

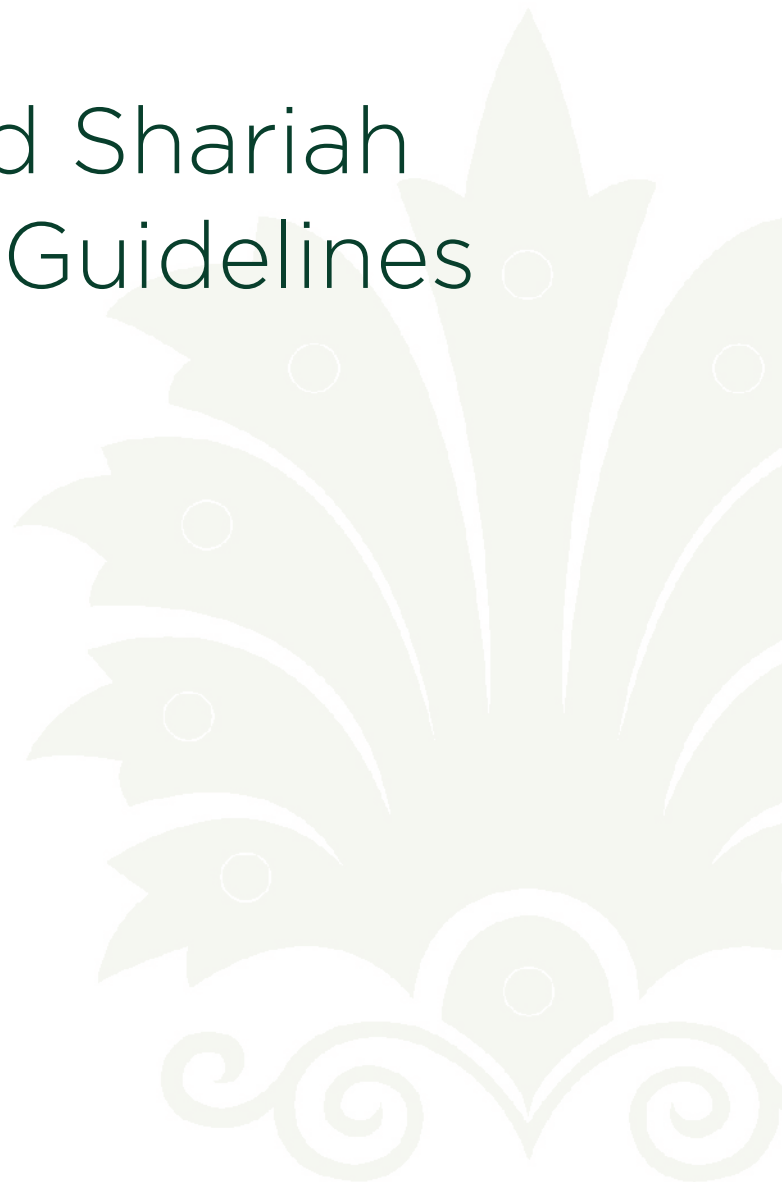


AZZAD

ASSET MANAGEMENT

*Invest with faith*

# Ethical and Shariah Investment Guidelines





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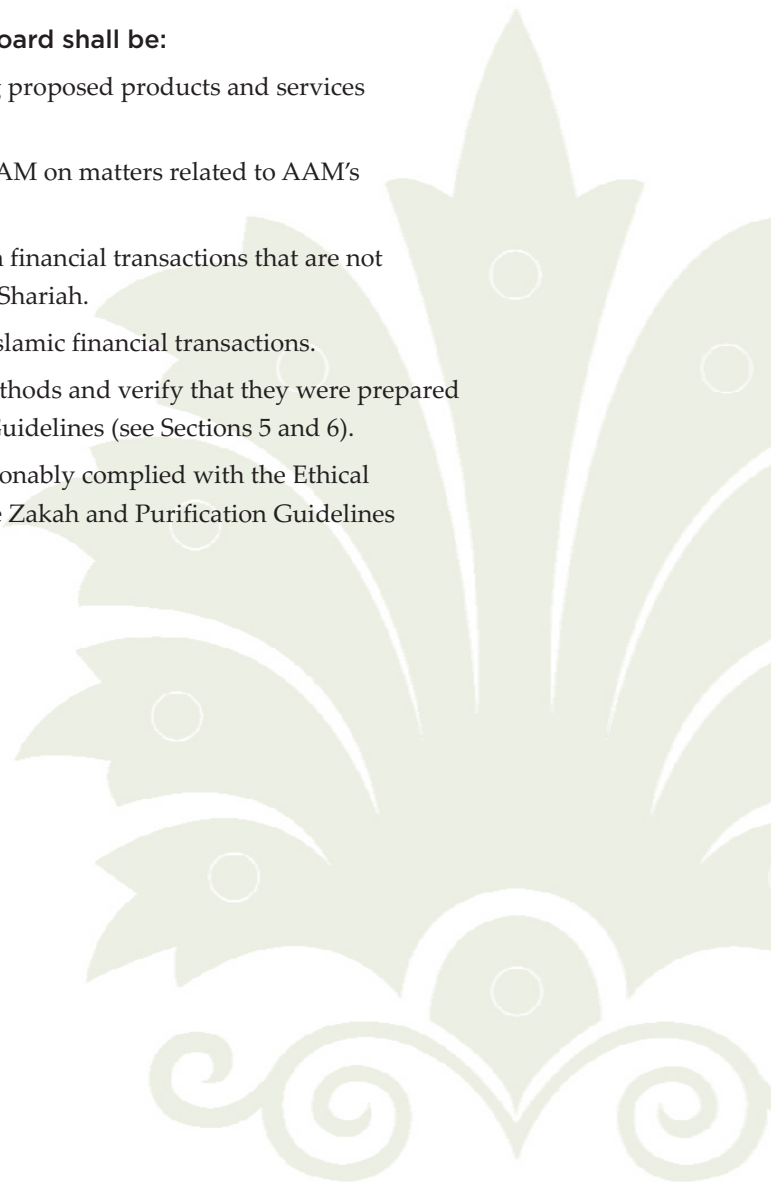
## **SECTION 1: SHARIAH ADVISORY BOARD**

The Shariah Advisory Board (SAB) shall be an independent body composed of qualified scholars specializing in Islamic jurisprudence and fatwa (Islamic legal opinion). Such scholars will generally be experts in the field of contractual transactions and financial dealings in accordance with Shariah, or Islamic sacred law.

The SAB shall advise Azzad Asset Management (AAM) on its ethical investment guidelines. These guidelines are based on the principles and provisions of Shariah. The SAB shall review AAM's investment activities to ensure that products and services are compliant with the Ethical and Shariah Investment Guidelines ("Investment Guidelines") outlined in this document. AAM shall appoint the Shariah Advisory Board, which should consist of at least three members.

### **The main duties and responsibilities of the board shall be:**

- To advise and grant a Shariah opinion regarding proposed products and services introduced by AAM.
- To answer questions and provide guidance to AAM on matters related to AAM's investment advisory services.
- To offer possible solutions to problems arising in financial transactions that are not compliant with the principles and provisions of Shariah.
- To train AAM employees on matters related to Islamic financial transactions.
- To review zakah and purification calculation methods and verify that they were prepared in accordance with the Zakah and Purification Guidelines (see Sections 5 and 6).
- To issue an opinion as to whether AAM has reasonably complied with the Ethical and Shariah Investment Guidelines and with the Zakah and Purification Guidelines contained herein.





