For professional and institutional investors only. Not for retail investors.

SHARIAH INVESTING: **THE IMPORTANCE OF TAYYIB**

We believe the time is now for the Tayyib concept and the beautiful principles it encapsulates to come to the fore in Islamic finance.

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"The earth is green and beautiful, and God has appointed you his stewards over it."

"Whoever plants a tree and diligently looks after it until it matures and bears fruit is rewarded."

Prophet Muhammad (PBUH)

In the Islamic faith, stewardship and sustainability are deeply embedded. But how is Islamic finance fulfilling these duties?

The limitations to Shariah investing

Most typical Shariah-compliant equity funds focus solely on exclusion. They use a mechanical screening process to identify and exclude companies that produce forbidden products like alcohol, tobacco, weapons, pork, gambling and adult entertainment, as well as conventional banking, finance and insurance. But while this process can be a useful starting point in Islamic investing, there are limitations to taking this kind of approach. Simple screening neglects to address how companies' products or services are produced, as well as the positive or negative impact that companies can have on broader society and the environment – something that the higher objectives or *Maqasid* of Shariah are trying to safeguard.

By sticking solely to a screening process and failing to look more closely at the underlying businesses of the companies that are considered 'Shariah compliant,' including the way in which they operate, Muslim investors may unknowingly invest in companies that do not fit within the spirit of Islamic values. Indeed, we have identified several companies included in Islamic benchmarks that raise questions in terms of their broader impact on society and the environment.

Could another more tailored approach to Shariah funds allow Muslims to incorporate broader Islamic values more effectively into their investments?

Reflecting the values of Islam

The word *Halal*, meaning permissible or compliant, is well known. But perhaps a less well-known word is *Tayyib* – meaning wholesome and an aspiration for excellence and goodness in all aspects of life.

When using a simple exclusion screening process, Muslim investors are only able to identify businesses that are Halal 'on paper', without also considering whether they are Tayyib. However, to us, it does not make sense for Muslim investors to risk missing the purpose or spirit of Islam when investing. It seems obvious to us that God would want us to take care of people and the planet, something we believe requires looking beyond exclusions, to better understand the businesses behind the investments.

There is an urgent need for Islamic finance to move from a predominantly Halal paradigm to Tayyib, closer to the ideals and purpose or Maqasid of Shariah (Islamic law), which is to ultimately establish social justice in this world. This aspiration to evolve from being merely Halal to the ideal of Tayyib is a concept that is foundational in our Islamic tradition with the Holy Quran making reference to the word Tayyib no less than 40 times.[1]

Tan Sri Azman Mokhtar, Chairman, International Centre for Education in Islamic Finance (INCEIF) Malaysia

[1]Extract of speech titled *Scaling the Sustainability Mountain: Moving from Halal to Tayyib - Integrating Islamic Finance & the SDGs*, delivered at the United Nations and Islamic Development Bank Islamic Finance and the Sustainable Development Goals (SDGs) Virtual Global Summit on 28.09.21.

Direct active engagement

At Jupiter, people and planet considerations are a key part of our investment process – including within our Shariah-compliant strategies.

When investing on behalf of our clients, we want to ensure we really understand the businesses behind our investments. We recognise the limitations of relying solely on ESG screens or third-party scores, instead choosing to take an active approach. It is only through direct active engagement that we are able to build a clear picture of a company. By having ongoing dialogue with the companies in which we invest, or we are considering investing in, we can advise and encourage positive change, while avoiding investing in – or divesting from – businesses that do not align with our beliefs.

For many, particularly smaller companies and/or those in developing countries, 'ESG' can still be a relatively new concept. This allows us an additional opportunity to advise and steer management teams.

