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## Islamic Scholars Play Role in High Finance

Alexia Garamfalvi

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For those with a passing knowledge of the strictures of Islamic law, in particular its prohibition on the charging of interest, the term “Islamic financing” might seem to contain an inherent contradiction.

But far from being disfavored, deal work in the Islamic world is booming. Ten years ago, best estimates put the amount of global financing done under Islamic law at about $70 billion. This year, it’s ballooned more than tenfold to an estimated $750 billion. That’s enough to propel the Islamic finance industry out of its niche market status and into the mainstream of international banking.

It also means the industry is facing growing pains, with an acute shortage of lawyers and Islamic scholars who can advise companies and financial institutions on how to structure their investments and deals so as to comply with Islamic law.

A recent game of musical chairs among lawyers with Islamic finance expertise at U.S. and U.K. firms in Dubai shows that firms are scrambling to get in on the action and are looking to ramp up their Islamic finance capabilities.

“The market for Islamic finance lawyers is hot,” says Ayman Khaleq, a Dubai-based partner with Vinson & Elkins, who worked on the first sukuk, or Islamic bond, to be issued in the United States for East Cameron Gas Co. last July. “There’s a relatively small pool of good Islamic finance lawyers,” says David Church, DLA Piper’s regional managing partner for the Middle East.

Church should know, having scoured the market for lawyers to kick-start DLA’s Islamic finance practice. In February, the firm announced it had scooped up Oliver Agha, a project finance lawyer with al-Jadaan, Clifford Chance’s affiliate in Saudi Arabia, to launch its Islamic finance practice.

Earlier this month, DLA Piper brought on another three Islamic finance specialists, including Adil Hussain, the former head of the Islamic finance group in the Bahrain office of Norton Rose, a British firm considered to have one of the leading Islamic finance practices. DLA Piper, which only opened its Dubai outpost last year, aims to have a 12-to-13-lawyer Islamic finance practice by year’s end, says Agha, who heads the practice.

“In the last three years, the industry has gone from nascent to burgeoning,” he says.

Broadly speaking, Islamic finance involves structuring investments and transactions in a way that complies with the strictures of Islamic law, or shariah, which is intended to govern all aspects of Muslim life, including business affairs.

One of the most fundamental prohibitions is the charging of interest. The key idea is that investors should not make money off simply lending money. This puts shariah at odds with most conventional financing techniques, such as loans and bonds. So deals have to be structured in other ways, often as leases, profit-sharing, or trading.

Shariah also bans investing in a number of activities that are considered sinful, such as gambling, pornography, the manufacture or distribution of alcohol or tobacco, and the consumption of pork. It additionally prohibits highly speculative investments and investing in companies that are highly leveraged (that have excessive amounts of debt).

Bankers, lawyers, and shariah scholars have come together to develop a number of different investment vehicles that comply with these prohibitions. One of the most recent innovations is the sukuk, which has been dubbed an Islamic bond and is similar to an asset-backed security. A sukuk can be structured to offer a fixed return similar to the interest on a conventional bond. But unlike a bond holder, a sukuk holder is granted an ownership interest in the assets or business being financed, and the return is tied to the performance of the underlying assets.

## GULF STREAM

DLA Piper is far from the only firm raiding its competitors for Islamic finance talent. Last October, British firm Herbert Smith announced that it would open an office in Dubai with two lawyers, Zubair Mir and Nadim Khan, Islamic finance experts it poached from Norton Rose.

Meanwhile, in February, Lovells, another U.K.-based firm, scored a major coup when it recruited a three-lawyer group from U.K. rival Denton Wilde Sapte to start its own Dubai shop, which it plans to open in May. The group — Rahail Ali, chairman of Denton's Islamic finance practice; Rustum Shah, a banking and finance lawyer; and corporate lawyer Imtiaz Shah — has been involved in some of Dubai's most high-profile Islamic finance deals, including advising the underwriters, Dubai Islamic Bank and Barclays, on a $1 billion sukuk offering for the expansion of the Dubai airport and a $3.5 billion sukuk issued in connection with Dubai Ports World's $6.8 billion acquisition of P&O, the largest sukuk offering to date.

That deal garnered more attention in the United States for the furor that ensued over whether DPW's acquisition of P&O's port assets in the United States would be a national security risk than for the fact that it was partially financed by a sukuk issuance.

DPW was represented by Clifford Chance, one of the top firms in the field. Established in 1975, the firm's 50-lawyer Dubai office dwarfs most of its competitors. The firm beefed up its Islamic finance practice early, having transferred a number of practitioners to Dubai last spring.

Not to be outdone by its British competitors, King & Spalding, the first U.S. firm to have an Islamic finance team when it established its practice in 1994, launched its Dubai shop earlier this year to service its Persian Gulf-based clients. "We wanted to protect our franchise," says Isam Salah, a partner in the firm's New York office and the head of its Islamic finance and investment practice, noting that the firm has more than 20 lawyers who do the work almost exclusively.

The firm is in essence following its Middle Eastern clients, many of which have been increasing investment in the region.

Meanwhile, Michael McMillen, Salah's former partner at King & Spalding, moved to Dechert's New York office to launch that firm's Islamic finance practice. The firm also lured former Norton Rose associate Abradat Kamalpour and Clifford Chance partner Andreas Junius. Both are partners at Dechert.

