

Islamic finance gets ready to spread

By David Oakley

Published: November 24 2006 02:00 | Last updated: November 24 2006 02:00

Next week, London's Alternative Investment Market will give itself a slightly more Islamic hue: Shariah Capital, a US-based group, will become only the second company that complies with Islamic law to list on the exchange.

But what is of even more interest is that the core of the company's business franchise is not targeted at specifically Islamic companies but rather at western banks and companies that are starting to develop an interest in using shariah-compliant products.

Run by a Catholic American former hedge fund manager, the company - which numbers among its executives the first ever chief shariah officer or CSO - is aiming to help western companies, hedge funds or banks use instruments that are shariah-compliant, such as sukuk, the so-called Islamic bonds.

Eric Meyer, president and chief executive officer of Shariah Capital, said: "This is just the very beginning. There is no question in my mind this market will take off, and we aim to play a part in that.

"We are the first shariah-compliant money market alternative. Our role as a financial engineer provides something so unique.

"We can approach a lot of hedge fund managers and say if you want to use our screening, we can make you shariah-compliant. We are a turn-key solution."

At the moment it is unclear how many western companies will swallow the marketing pitch. So far, the only US company that has issued sukuk is East Cameron, a small oil company, which conducted a small-scale deal this year.

However, Mr Meyer, who ran his own hedge fund in the 1990s, believes that companies operating in US and European healthcare, technology and oil and gas industries, which want to build links with the Middle East, are particularly natural candidates to tap into this region's liquidity.

It is this region that offers, perhaps, the biggest potential for the sukuk bond market after two years of an oil-related boom that could fund billions of dollars of new issuance.

There has been roughly \$45bn of sukuk (a bond that does not pay interest as it is banned under Islamic law, or shariah) issued globally to date, mostly from Malaysia.

But, significantly, the biggest deal came out of the Middle East, a \$3.5bn issue from state-owned Dubai Ports World, earlier this year.

Next week, the Nakheel Group, the Dubai government-owned property developer, is expected to price a \$2.5bn shariah-compliant bond.

In London, the interest is growing by the day with GFI, the US interbank dealer, becoming the first broker to set up an Islamic finance desk. Launched in July, it is specifically targeting the Middle East.

With an estimated \$13bn of bonds issued in the Middle East, mostly floating rate notes, GFI is already seeing prices, albeit in small amounts.

It predicts that the sukuk market will start to expand rapidly next year with the Nakheel deal likely to nudge it further along the way.

The growth in the sukuk market can be traced back to 2001's September 11 attacks in the US as many affluent Middle Eastern investors returned to what they considered to be the relative safety of their own soil in the wake of a backlash against Muslims.

According to Ayman Khaleq, the UAE-based partner with Vinson and Elkins law firm, many Muslims are increasingly seeing the sukuk as the ideal investment. Michael Gassner, a German consultant in Islamic finance who travels across the Middle East, said the growth of sukuk is being driven by affluent Saudi investors.

This, he said, is helping to lay the foundation for a larger Islamic debt market in the region. "All these developments are leading to the creation of a regional Islamic debt market."

However, some bankers warn that the enthusiasm surrounding the growth of sukuk may be misplaced.

"Investors from the Middle East would not always remain averse to returning to US markets in a big way," said a western banker based in the region. "If there is a US pull-out from Iraq, and within the US there is a belief that new relations have to be formed with Muslims, many Middle Eastern investors may see those as conciliatory signs.

"Such a change of trend, which marks the return of Middle Eastern money to the US and other western markets, should not be excluded."

Other bankers warn that the sukuk comes with inherent limitations that could make it a difficult vehicle for investment in some of the world's largest companies.

This includes the possibility of board members from leading international companies being reluctant to hand over their financial records for scrutiny to shariah-compliant scholars.

"Many in the western world would just not be comfortable with the idea of dealing with shariah scholars in this way," said a US lawyer who advises banks in the Middle East.

"People may be interested in seeking Arab money but not necessarily through the sukuk route."

Mr Meyer and his team at Shariah Capital, however, would strongly disagree and they could play a big part in proving the sceptics wrong.