## SECTION 2: ETHICAL AND SHARIAH INVESTMENT GUIDELINES

- AAM shall avoid investing in companies that are mainly<sup>1</sup> in lines of business deemed to be prohibited by the Shariah, such as tobacco, alcohol, pork-related products, gambling, pornography, and weapons. AAM shall not invest in banks and financial services institutions that derive their income from lending in interest and/or from gambling (*maysar*).
- AAM shall not invest in trading debt-based financial instruments, nor shall it invest in debt instruments generated from lending in interest.
- AAM may invest in securities structured on the basis of Islamic financial contracts such as *murabaha*, *salam*, *istisna*, and any other Shariah-compliant securities that are traded (bought and sold) with the issuer (primary market), taking into consideration the terms of debts and cash assets (rules of *sarf*).
- AAM may invest in Shariah-compliant bank deposits.

AAM shall to the best of its ability invest clients' assets in shares of companies traded in the secondary market and screen out shares of companies with the following financial ratios:

- Total interest-bearing debt<sup>2</sup> divided by market capitalization of shareholders' equity<sup>3</sup> is greater than 30%
- Total amount of interest-taking deposits, whether short-, medium-, or long-term debt divided by market capitalization of shareholders' equity is greater than 30%<sup>4</sup>
- Impermissible income is greater than the negligible amount (5% of the total income generated by the company)<sup>5</sup>
- Shares of companies whose total market value of (tangible assets + benefits + rights) divided by total assets is less than 30%<sup>6</sup>

AAM shall endeavor to use clients' shareholder rights to vote on corporate proxies to influence corporations to operate in a socially and environmentally responsible manner consistent with the Ethical and Shariah Investment Guidelines.