CASE STUDY — SOCIAL IMPACT – LABOUR RIGHTS ENGAGEMENT

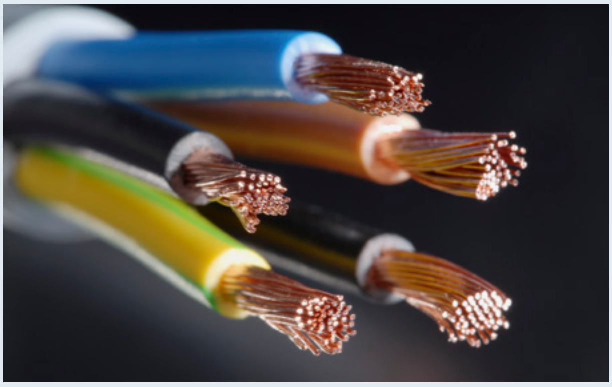
CHINESE SPORTSWEAR COMPANY

- We had invested in a Chinese sportswear company for a long time, given its high returns, strong brand and runway for growth, alongside multi-year increases in sports participation in China.
- Our concerns grew around the possible use of forced labour in the Xinjiang province of China. As China accounts for 20% of global cotton supply and 80% of China's cotton comes from Xinjiang, most global apparel makers face this issue.
- We engaged actively with the company, wanting to understand the steps it was taking to ensure its own supply chain was clean, and making clear our expectations that the company should uphold the highest labour standards in line with the UN Global Compact.
- Following our engagement, the company initially made some progress in terms of improving supply chain disclosures and signing up to the Better Cotton Initiative (BCI). However, it later made a sudden announcement indicating its intention to withdraw from the BCI and said it would continue to source cotton from China, including the Xinjiang region, as part of a wider government-led push to support the Chinese cotton industry.
- We decided to divest from the company as we could not get the assurances we needed that their supply chain was free from forced labour.

As a sportswear company, this business would be classed as 'Shariah compliant' – without question – by the standard mechanical screening-based definition; indeed, this company is included in many major Islamic Indices. However, for a company to be Tayyib, we believe it should also safeguard workers' rights, at all levels of its supply chain.

> *"Pay the worker his dues before his sweat has dried up";*
> *"Those workers are like your brothers."*
>
> **Prophet Muhammad** (PBUH)

CASE STUDY | ENVIRONMENTAL IMPACT – EMISSIONS ENGAGEMENT



INDIAN CABLE & WIRES BUSINESS

- The manufacture of cables can be very energy intensive.
- As signatories to the Net Zero Asset Management Initiative, reducing carbon emissions is a big focus for our teams at Jupiter and an important part of Tayyib commitments in taking care of God's planet. Our aim is to achieve real world decarbonisation.
- As a first step to de-carbonising, companies must fully recognise their current emissions. Publishing this data creates greater transparency and, along with committed targets, allows shareholders to hold investee companies to account.
- Following engagement, the company publicly disclosed its Scope 1 and 2 emissions for the first time this year, and it is developing a methodology for calculating Scope 3 emissions.[2] The company has set internal targets for medium- and long-term emissions reduction.
- We continue to encourage management to formally publish these targets and, in doing so, create a bolder commitment. We are encouraged that the company continues to make progress on its use of renewable electricity. At 17% of the company's consumption, this is significantly higher than its best performing peer, at 9%.

This business is undeniably classed as 'Shariah compliant'; however, without understanding the care the company is taking in protecting the planet, investors may miss its contribution to promoting Tayyib principles.

We are seeing other faith-based asset allocators becoming increasingly active in their ESG engagement, as they move to accurately reflect their religious beliefs and values. For example, in June this year, the Church of England announced its intention to sell its investments in several global oil & gas majors, after having taken the view that these companies had failed to fulfil their promises to take sufficient action to tackle climate change.

> *"We have long urged companies to take climate change seriously, and specifically to align with the goals of the Paris climate agreement. Some progress has been made, but not nearly enough. The church will follow not just the science, but our faith – both of which call us to work for climate justice".*[3]
>
> **Justin Welby**, Archbishop of Canterbury

