

# ALL SHARES ISLAMIC INDEX OF PAKISTAN

(Developed by Karachi Stock Exchange and Meezan Bank Limited)

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## ALL SHARES ISLAMIC INDEX OF PAKISTAN

### 1. Background:

The Steering Committee of the Government of Pakistan for development of Islamic banking and finance, constituted a sub-committee for promotion of Islamic Capital Market. The first meeting of the sub-committee was held on March 6, 2014 wherein it was decided to initiate development of an All Shares Islamic Index of Pakistan, comprising of all Shariah compliant companies listed on the Karachi Stock Exchange (KSE)<sup>1</sup>. The sub-committee decided to recommend to the Securities and Exchange Commission of Pakistan (SECP) to constitute a Technical Committee for the development of All Shares Islamic Index of Pakistan which shall comprise of members from SECP, State Bank of Pakistan (SBP), KSE, Meezan Bank Limited (MEBL) and Mutual Funds Association of Pakistan (MUFAP). SECP on recommendation of the sub-committee constituted the Technical Committee comprising the following:

Name	Organization	Status
Dr. Mohammed Imran Usmani	Shariah Advisor-Meezan Bank Ltd	Chairman Committee
Mr. Mr. Amir Khan Afridi	Director (CI), SECP	Member/ coordinator
Ms. Nighat Tanveer	Additional Director, IBD, SBP	Member
Mr. Asif Iqbal	Joint Director (PRDD), SECP	Member
Mr. Sani-e-Mehmood Khan	General Manager, KSE	Member
Mr. Farhan ul Haq Usmani	SVP, PD,SC Meezan Bank Ltd	Member
Mr. Ali Alvi	Head of Risk Management, UBL Funds	Member

# Methodology for Development of All Shares Islamic Index of Pakistan:

The selection criteria for the companies / shares which can be included in All Shares Islamic Index of Pakistan comprises of two broad categories:

1. Shariah Screening Criteria; and
2. Technical filters

1.1

## Eligibility Criteria

### 1.1.1 Shariah Screening Filters

For any stock to be Sharia compliant, it must meet ALL six criteria given below:

#### 1.1.1.1 Screening Criteria # 1: Business of the Investee Company

The core business of the company should not violate any principle of Shariah. Therefore, it is not permissible to acquire the shares of the companies providing financial services on interest like conventional banks, insurance companies, leasing companies or the companies involved in some other business not approved by the Shariah e.g. Companies making or selling liquor, pork, haram meat, or involved in gambling, or any other impermissible activities as per Shariah. Further, companies carrying out Tobacco and Explosive business will be excluded on ethical grounds.

#### 1.1.1.2 Screening Criteria # 2: Interest Bearing Debt to Total Assets, <37%

The Interest Bearing Debt to Assets ratio should be less than 37%. To understand the rationale behind this condition, it should be kept in mind that such companies are mostly based on interest. Here again, the aforementioned principle applies i.e. if the shareholder is not personally agreeable to such borrowings, but has been overruled by the majority, these borrowing transactions cannot be attributed to him/her. Debt, in this case, is classified as any interest bearing debt including Bonds, TFCs, Commercial Paper, Conventional Bank Loans, Finance Lease, Hire Purchase, issuing preference shares etc.

#### 1.1.1.3 Screening Criteria # 3: Non-Compliant Investments to Total Assets, <33%

The ratio of Non-Compliant Investments to Total Assets should be less than 33%. Non-Shariah Compliant Investments include investments in conventional mutual funds, conventional money market instruments, Commercial Paper, interest bearing bank deposits, Bonds, PIBs, FIB, T-Bills, CoIs, CoDs, TFCs, DSCs, NSS, derivatives etc. Non-Compliant investments also include investments in companies which are declared Shariah non-Compliant due to non-compliance to any of the mentioned criteria for Shariah Compliance.

#### **1.1.1.4 Screening Criteria # 4: Non-complaint Income to Total revenue, <5%**

The ratio of Non-Compliant Income to Total Revenue should be less than 5%. Total Revenue includes Gross Revenue plus any other income earned by the company. Non-Compliant Income includes income from gambling, income from interest based transactions, income from Gharar based transactions i.e. derivatives, insurance claim reimbursement from a conventional insurance company, any penalty charged on late payment in credit sale, income from casinos, addictive drugs, alcohol, dividend income from above mentioned businesses or companies which have been declared Shariah Non-Compliant due to non-compliance to any of the mentioned criteria for Shariah Compliance etc.