AAM shall provide purification calculation services for the Azzad Funds updated daily and available online and to Azzad Ethical Wrap Program clients once a year. AAM should endeavor to know the proper purification amounts.

AAM shall inform clients about the methodology of the purification calculation and shall disclose to clients that such methodology is based on an estimation (*khars*).

Please refer to Section 6 for information on purification. AAM shall issue a disclaimer to investors that the purification calculation figures are estimates and may not be the exact amounts of prohibited income earned by companies from lines of business deemed to be inconsistent with the firm's investment guidelines. Therefore, AAM shall not be liable for the inaccuracy of such amounts.



AAM shall not trade shares of companies on margin, trade options of shares of companies, or engage in forward sales of shares of companies. AAM shall not trade indexes and futures or conduct short selling, whether such trades are for the company itself or for its clients.

AAM shall not rent shares nor invest in preferred shares of companies; AAM will not conclude swaps, options, or futures contracts with respect to shares and their returns. Furthermore, the contract of *salam* is not permissible in shares.

AAM shall monitor its clients' portfolio holdings regularly to ensure compliance with these guidelines. AAM shall liquidate shares of companies that fail to comply with the above investment guidelines within three months and in a reasonable manner that considers the clients' best interests and at market price.

## NOTES

- <sup>1</sup> Companies are deemed to be mainly in a business if they generate revenue of more than 5% from such business. (AAOIFI Shariah Standard 21 "Financial Papers," clause number 3/4/4)
- <sup>2</sup> Total debt = short-term debt + current portion of long-term debt + long-term debt. AAOIFI Shariah Standard 21 "Financial Papers," clause number 3/4/2. Interest-bearing debt is prohibited regardless of the amount.
- <sup>3</sup> Market capitalization of shareholders' equity = the average market capitalization trailing twelve months (MCTTM).
- <sup>4</sup> Total value of interest-taking deposits (or instruments) = total cash and cash equivalents + short-term investments + debt portion of long-term investments. (AAOIFI Shariah Standard 21 "Financial Papers," clause number 3/4/3.) Interest-bearing debt is prohibited regardless of the amount.
- <sup>5</sup> Income is considered impermissible whether this revenue was from engaging in haram activity or from a haram acquisition. In case revenue is not disclosed, effort must be made to know these sources, taking into account reserves, in order to comply with AAOIFI Standard 21.
- <sup>6</sup>  $(MCTTM + debt - [cash and cash equivalents + short-term investments + accounts receivable + debt portion of long-term investments]) / total assets < 30\%$ . This condition will apply providing the objective of the company is not dealing in gold, silver, or currencies in line with AAOIFI Shariah Standard 21, "Financial Papers," clause number 3/19.

If the assets of a corporation are composed of tangible assets, benefits, cash, and debts, the rule for trading in the shares of such a corporation will differ according to the primary asset. If its purpose and activity pertain to trading in tangible assets, benefits, and rights, trading in its shares is considered permissible without taking into account the rules of sarf, or transaction in debts with the condition that the total market value of assets, benefits, and rights, should not be less than 30% of the total asset value of the corporation including all assets, benefits, rights, and cash liquidity (irrespective of secondary considerations such as size).

If the objective of the corporation and its usual activity is dealing in gold, silver, or currencies (*sirafah*), it is obligatory to undertake trading in its shares in light of the rules of sarf. There is a difference between gold exploration and mining companies and gold trading companies as follows:

- Gold exploration and mining companies shall apply the same Shariah rule as companies that deal in tangible assets and benefits and apply trading standards as mentioned in Shariah Standard No. 21.
- For companies whose primary purpose is to trade in gold, not exploration and mining, the Shariah Advisory Board (SAB) decided to apply sarf rules as mentioned in Shariah Standard No. 21.



