

Venture introduces Islamic investors to hedge funds

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September 13, 2007

The world of Islamic finance is on the cusp of transformation with the launch of an investment platform that will enable observant Muslims to invest in hedge funds.

Shariah Capital, the New Canaan consulting firm that helps hedge fund managers craft strategies compliant with Islamic law, or Shariah, has teamed with London-based Barclays Capital to jointly launch the Al Safi Trust by year's end.

"It is a real turning point for my company, and I think it is a pretty significant event for the Islamic finance world as well," said Eric Meyer, Shariah Capital's president and chief executive officer.

The trust will invest with fund managers who have passed Shariah muster, and will enable Islamic investors to tap into hedge funds effectively for the first time, said Sheikh Yusuf Talal DeLorenzo, former chairman of the Dow Jones Islamic Index and now the chief Shariah officer for Meyer's firm.

The platform, which will be marketed and prime-brokered by Barclays, targets hedge funds that want to accommodate Islamic investors and institutional investment managers looking to make alternative investments without violating Shariah principles.

Shariah Capital will serve as the platform's Shariah adviser.

Barclays Capital, the investment-banking arm of Barclays Bank PLC, is a powerhouse in conventional and Islamic finance, bringing the legitimacy that Persian Gulf investors are looking for, Meyer said.

The Al Safi Trust will initially have six fund managers, said Frank Gerhard, Barclays Capital's head of project strategy in fund-linked derivatives.

Growth "will depend on the reception of investors and other managers," Gerhard said. Barclays is looking to attract assets of at least \$500 million within the first 12 months of launch, he said.

Barclays is one of the biggest and most successful players in the market for Middle Eastern sukuk, or

Islamic bonds, Gehard said. The company began talking to hedge fund managers a year ago about expanding into the Gulf region.

Barclays' early impression was that the work and resources it would take to bring hedge funds to the Middle East were too prohibitive. That was where Shariah Capital came in.

Listed on the London Alternative Investment Market, Shariah Capital spent six years working with Islamic scholars, as well as Western financial and legal experts, to develop risk-management tools that would enable Islamic investors to invest in hedge funds.

Islam forbids practices that are the bread and butter of many hedge funds, Meyer said. The Quran doesn't allow a person to sell something he doesn't own, which rules out short-selling. Undue risk and speculation is forbidden, as is paying or receiving interest.

The firm received fatwas, or religious blessings, on Shariah-compliant investment vehicles that would provide an alternative to short-selling and options trading. It also developed data-mining software to screen thousands of publicly traded companies for Shariah compliance.

Barclays worked with Shariah Capital and the scholars to write a Shariah-compliant prime broker document.

Initially, Shariah Capital sought to launch its own hedge fund or fund of funds, but decided to switch course after working with Barclays, Shariah Capital Managing Director Joseph Gau said.

"Our job is to get many strategies and hedge fund managers on this platform to make it very broadly appealing," Gau said.

The trust will be composed at first of hedge fund managers who use equity long-short and market-neutral strategies. Each hedge fund manager will have his own account, with independent reporting, under the umbrella trust, Gau said. Investors will then have a cadre of hedge fund managers and strategies to pick from.

DeLorenzo, the Shariah officer, said Islamic banking a decade ago was a small niche. Unable to find investment alternatives that were Shariah-compliant, Islamic banks could barely operate. They are prohibited from using virtually all the investment practices that fuel the coffers of conventional banks, such as charging interest, trading debt and holding treasury bills and corporate bonds.

The creation of the Dow Jones Islamic Index in 1999 gave observant Islamic financial institutions the ability to trade on the stock market, he said.

"Everything changed overnight," DeLorenzo said. "We went from having six Shariah-compliant equity funds in the world to 120. Today there are over 500."

With that development, a number of international banks stepped into Islamic finance arena. Things changed more dramatically in 2004 when the sukuk, or the Islamic equivalent to a bond, was

established. The \$70 billion sukuk market has doubled every six months, he said.

The ability for Islamic investors to finally enter the hedge fund arena is significant to managing risk and liquidity, DeLorenzo said.

"By providing a platform for hedge funds, Barclays and Shariah Capital have supplied a major tool for the industry - a very, very needed one," DeLorenzo said.

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