#### **1.1.1.5 Screening Criteria # 5: Illiquid Assets to Total Assets, >25%**

The ratio of Illiquid Assets to Total Assets should be at least 25%. The Sum of all those assets whose trade price can deviate from par value, according to the rules of Shariah, is considered the aggregate value of illiquid assets. Illiquid Assets include inventory of raw materials, work-in-process, all fixed assets such as property, plant & equipment, stores and spares, stock in trade etc.

#### **1.1.1.6 Screening Criteria # 6: Net Liquid Assets/Share Vs Market Price/Share**

Market Price per share should be at least equal to or greater than net liquid assets per share. Net liquid assets per share is calculated by using the following formula:

Net Liquid Assets Per share =

$$\frac{\text{Total Assets - Illiquid Assets - Long Term Liabilities - Current Liabilities}}{\text{No. of Shares Outstanding}}$$

1.1.2

## **Technical Screening Filters**

#### **1.2.2.1 Screening Criteria # 1:**

The Company which is on the Defaulters' Counter and/or its trading is suspended, declared Non-Tradable (i.e. NT) as on the re-composition date shall NOT be considered for inclusion in All Shares Islamic Index.

#### **1.2.2.2 Screening Criteria # 2:**

The Company will be eligible for All Shares Islamic Index of Pakistan of Pakistan if its securities are available in the Central Depository System;

### **1.2.2.3 Screening Criteria # 3**

Newly listed company shall be included in index re composition list which full fills the other eligible criteria.

### **1.2.2.4 Screening Criteria # 4**

The company must have an operational track record of at least one financial year;

### **1.2.2.5 Screening Criteria # 5**

The Company which have less than 5% free-float and / or of its shares are traded for less than 75% of the total trading days of the review period shall be included in Index however disclosed separately in the index.

### **1.2.2.6 Screening Criteria # 6**

Mutual Funds (both Open-Ended and Closed-Ended) are ineligible for inclusion in the All shares Islamic Index, however a separate list of all Shariah complaints investments will be developed including mutual fund and Sukuk to provide investment with comprehensive list of Shariah complaints investment avenues in the capital market.

### **Explanation:**

The principal objective of the All Shares Islamic Index is to gauge the performance of the Shariah compliant segment of the equity market. Accordingly, it is important that all those shares which meet the Shariah screening criteria should be included in the All Shares Islamic Index in order to ensure completeness of the index and adherence to the core objective of the proposed All Shares Islamic Index. However, it is also worth noting that many of the listed companies in Pakistan are closely held by sponsors, resulting in very small free floats. Such shares can be illiquid and carry a high risk of price distortion. In order to achieve the objective of the index, companies which do not meet the requirements of “minimum free float of 5%” and “atleast 75% days trading”, should be disclosed as a separate category to inform the investors about the illiquid nature of these shares.

## **Selection Criteria**

During the selection process, each company’s financial reports are thoroughly reviewed by research analysts of Al-Meezan to ensure that the company meets benchmarks or thresholds for Shariah compliance screening. Those that are found to be non-compliant are screened out. The industries that are considered non-compliant (as defined in the eligibility criteria) are not considered for inclusion in the All Shares Islamic Index, as these would not be appropriate for investment from Shariah perspective.

## Base Period

The Governing Policy Committee of Islamic Index shall ultimately determine and direct the Management regarding the base period and base index value. However, for the simulation purposes, The Index Technical Committee has used **\_15000\_points\_** as the base value, whereas Dec 31, 2014 serve as the base period for the index. The value of Islamic Index shall be arrived at by dividing the Full market capitalization (Total shares \* market price) of all eligible Islamic Securities in the Index by a number called the Index Divisor. The Divisor is the only link to the original base period value of the Islamic Index . It will keep the Index comparable over a period and will be the adjustment point for all future corporate actions, replacement of scrips etc.

## Maintenance of All Shares Islamic Index of Pakistan

The day-to-day maintenance of the Index will be carried out within the Broad Index Policy Framework set by the Exchange and Al Meezan. The Management will ensure that Islamic Index and KSE Index family maintain their benchmark properties by striking a balance between frequent replacements in indices and maintaining their historical continuity.

