accept any liability for the results of any action taken on the basis of the foregoing. Such parties shall further take responsibility for ensuring its Islamic investment product conforms to Shariah law.

The PSE and its affiliates, officers, directors, employees, agents and licensors cannot and do not make any representations and disclaims all warranties, express or implied, in respect of the results of the screening, including, but not limited to, guarantees, representations and warranties regarding truth, adequacy, reasonableness, accuracy, timeliness, completeness, non-infringement, merchantability, satisfactory quality, or fitness for any particular purpose, or any representations or warranties arising from usage or custom or trade by operation of law. The PSE and its affiliates, officers, directors, employees, agents and licensors assume no responsibility for the consequences of any errors or omissions in the results of the screening.