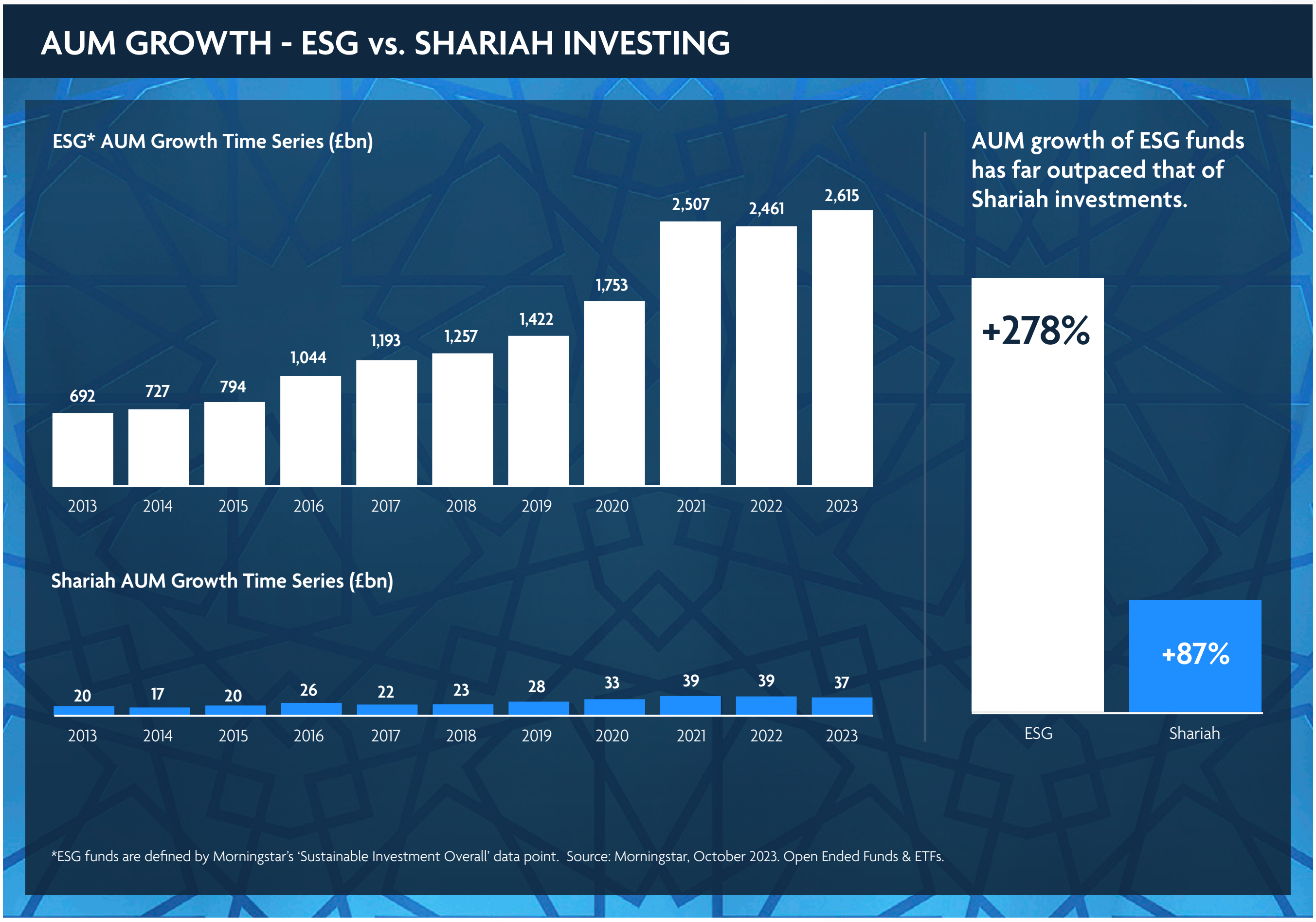
[2] Scope 1: emissions from sources that a company owns or controls. Scope 2: emissions a company causes indirectly that come from where the energy it purchases and uses is produced. Scope 3: all emissions not covered in Scope 1 & 2, created by a company's value chain.
[3] Church of England dumps oil majors over climate concerns | Financial Times (ft.com).

Market opportunity: Growth of ESG vs Shariah

The limitations of a Shariah-compliant exclusions process could go some way towards explaining why Shariah-compliant funds have struggled to gain traction and capture market share of the burgeoning responsible investment/ESG fund market to date.

