

International Investing Guide

Hedging

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Eric Meyer's Shariah Capital trades on London's dicey AIM market but is headquartered on Elm Street in New Canaan, Conn. In this wealthy suburb, a few doors down from Baskin-Robbins, Meyer has built a system he claims will soon create a vibrant universe of hedge funds trading under the strict principles of the Koran. His firm won't be operating Koran-safe hedge funds; it will make its money telling portfolio managers how to accomplish that feat.



It's a challenge. The Prophet's teachings forbid the paying of interest, and everyday hedge fund tricks like selling short and using derivatives (almost all of which have interest, explicit or not, built into their economics) come into question. But Meyer and his sharia compliance officer, Sheikh Yusuf DeLorenzo, say they have cracked the code. They have designed, along with secular lawyers, a hedge fund system that includes trading software, stock screens that filter out companies that don't meet Islamic principles, a means of purifying portfolios of the remaining "pollutants," and finally a way to get a fatwa, signed by scholarly heavyweights, certifying a client's hedge fund as compliant.

How do they handle a short? Meyer spent \$5 million of his own money and eight years of his life on the project, so he won't, he says, reveal his "special sauce." But from what FORBES can tell, it's not making money on a stock in retreat that is the problem for Muslims but the short-selling step that entails borrowing a security you don't own. The Shariah Capital system seems to use a down payment—to establish ownership of the stock—before the "short sale."

Shariah Capital's trading system is operated by Barclays Capital. In May the Dubai International Financial Centre issued Shariah Capital a license to operate its platform, and a hedge fund firm in Boston gave the system a dry run. Meyer's first client, signed in June, is William D. Witter, a money management company created by Dean Witter's son and now run by his grandson. Meyer's fee is 1% of an Islamic hedge fund's assets.

Where there's a will, financiers will find a way. For years property-casualty insurance was problematic, since it is a form of gambling (the underwriter is gambling that your oil well won't blow over). Solution: a policy that resembles a sharing of losses, as practiced for centuries by Islamic families. Charles Bouloux, who runs American International Group's operations in the Middle East and south Asia, has just launched AIG Takaful after two years spent getting the scholars to sign off. "It's basically the same structure the Scottish mutuals created 200 years ago," says Bouloux. The Takaful fund is owned by the policyholders; AIG earns a management fee for running it.