### Derivation

- Market value of non-*rebawi* assets / market value of total assets < 30%
- Market value of non-*rebawi* assets = market value of tangible assets + benefits + rights
- Market value of *rebawi* assets = market value of cash and cash equivalents + accounts receivable + short-term investments + debt portion of long-term investments
- Market value of *rebawi* assets + non-*rebawi* assets = market value of total assets
- Market capitalization = market value of equity = market value of assets – debt = market value of *rebawi* assets + non-*rebawi* assets – debt
- Market value of non-*rebawi* assets = market capitalization + debt – market value of *rebawi* assets = MCTTM + debt – cash and cash equivalents + short-term investments + accounts receivable + debt portion of long-term investments

## SECTION 3: DEPOSITS GUIDELINES

AAM may invest in deposits as long as they are approved by a Shariah advisory board consisting of three scholars, in accordance with AAOIFI governance standard number 1. Working with this opinion is considered an allowed *ijtihad* of the basis of other due diligence.

The SAB will study and evaluate Shariah reputational risk in coordination with the SAB's executive member as needed.

## SECTION 4: SUKUK GUIDELINES

AAM may invest in sukuk that are endorsed by a Shariah advisory board consisting of three scholars, in accordance with AAOIFI governance standard number 1. Working with this opinion is considered an allowed *ijtihad* of the basis of other due diligence.

The SAB will study and evaluate Shariah reputational risk in coordination with the SAB's executive member as needed.

## SECTION 5: ZAKAH GUIDELINES

*Zakatul mal* (*zakah*) is a financial obligation that every Muslim must pay on certain assets that are at or above a certain minimum value (*nisab*) and that he or she has owned for at least 12 lunar months (*hawl*). *Zakah* is required of every Muslim male and female, regardless of age or mental capacity. The *nisab* of *zakatul mal* is 85 grams of gold or its market value on the *hawl* date. Therefore, any Muslim who owns *zakatable* assets in the form of cash, cash equivalents, or goods for trade worth 85g of gold or more and has held these assets for 12 lunar months is required to pay *zakah* on these assets.



Since zakah is assessed based on the ownership of zakatable assets, the calculation is based on the financial data of an individual's balance sheet as of the hawl date, not on his or her income statement. Expenditures, profits, and losses are not considered when calculating zakah. Zakah is not obligatory on wages, salaries, or income at the time of receiving such revenue. One's zakah base equals zakatable assets minus liabilities that are payable by the hawl date.

AAM calculates zakah every year on accounts held by its clients for at least 12 lunar months. Calculations are usually performed once a year based on a predetermined hawl date. The hawl date is usually set for *Sha'aban* 23 of every *Hijri* calendar year, seven days before the month of Ramadan begins.

### **Zakah Calculation Methodology**

#### *Estimation*

Khars means estimation, approximation, or rounding based on the most relevant data available regarding assets. Khars can be used to determine whether zakah is owed on certain assets and in considering hawl and nisab. At AAM, khars will be used to assess the amount of zakah owed on assets.

AAM assumes that clients owned the assets in their accounts for the entire hawl period, regardless of when they were deposited. If this is not the case, clients should prorate the zakah amount reported by Azzad to reflect the actual period that they owned those assets.

AAM assumes that account owners have zakatable assets equivalent to 85g of gold or more at the date of the hawl.

#### *Zakah on Cash, Gold, and Silver*

Zakah is owed on all cash, gold, and silver, based on their value on the day of the hawl.

#### *Zakah on Debt*

If the debt is in good standing, the financier of the debt owes zakah every year on the hawl date. The financier does not owe zakah on debt that is in bad standing. However, once the financier recovers the debt or the debt reverts to good standing, then zakah is owed beginning that year only, regardless of the number of years the debt was in bad standing.

Zakah on interest-based debt securities including bonds, banking notes, CDs, commercial paper, money markets, and other liquid securities is required on the principal amount only; zakah is not owed on any gain from accrued interest or market appreciation, as those are not recognized as lawful assets. Such gains should be donated to charity with the knowledge that deposits with interest or discounting accounts receivable is prohibited.

Debt owed and due before the hawl date is deductible from one's zakah base, but debt owed and payable after the hawl date is not deductible from one's zakah base. However, one may deduct debt from acquiring commercial assets (*arood tijarah*) from his or her zakah base. The interest portion payable on any debt acquired in a non-*halal* way should not be deducted from the zakah base.



#### *Zakah on Lawful vs. Unlawful Assets*

Zakah is only owed on halal and lawful assets (*mal mutaqawwam*). No zakah is owed on *haram*, or unlawful, assets such as liquor, pork, profits from gambling (mayser), interest (*riba*), stolen money, drug money, bribes, or any other “dirty money.” Such assets or monies must be returned to their lawful owners, and if the lawful owners are not accessible, then they must be donated to charity. Owners should resort to repentance and firmly resolve not to approach such a way of gaining money again.