Muslims account for a quarter of the world's population, but less than 0.2% of assets under management are Shariah compliant[4]. While we have seen some growth in the AUM of Shariah funds in the past 5 or so years, this has been far outpaced by AUM growth in ESG funds (as seen in the chart below), with the AUM of Shariah funds accounting for just over 1% of the size of ESG AUM as of October 2023[5].

While investors in Asia and the Middle East are sometimes perceived as lagging behind the West in terms of ESG considerations, data actually suggests that sustainability and climate change could be of greater consideration in Asia and the Middle East than other areas of the world[6]. If Muslims were able to incorporate broader Islamic values more effectively into their investments, we could start to see greater momentum in terms of the growth of assets in Shariah-compliant funds.



[4] Source: Morningstar, October 2022.
[5] Source: Morningstar, October 2023, open-ended funds and ETFs.
[6] Source: Schroders & Maybank Islamic, November 2019.

Why we need a Tayyib kitemark

To help Muslims to effectively integrate Tayyib-inspired considerations into their investment decisions, Jupiter is supporting the Islamic Finance Council UK (UKIFC) and Global Ethical Finance Initiative (GEFI) in launching a new Tayyib seal for investment products.

> *The Tayibb Project seeks to create a seal that will identify investment products that are both Shariah-compliant and* ***incorporate sustainability-related factors such as climate, nature and biodiversity, as well as workers rights,*** *as reflected both in existing leading ESG principles and frameworks and the highest principles of Shariah.*

> *The Tayyib seal aims to encourage the Islamic investment community to augment existing practices and innovate by* ***proactively incorporating ESG and socially responsible investing factors into current Islamic investment management processes****.*

> ***ESG and Islamic finance have so much overlap already and each sector can further learn from each other.*** *We look to contribute and collaborate with key stakeholders in the ESG and Sustainable finance space to* ***enhance adoption and ensure Islamic finance has a voice to inform and shape discussions and developments in the sector****.*

Omar Shaikh,
Managing Director, GEFI
Director, UKIFC

Dame Susan Rice,
Chair, GEFI

Why now?

Quite simply – because it is now possible. The natural evolution from Shariah to Tayyib is possible because there is much more accurate ESG-related information available now than there used to be. In addition, regulatory bodies around the world are increasingly requiring companies to disclose certain information on the way they manage social and environmental challenges. There are also growing expectations from investors that companies publish the material risks that climate change poses to their operations, resulting in more disclosure on areas like carbon footprint, water usage, supply chain policies, and more. This means that it has become easier to more effectively incorporate Tayyib considerations into investment decisions.

With the 2023 UN Climate Change Conference (COP28) being held in Dubai this year, it seems like the opportune time to acknowledge the current limits of Shariah-compliant funds and to discuss how Islamic investing can better reflect the spirit of Islam.

We are keen to support GEFI and UKIFC as they work with global standard setting bodies, along with conventional and Islamic financial institutions, to launch their Tayyib seal at COP28.

Conclusion

To accurately reflect the true values of Islam, we firmly believe that Muslim investors should move away from using investment processes that simply identify Halal companies, towards the idea of integrating Tayyib into their investment decisions.

In our view, to successfully do so, this requires active engagement from investment managers, to truly understand the businesses behind their investments, including the positive or negative impacts these companies have on society and our planet. Through our active engagement with companies, it is possible to not only inform companies about their impact, but also to encourage positive change.

We believe the time is now for the Tayyib concept and the beautiful principles it encapsulates to come to the fore in Islamic finance.

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IMPORTANT INFORMATION

This whitepaper is for professional and institutional clients only. It is intended for information purposes only and is not investment advice.

Past performance is not a guide to future returns. Market and exchange rate movements can cause the value of an investment to fall as well as rise and you may get back less than originally invested.

The views expressed are those of the authors at the time of writing and may be subject to change. This is particularly true during periods of rapidly changing market circumstances.

Every effort is made to ensure the accuracy of the information provided but no assurance or warranties are given.

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JUP-1173-11.23

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