



Capitalism That Crosses Cultures

Will U.S. firms embrace Islamic investment rules?

By Kit R. Roane

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Few American CEOs have ever heard of Islamic bonds, much less tried to float them to investors. But one Connecticut money manager is betting that they will soon be lining up to do so.

Eric Meyer once spent his days ferreting out socially responsible investments for groups like the Boy Scouts of America and the Roman Catholic Archdiocese of New York. Now, as president of Shariah Capital in New Canaan, Conn., he's trying to convince American companies that they should seek out oil-rich Muslim investors in the Middle East to finance growth.

On the surface, the pitch makes perfect sense. Rising oil and gas prices have left Persian Gulf nations swimming in petrodollars. At the same time, there is an increasing desire among the world's 1.5 billion Muslims for investment products that comply with *sharia*, Islamic law as laid out in the Koran.

Sharia strictly forbids Muslims from taking or charging interest, holds that money should be lent only on physical assets, bars speculation, and prohibits investing in items like pork, alcohol, gambling, and pornography.

So, unlike typical corporate bonds in which companies pay a fixed rate of interest to investors, Islamic bonds, or *sukuk*, derive their investment return from the assets used to back them. The concept is not unlike that of a revenue bond that a city might use to finance a municipal project. The first American company to issue an Islamic bond, for example, did so based on its ownership of oil reserves in the Gulf of Mexico.

"It is not lost on either corporate issuers or institutional investors that there is a large and ever growing liquidity in the Middle East," says Meyer, whose firm also runs screening and *sharia* certification services for hedge funds wanting to set up Islamic funds.

Petrodollars. There's no lack of money in the Islamic world; oil-exporting, emerging economies, such as those in the Persian Gulf region, took in some \$500 billion more in 2006 than they were able to spend or invest elsewhere.

But unlike with the last Persian Gulf oil boom in the late 1970s, investors aren't parking as much of their money in traditional western investments. Real estate is still a big seller, but instead of just being socked away in U.S. treasuries, more of this new oil wealth is being invested back in Muslim countries, businesses, and stock markets, or being funneled through trade into Asian economies. Fallout from the American response to 9/11 and the invasion of Iraq has "resulted in the repatriation of funds to the Middle East," says Tahir Jawed, a Dubai lawyer with the Cayman

Islands-based firm of Maples & Calder, which advises clients on complex, *sharia*-compliant financial structures. "On a social level, world events have resulted in many Muslims looking more closely at their religion, and many have sought to incorporate their religion into all aspects of their lives, including investments."

This has meant that western financial institutions have had to roll out more specialized products to attract Muslim investors they once took for granted. "Companies that do business in the Middle East are realizing that Islamic finance is not just a flash in the pan but is a regional and generational development," says Yusuf Talal DeLorenzo, Meyer's new chief *sharia* officer. "It isn't going away."

HSBC, Citigroup, and Lloyds TSB Bank now carry lines of *sharia*-compliant mortgages. Several companies, including Dow Jones, offer Islamic funds and investing indexes. Some conventional multinational and Middle Eastern banks have opened *sharia*-compliant units or are converting their whole operations. UBS recently opened a separate Islamic private bank in Dubai for well-heeled Middle Eastern clients. And last year the British government launched a *sharia*-compliant children's education savings account.

The market for Islamic bonds—what Meyer is betting U.S. corporations will soon be issuing—is growing at breakneck speed. While Persian Gulf countries and industries issued only \$3 billion in Islamic bonds between 2001 and 2003, more than \$20 billion in Islamic bonds is expected to be issued in 2007, says Alain Marckus. He helps run GFI Group's new London trading desk for Islamic bonds, the first set up to handle the nascent secondary market that allows the bonds to be easily traded.

Even \$20 billion in bonds is a drop in the bucket compared with the conventional bond market. But GFI's decision to open a trading desk shows that western investors see growth potential. "It is very hard work, and we are six months to a year from it reaching its full potential, but the upside is massive," says Chris Steer, head of GFI Group's Islamic finance desk.

Those who ignore the trend do so at their peril, adds DeLorenzo. "Conventional banks [in the Persian Gulf], even the local ones, are losing clients and deposits every day to Islamic institutions," he says, noting that one recent study showed non-Islamic banks there could lose up to 40 percent of their clients over the next 10 years to Islamic counterparts.

Cash flows. But significant hurdles stand in the way of Islamic financial products being universally accepted. Not all Muslims agree on what it takes to make a *sharia*-compliant bank account, mortgage, credit card, or bond. Many Islamic banks lack the expertise needed to develop a *sharia*-compliant investment that would also pass muster with western credit-rating agencies like Standard & Poor's.

To comply with *sharia* principles, a company looking to finance an expansion might have to issue securities that make payments based on cash flow from an underlying tangible asset, like a toll road, or offer lenders some sort of fixed rate of return based on the bank's increasing ownership of the actual asset.

Most Islamic bonds continue to back infrastructure projects in Muslim countries, although the World Bank and the German state of Saxony-Anhalt have also floated them. Also, few public western companies state themselves to be fully *sharia*-compliant. The notable exceptions are Meyer's company, which went public in December on a small-company stock exchange in London, and Caribou Coffee, which is predominantly owned by an Islamic investment bank.

Only one American company, a small Texas oil and gas exploration firm called East Cameron Partners, has issued an Islamic bond based on U.S. assets—some of its offshore Louisiana gas reserves. It raised \$116 million in July. Campbell Evans, the company's general manager, said at the time that the Islamic bond proved a good alternative to conventional oil and gas financing.

Still, the easy terms now available in western debt markets mean most American companies don't have to look outside them to gain low-interest financing. "They haven't felt the need to go to a *sharia*-compliant solution," says Zamir Iqbal, a principal financial officer with the Treasury of the World Bank.

That, of course, could change if the credit markets tighten. And Meyer notes that the East Cameron offering was the latest of several watershed moments for the Islamic bond market. The issue was heavily subscribed, with many western investors, particularly hedge funds, attracted to the diversification and strong asset backing provided by a rated Islamic bond. Meyer says several other western oil and gas companies have already contacted him about floating similar products.

"In many ways, Cameron was a trial balloon" to see if Middle Eastern investors would respond well to a nongovernment, America-based *sukuk*, says DeLorenzo, who worked on the East Cameron deal before joining Shariah Capital.

There is more at work than simple profit motive for companies like East Cameron Partners. "U.S. companies are always thinking about their bottom lines, but here they are also thinking about goodwill," says DeLorenzo. Embracing Islamic financial solutions could "make a difference in how they are perceived going forward."