Only securities of companies deemed to be halal according to one of the sources below are liable for zakah:

- The Ethical and Shariah Investment Guidelines adopted by the AAM Shariah Advisory Board (see AAM’s Ethical and Shariah Investment Guidelines in Section 2).
- The majority of Islamic scholars versed in the financial field.
- Globally recognized *fiqh* institutions and councils such as AAOIFI, the Fiqh Council of the Organization of Islamic Cooperation, or other similar institutions.

Financial options and derivatives do not represent lawful assets from a Shariah point of view and are not eligible for zakah.

#### *Zakah on Income Stocks*

Stocks held for the purpose of deriving an income or for benefiting from dividends are considered capital goods.

If it is possible to know the zakah amount due on stocks in which AAM invests, then zakah will be calculated as (number of shares owned times zakah amount per share).

If a company in which we invest does not calculate zakah, then shareholders’ zakah should be calculated based on the zakatable assets after deducting the liabilities, according to the zakah standard. If it is difficult to know the zakatable assets, then we have to calculate based on estimation. If the company in which we invest does not have zakatable assets, then we have to pay zakah based on the remaining net income at the end of the hawl.

If a company in which we invest has paid zakah on behalf of shareholders, whether they are individuals or institutions, then zakah is not due again to prevent duplicated zakah payments. This is only the case with stocks held for trading purposes.

#### *Zakah on Growth Stocks*

Stocks held for the purpose of trading and benefitting from their growth and price appreciation are considered commercial goods.

To calculate zakah on such stocks, take the market value on the hawl date and deduct anything the company has already paid for zakah. If the amount the company paid was not sufficient, the investor should pay the difference. If the company paid more than the zakah due, the individual may credit that amount toward future zakah payment.



### *Zakah on Sukuk*

The owner of an investment sukuk, of which there are different types, must pay zakah based on the assets the sukuk represents. For sukuk purchased with the intention to derive income and representing ownership of assets leased for deriving rent as income, only the amount of income held for 12 lunar months or longer will be liable for zakah.

Zakah is required on asset-backed sukuk that are intended to be used as commercial goods. In these cases, zakah will be assessed on the market value of the sukuk at the time of the hawl. For sukuk that represent debt, zakah is calculated based on book value. The zakah base of hybrid sukuk composed of both debt and tangible assets or the usufruct of assets intended for income should be assessed proportionately to the debt segments of the sukuk. (Please refer to AAOIFI clause 5.1.4.2, Zakah Shariah Standard, page 575.)

The zakatable base for non-hybrid sukuk will be researched based on the prospectus and other sources. If the information is not available, then it will be estimated.

### *Zakah on Shariah Compliant Deposits*

Zakah is assessed on 100% of the book value of Shariah compliant deposits at the end of the hawl whether the deposit account was held for 12 lunar months or longer. (Please refer to AAOIFI clause 5.1.3.2, Zakah Shariah Standard, page 574.)

### *Ownership of Assets for Zakah*

Zakah is required on assets that are completely owned and vested for the owners. Complete ownership means that assets be accessible and disposable by the owners without the interference of others. Assets that are not accessible by the owners are considered incompletely owned and owners are not liable for zakah on such assets. Taxes and penalties levied on accounts upon liquidation and distribution do not hinder the complete ownership of assets.

### *Zakah on Clients' Accounts*

Stocks in client accounts are categorized into commercial goods or capital goods based on the intention of AAM's portfolio managers.

The zakah of client accounts shall be reduced by the amount of taxes and penalties, if any, that would become due if they were to be liquidated or distributed. The amount of such taxes will be calculated based on the federal and state tax bracket of the account owner. Penalties will be assessed based on the age of the account owner.

The zakah base shall be further reduced by the purification amount calculated and accrued on a daily basis for all the securities purchased during the year of the hawl. Purification amounts, including all interest from lending earned during the hawl, are not subject to zakah. Account owners should eliminate such amounts by donating them to charities and should not benefit directly or indirectly from these donations.

AAM provides zakah and purification calculations only. It is the responsibility of clients to disburse the amount of zakah and purification to their preferred charities or recipients.



Zakah does not have to be paid from the account on which zakah is assessed. Zakah can be paid from any other accounts that clients own.

Clients bear all liability for taxes and penalties they may incur when they withdraw money from their accounts. AAM does not provide tax advice. Clients should consult with their tax advisors for any tax consequences that may result from liquidation or distributions.