## Review Period and Re compositions

The Index will be re-composed on semi-annual basis as follows:

Basis		Revision	
December	31	May	15
June	30	November	15

To minimize the impact of corporate actions implemented between the revision date and review period, the 31st March and 30th September prices shall be used for the May 15<sup>th</sup> and November 15<sup>th</sup> revisions respectively

## Computation and Real Time Dissemination

All Shares Islamic Index shall be calculated and disseminated to market participants, regulators and trading screens on real-time basis. The Index shall be computed on the executed orders only.

## Adjustments in the All Shares Islamic Index against Corporate Actions

Maintaining the All Shares Islamic Index will include monitoring and completing the adjustments to the securities of individual companies cash dividends, additions and deletions, share changes, stock splits, stock dividends, and stock price adjustments due to restructurings or spin-offs.

To maintain the index's continuity, adjustments to the base date value capitalization are performed as often as necessary. Corporate actions and capital changes such as mergers acquisitions, spin-offs, and right offerings, repurchases of shares, public offerings and special cash of stock distributions of other than the same stock may also call for adjustments to be made. Such adjustments are necessary to prevent the value of the index from changing due to such events. Hence, this helps in keeping the value of the index an accurate and unbiased gauge of performance, and ensures that the movement of the index is not affected by corporate actions of constituent companies. Divisor adjustments are made after the close of trading and after the calculation of the closing value of the index.

Given the circumstances, the revised market capitalization is divided by closing index value (prior to adjustment) to get the new divisor which takes care of the impact arising out of cash dividend, bonus, right issues or other such corporate actions affecting the market price or number of outstanding shares.. The calculation will be carried out one day prior to the commencement of closure of share transfer register on T+2 settlement basis and the prices shall be opened on ex entitlement basis one day prior to the commencement of book closure of share transfer register.

### 1.7.1 Adjustment for Cash Dividend

If company declared a 10% cash dividend:

All shares Islamic Index	=	1120
All Shares Islamic Index market capitalization	=	13,950,000,000
Divisor	=	12,454,545,455

#### Step-1

Determine the ex-dividend price of the stock a to calculate the revised market capitalization and a new divisor for the next day

Stock A

Par value: Rs.10 per share

Market value on day 3: Rs 22.50 per share

Cash Dividend: 10 %

$$\text{i) Cash dividend amount per share} = \text{par value} \times \text{dividend\%} = \text{Rs } 10 \times 10\% = \text{Rs.1}$$

$$\begin{aligned} \text{ii) Ex-dividend price} &= \text{market price} - \text{cash dividend amount} = 22.50 - 1 \\ &= 21.50 \end{aligned}$$

### 1.7.2 Adjustment for Bonus Shares

Declaration of Bonus requires adjustments in the capitalization and within the Index Divisor itself. The following process illustrates the process for a situation whereby an equity called “A” has declared 10% bonus in terms of shares. Following steps are recommended to be followed in order to determine the price of Ex-Bonus of Company “A” to calculate the revised market capitalizations and new divisor for the next day.

### 1.7.3 Board Lot Adjustment

All shares Islamic Index	= 1,120	<b><u>Company A</u></b>	
Market capitalization	= 13,950,000,000	Market value of share	22.50/
Divisor	= 12,455,357	Bonus:	10 %
		Board-lot	100 Shares

Given below example, calculates the Ex-bonus price on the basis of a board-lot of 100 shares by observing following steps.

- Total shares after the Bonus issue:  $100 + (100 \times 10\%) = 110$  shares
- Cost of a Board-lot: 100 shares x market price of Company “A”

$$100 \times 22.50 \text{ is Rupees } 2,250/=$$

Divide unadjusted board lot value by adjusted lot-size in order to get Ex-Bonus Price:

$$2250/110 = \text{RS } 20.45$$

### 1.7.4 Illustration, Revision of the equity

The equity “A” is to be revised thereby increasing the size by the percentage declared as Bonus.

- Total number of shares + (Bonus % x total number of shares)
- Revised Size =  $50,000,000 + (10\% \times 50,000,000)$

$$= 55,000,000 \text{ shares}$$



Share price and the total number of shares of “A “is adjusted in the following manner to calculate the New Divisor for the next day.

