

Shariah Funds: A Balanced View

by Sundar Sankaran¹

A leading economic daily, recently (December 4, 2014) published an article which was highly critical of a public sector mutual fund that proposed to launch a Shariah fund. The published article included a link to another article, which was said to offer a contrary view on the subject. Surprisingly, even that link only fortified the view point of the author of the published article, using examples from loan products that are not at all comparable with mutual funds. This article seeks to present a balanced view on Shariah funds.



What are Shariah funds?

These are funds that adopt Islamic principles to decide on the stocks they will invest in. Just as a large cap fund invests in large company stocks, and a banking sector fund invests in shares of banking companies, Shariah funds invest in shares of companies that comply with Shariah principles.

Shariah disapproves of businesses that are associated with interest-earning, gambling, wine, pork, pornography etc. So Shariah funds do not invest in companies where these businesses have a significant role.

Interestingly, there is reasonable convergence in the barred activities across Islam, Hinduism, Christianity and Jainism. The bar on interest-earning is unique to Islam.

Are Shariah funds legal?

Yes. There is one actively-managed Shariah fund, and one passively-managed Shariah fund in the Indian market. Globally, such funds are categorized as 'ethical funds'. These are not always religion-based. For instance, a fund that invests only in green companies would also be classified as an 'ethical fund'.

What were the objections raised in the published article?

The author criticizes Islam and Islamic finance in debatable and general terms, without getting into the specifics of, or the relevance of the criticism in the context of, a mutual fund product. Stripped of the emotional jingoism, three principal objections are raised in the published article:

- Investments in the fund would be based on *fatwas*.
- A public sector mutual fund should not offer such a fund
- Investors who wish to invest in such funds can put their moneys in the actively-managed Shariah fund that already exists in the market.

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Are these objections valid?

- The word 'fatwa' has got a bad name, because Islamic fundamentalists have used fatwas to issue death threats against people who hold a contrary view. A more balanced explanation is that fatwa is an expert's interpretation of an issue, based on Quranic principles. It is not even binding on all Muslims.

The Gita, Quran, Bible, Granth Sahib etc. lay down the principles that are the cornerstone of the concerned religion. But these holy books and scriptures, quite understandably, do not envisage all situations that arise in the modern world. Hence the need for an expert to give an interpretation. This is similar to a lawyer giving an interpretation, for a situation that is not specifically provided for in a law.

There is nothing wrong in using such interpretations to filter out companies that fail to satisfy the expectations of a religion. As in any fund, the Shariah fund manager finally decides which of the qualifying companies to invest in. Such a process of screening companies is perfectly legal; and the fund will in any case invest in businesses that are legal.

- Even in the years of the "license raj", activities were reserved for the public sector; there was never a reservation for the private sector. A plea to reserve the Shariah fund activity for any sector, least of all the private sector, is devoid of political or economic logic.

A secular and inclusive view would be that every religion and sect has its comfort zones. If a public sector mutual fund through a Shariah fund inspires Muslims to invest their vast surpluses in the formal sector, it would be performing a critical nation-building role.

- The view that Muslims do not need another Shariah fund, because they already have a fund that invests as per Islamic principles, is to be treated with the contempt it deserves. There is no need to dignify the arrogant and myopic view with a response.

Do Shariah funds have any investment logic beyond religion?

The widely followed stock indices, CNX Nifty and S&P BSE Sensex, are dominated by the financial sector. For instance, Financial Service contributes 28% to the Nifty; the next largest sector in the Nifty is at a distant 16%. The corresponding numbers for the Sensex are 30% and 16% respectively. Not surprisingly, financial services is the top sector in 9 out of 10 diversified equity funds.

In comparison, the contribution of financial service in the CNX 500 Shariah index is a measly 0.38%. Thus, Shariah funds are a great investment option for anyone who seeks to reduce the role of financial services in her mutual fund equity portfolio. Shariah funds are not meant only for Muslims.

Will the Indian mutual fund sector see another Shariah fund?

Most certainly, yes. In order to make it politically palatable, it could be offered as a suite of funds. Joint launch of Gita fund, Shariah fund, Christian fund and Jain fund – is the industry listening?