#### *Zakah on Retirement Accounts*

Retirement accounts, including traditional individual retirement arrangement (IRA) accounts, Roth IRA accounts, IRA rollover accounts, Simplified Employee Pension Plan (SEP) IRA accounts, and Savings Incentive Match Plan for Employees (SIMPLE) IRA accounts, are zakatable. The zakah on these accounts is calculated by adding all the zakatable assets, subtracting any taxes, penalties, and purification amounts, then multiplying the net amount by 2.5%.

Taxes and penalties on income stocks are deductible from the zakah base, even if the taxes due could reduce the zakah base to zero.

Qualified retirement plan accounts including 401(k) and 403(b) accounts, profit sharing accounts, defined benefit plan accounts, and cash balance plan accounts that are vested and accessible by the participants are zakatable. The zakah on these accounts is calculated by adding all zakatable assets that are vested, subtracting any taxes, penalties, and purification amounts, then multiplying the net amount by 2.5%. Accounts that could not be accessed by participants unless they resigned or were terminated are not zakatable. However once accounts become accessible for any reason such as retirement, termination, or resignation by the participants, then the zakah is owed beginning that year regardless of how many years the accounts were not accessible. Of course, the accounts will then continue to be zakatable every year moving forward.

#### *Zakah on Education Savings Accounts*

Uniform Gifts/Transfers to Minors Act (UGMA/UTMA) accounts, Coverdell Education Savings Accounts, 529 plan accounts, and health saving accounts (HSAs) are zakatable. The zakah on these accounts is calculated by adding all the zakatable assets, subtracting any taxes, penalties, and purification amounts, then multiplying the net amount by 2.5%.



## SECTION 6: PURIFICATION

Purification is a cleansing process that involves the donation of income earned from any non-halal business activities by companies in which the shareholder is invested. The purification calculation accrues the portion of income from non-halal business activities allocated to the shares of the companies in client accounts. The investor or his or her agent should not intend to benefit from such activities when the shares of these companies are purchased. Shares are purchased only to benefit from the halal business activities that overwhelmingly form the core business of the company.

Although AAM follows strict Islamic guidelines when investing for its clients, it advises its clients to cleanse any income that may have been earned from non-halal business activities by the companies in which they are shareholders. AAM shall provide purification calculation reports to its clients once a year, applying to the past 12 lunar months ending on *Sha'aban* 23 of the Hijri calendar.

AAM shall inform its clients of the methodology for calculating purification amounts and disclose to clients that such a methodology is based on estimation (khars).

The purification amount for each account shall be the sum of any unintended and unavoidable interest income earned (if any) from cash in the brokerage account, interest income per share allocated to all shares of the companies owned in client accounts, as well as revenue from insignificant prohibited business activities attributed to shares of companies owned in client accounts. Azzad will revert to estimation in cases when the amounts of revenue from insignificant prohibited business activities could not be determined. AAM shall issue a disclaimer to investors that the purification calculation figures are estimates and that it is likely that the estimated haram revenue may not be the exact amount of impure revenue earned from business activities deemed to be inconsistent with the AAM's Ethical and Shariah Investment Guidelines. Therefore, AAM shall not be liable for the inaccuracy of such amounts.

### Purification Calculation Methodology

Purification amounts, including all unintended and unavoidable interest income from lending earned (if any) during the hawl year, are not subject to Zakah. Account owners should eliminate these monies by donating them to charity and should not benefit directly or indirectly from those donations. Scholars recommend not donating such money to build mosques or to print the Holy Quran.

AAM calculates purification and accrues it on all securities that are owned by its clients.

AAM's proprietary purification accounting software calculates the purification by considering the following:

- The number of shares of each security
- The *haram* revenue per share for each security
- The number of days each security was held



AAM provides only the calculation figures for purification. It is clients' responsibility to disburse the purification amount to their preferred charities or recipients.

Purification can be paid from any money clients possess; it is not required to be paid from the accounts on which the purification calculation is assessed.

Clients bear all liability for taxes or penalties they may incur when withdrawing money from their accounts. AAM does not provide tax advice. Clients should consult with their tax advisors for any tax consequences that may result from liquidation or distributions.

**Disclaimer:** *This document is not a binding legal document and does not create any rights or obligations between Azzad Asset Management and the client. This document does not imply that the Shariah Advisory Board exercises any control over Azzad Asset Management or possesses any management powers. Azzad Asset Management may change the provisions of this document at any time.*