- Value as per unadjusted prices:  $50,000,000 \times 22.50 = 1,125,000,000/=$
- Ex-Price is calculated by dividing unadjusted value of whole of the equity (shares) the revised size in the following manner:

$$1,125,000,000 / 55,000,000 = 20.45$$

### 1.7.5 Illustration, Revision in the Market Capitalization and Divisor

Following table present a scenario thereby the Islamic Index horizon has three symbols:

S#	Equity	Share Price	Shares	Market Cap
01	A	20.45	55,000,000	1,125,000,000
02	B	41.00	150,000,000	6,150,000,000
03	C	44.50	150,000,000	6,675,000,000
<b>Revised Market Cap</b>				13,950,000,000

$$\text{New Divisor} = \frac{\text{Revised Market Cap.}}{\text{Index point}}$$

$$13,950,000,000 / 1120 = 12,455,357$$

### 1.7.6 Adjustment for Right Shares

The Right issues of the companies, which constitute the All Shares Islamic Index, are adjusted in two stages. At first stage, the Ex-Right price is adjusted and at the second stage the capital ( shares) are adjusted. A brief detail about the right issues is mentioned below:

- The company, which declares Right shares, has to close its books (shareholders register) to determine entitlement within 45 days of the declaration.
- At the date of book closure, the Ex-Right price is ascertained and if the company belongs to the Islamic Index then the Divisor is adjusted due to the Ex-Right price of the company.
- When the company informs the Exchange that it has dispatched Letter of Rights Offer to the shareholders, the trading in the Letter of Rights Offer (Un- paid) is commenced. A separate block of capital, Un-Paid-Right, is

formed equal to amount of right issue and the trading continues till next 30 business days or till the last date of payment.

After the last date of payment, the trading in Un-Paid-Right (Letter of Rights Offer) is discontinued. By the end of 30<sup>th</sup> day of the last date of payment or earlier, the company informs that shares certificates are ready for exchange with Right Allotment Letter (RAL) or credited in the CDS, the capital of the RAL is merged with the company. At this stage, the Divisor of the Islamic Index is adjusted for the increase in the number of shares of the company.

### 1.7.6.1 Right issue without premium

Following illustration, explain the case of Right Issue without premium. Let us assume that the Company “A” issues 10 % right in terms of shares thereby starting the Book Closure Process from the fourth day. Adjustments are deemed to be made in two stages; first being one day prior to the commencement of closure of share transfer register and 2<sup>nd</sup> being on the 15<sup>th</sup> day when RAL shares are merged with the company and divisor is adjusted.

### 1.7.6.2 First Stage of RAL Adjustment

Following actions are to be taken-in order to determine the Ex-Right price of the Company “A” to calculate the revised market capitalization and a new divisor

All Shares Islamic Index on Day-3 = 1120

Market Capitalization = 13,950,000,000

Divisor = 12,455,357

- Market value of the Equity = 22.50
- Percentage of Right Declared : = 10 %

Ex-Right Price Calculation on the Board Lot of 100 shares.

- Total shares after the Right issue :  $100 + (100 \times 10\% \text{ Right}) = 110 \text{ shares}$
- Revised Cost of single Board Lot:  $100 \times \text{Market Price} + 10 (\text{right shares} \times \text{par value})$

$$= 100 \times 22.50 + (10 \times 10)$$

$$= 2350$$

- Ex- Right price per share is determined by dividing Revised Cost of Board Lot by Revised Board Lot

$$= 2350/110$$

$$= 21.36$$

Share price of A is adjusted in order to get a revised divisor for next business day

Following table present a scenario thereby the All Shares Islamic Index horizon has three symbols:

S#	Equity	Share Price	Shares	Market Cap
01	A	21.36	50,000,000	1,068,000,000
02	B	41.00	150,000,000	6,150,000,000
03	C	44.50	150,000,000	6,675,000,000
<b>Revised Market Cap</b>				13,893,000,000

New Divisor = Revised Market Cap. / Index point

$$13,893,000,000 / 1120 = 12,404,464$$

### 1.7.6.3 Second Stage of RAL Adjustment after 14<sup>th</sup> Business Day

After 15 days of the last date of payment the company confirms the subscription amount, accordingly, the capital of RAL is merged with the company and the Divisor is adjusted for the increase in number of shares in the following manner.