## BOOM TIMES

So what's behind this recent flurry of activity and why are firms so eager to launch an Islamic finance practice?

In large measure it's tied to the emergence of Dubai as a regional financial center. In the past few years, at least six U.S. and seven British firms have opened up shop in Dubai, following an earlier migration of investment banks.

“It’s a natural follow-on to opening an office in Dubai,” says Mark Walters, a Dubai-based recruiter with First Counsel. The market for legal work in Dubai and the Middle East is soaring, he explains. And because a larger and larger proportion of the deals being done in the region are at least partially funded according to Islamic precepts, firms active in the Middle East need to have Islamic financing capabilities in order to attract clients. Although many lawyers in the region have worked on deals involving an Islamic financing component, many of them “were learning on the job,” so having genuine expertise sets a firm apart, Walters says. Vinson & Elkins’ Khaleq agrees: “Eight times out of 10, clients ask if you can advise on Islamic finance matters,” he notes.

Lawyers in the region attribute the increase in the number of Islamic finance deals in large part to the Middle East’s overall economic boom resulting from record oil profits. The surge of liquidity in the market has driven investors to demand a broader range of financial instruments in which to invest. And more of the money is staying in the region than it did during the oil booms in the 1970s and 1980s. “Muslim investors’ increasing interest in Islamic finance is also tied to a groundswell in religious identity that has been building in the Middle East in the post-colonial period,” says Ali Adnan Ibrahim, who teaches a course in Islamic finance at Georgetown University’s law school. “Real movement is afoot in the Middle East. Investors want alternative ways to invest their money,” says Agha.

Islamic finance is not limited to the Middle East, however. King & Spalding's Salah points out that many of the financial structures used in Islamic financing were developed for shariah-compliant investment firms doing deals in the United States. The firm represents Arcapita, a Bahrain-based, shariah-compliant investment bank, in many of its private equity transactions in the United States, including the purchase and then sale of New York-based clothing company Loehmann’s Inc.

One of the real trailblazers in the industry is Malaysia, which pioneered the use of the sukuk and still accounts for a majority of the Muslim world’s sukuk offerings. And London is viewed as the Western capital of Islamic finance. Georgetown’s Ibrahim says estimates put 58 percent of the total assets invested in the industry in the Middle East, with Southeast Asia (including Malaysia, Indonesia, and Singapore) at 22 to 25 percent, and Europe, the United States, and South Asia making up the rest.

The increased demand has led large financial institutions to realize that they are going to be able to do enough of these deals to amortize the cost involved in developing new structures, says Dechert’s McMillen. “The industry has grown up,” says Sheikh Yusuf Talal DeLorenzo, a Virginia-based shariah scholar who has been involved in the industry since the 1980s and is now the chief shariah officer for New Canaan, Conn.-based Shariah Capital.

In just the past year, ABN Amro, Societe Generale, UBS, and Deutsche Bank have all launched Islamic investments. And as more deals get done, templates emerge and the transaction costs of doing deals go down, bringing in other investors who might have been reluctant to trade commercial benefits for deals that are religiously compliant. And on goes the cycle.

**SIGNING OFF**

The boom in the industry has also caused a run on the shariah scholars who decide whether deals meet the strictures of Islamic law. Shariah scholars review transactions to determine whether they comply with Islamic law before issuing a pronouncement, or fatwa, that is akin to a legal opinion, approving the deal and assuring investors that it is acceptable from a religious perspective.

There’s a real dearth of shariah scholars who have an in-depth knowledge of Islamic law along with a sufficient understanding of complicated financial structures and the ability to read hundreds of pages of deal documents in English, DeLorenzo says.

“There’s very little bandwidth,” notes Bill Redman, Shariah Capital’s managing director. Lawyers estimate there are only about 10 to 20 shariah scholars who are sufficiently qualified and whose opinions are respected enough to sign off on these deals.

And as the industry continues to mature, it faces other challenges, as well. The deals are often segmented among regional markets, and although a few countries have defined parameters for what counts as Islamic finance, most financial institutions continue to rely on their boards of shariah scholars to determine whether individual transactions comply with Islamic law. This can make it difficult to structure cross-border deals or develop financial products that can sell across the Muslim world. For example, Saudi Arabia-based scholars often judge Malaysian deals to be too “flexible.”

Although lawyers say they focus on getting approval from shariah scholars in the jurisdiction where the target investors are, the “issue of standards does come up more and more often,” Vinson & Elkins’ Khaleq says.

Some movement towards standardization is afoot. Dechert’s McMillen is advising the Malaysia-based Islamic Financial Services Board on the development of a legal infrastructure — including model uniform acts for each of the major Islamic finance structures and business entities used in Islamic finance.

Meanwhile, there’s been a gradual tightening among some shariah scholars of the standards for whether a deal is shariah-compliant and more legal push-back as new deals get done that scholars aren’t comfortable with, says Dechert’s McMillen.

DeLorenzo, for example, worries that new products, such as swaps and derivatives, will be designed to adhere to the letter of Islamic law but ignore the spirit behind the shariah’s prohibitions. He sounds a note of caution.

“The safe course is to ensure adherence to the letter of the law,” he says, “but when you are down in the trenches, it’s hard to step back and see where this is leading.”

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*Alexia Garamfalvi can be contacted at* ***agaramfalvi@alm.com****.*

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