1. Calculate the total number of shares of after with respect to declared percentage of the RAL:

- Total number of shares (5M) x Right issue percentage (10)

$$= 50,000,000 \times 10 \%$$

$$= 5,000,000 \text{ shares}$$

2. Revise the total size after accreditation /merger RAL Capital thereby enhancing the overall Capital of the Equity

Total number of shares + RAL Capital

$$= 50,000,000 + 5,000,000$$

$$= 55,000,000 \text{ shares}$$

3. Increase the number of shares of company A to calculate the New Divisor for the next day:

Following table present a scenario thereby the All Shares Islamic Index horizon has three symbols:

S#	Equity	Share Price	Shares	Market Cap
01	A	21.00	55,000,000	1,155,000,000
02	B	42.00	150,000,000	6,300,000,000
03	C	45.00	150,000,000	6,675,000,000
<b>Revised Market cap</b>				14,205,000,000

New Divisor = Revised Market Cap. / Index point as on Day 14

$$14,205,000,000 / 1136 = 12,504,401$$

#### 1.7.6.4 Right issue with premium

Following steps may be observed in case the listed equity announces Right and Premium in simultaneous. Let us assume that equity "A" declares a 10% Right with a premium of RS 10/= per share and determine the Ex-Right Price of the same stock for a single Board Lot:

- Market value of the equity - = 22.50
- The Company declares Right : = 10 %
- The Company declares premium : = RS 10 per right share

In order to calculate the Ex-Right price on the basis of a single board lot, following procedure may be adopted.

- Board Lot shall be revised :  $100 + (100 \times 10 \% \text{ Right}) = 110 \text{ shares}$
- Cost of a lot ( 100 shares) shall be revised :  $100 \text{ shares} \times \text{market price of A} + \{10 \text{ right shares} \times (\text{par value} + \text{premium})\}$   
 $= 100 \times 22.50 + 10 \times (10 + 10) = \text{RS } 2450$
- Ex- Right price per share shall be determined by dividing the value of new board lot by revised board lot size in the following manner:  
 $= 2450 / 110 = 22.27$

The rest of the working would be same as mentioned in the section 1.7.6.1, which explained the handling of Right issue without premium.

### 1.7.6.5 Bonus and Right Adjustments in Simultaneous

Let us assume that the same equity announces a Bonus of 10% and Right of 10% at a premium of RS 10 per share:

$$\text{Value of All Shares Islamic Index} = 1120$$

$$\text{Market Capitalization on } \text{—————} = 13,950,000,000$$

$$\text{Divisor } \text{—————} = 12,454,357$$

Following procedure illustrates the procedure and computations to calculate the Ex-Bonus and Ex- Right price of the equity on a single board lot.

- Revised Number of Shares shall be calculated after accommodating both the Right and Bonus Shares by using following equations :

$$100 + (100 \text{ shares} \times 10\% \text{ Right}) + (100 \text{ shares} \times 10\% \text{ Bonus})$$

$$= 100 + 10 + 10 = 120 \text{ shares}$$

- Revised Cost of Board Lot may be calculated in the following manner:

$$100 \text{ shares} \times \text{market price of A} + \{10 \text{ right shares} \times (\text{par value premium})\}$$

$$= 100 \times 22.50 + 10 \times (10 + 10) = \text{RS } 2450$$

- Ex-Bonus and Ex- Right price per share shall be determined by dividing the revised cost of the board lot by the revised board lot itself

$$= 2450 / 120 = 20.42$$

- Calculate the total number of shares after the Bonus issue using the following formula:

$$\text{Total number of shares} + \text{Total number of shares} \times \text{Bonus \%}$$

$$= 50,000,000 + 50,000,000 \times 10\% \text{ Bonus} = 55,000,000 \text{ shares}$$

- Share price and the total number of shares of A shall be adjusted to calculate the New Divisor for the next day

Following table present a scenario thereby the All Shares Islamic Index horizon has three symbols:

S#	Equity	Share Price	Shares	Market Cap
01	A	20.42	55,000,000	1,123,100,000
02	B	41.00	150,000,000	6,150,000,000

03	C	44.50	150,000,000	6,675,000,000
<b>Revised Market Cap</b>				13,984,100,000

New Divisor = Revised Market Cap. / Index point

$$13,948,100,000 / 1120 = 12,453,661$$

The rest of the working would be same as mentioned in the section 1.7.6.1, which explained the handling of Right issue without premium.