Modern Islamic Finance

Seminar at the National Council of US-Arab Relations
Islamic Finance and the Global Economic Crisis
February 17, 2009
9:00 – 11:30 a.m.

*The Rotunda Ballroom, The Ronald Reagan Building, Washington DC*

by
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• “Islamic Finance is the only example of a financial system directly based on the ethical precepts of a major religion, providing not only investment guidelines but also a set of unique investment and financing products.”
Origins

• God did not say, “Build Me a bank.”

• Modern Islamic Finance grew from the post-WWII quest for Muslim identity

• Islamic Finance is not a competing “ism,” but simply finance subject to another regulatory authority

• Shariah as a principles-based legal system is capable of development and subject to interpretation
the Basics

- Money is a measure of value
  - not a commodity

- Debt is a responsibility
  - not to be traded

- Finance aims at the creation of real goods and services
  - No notional constructs or exchanges

- Participatory Finance
  - Interested rather than “Disinterested” Finance
  - Not based on lender-borrower relationships

- Risk and Reward Sharing
  - Partnerships Encouraged… all kinds
• **Islamic banks do not lend money**
  - What about the NIM?

• **Islamic investment funds do not invest in bonds**
  - How are portfolios balanced?

• **Islamic treasuries do not invest in T-Bills, CDs, or money markets**
  - What about liquidity and risk management? … the regulators?
Making it Work

• Conception
  • Collaborative effort between business, legal and Shariah teams throughout product lifecycle

• Development
  • Adapting classical Islamic contractual models
  • Conversion of conventional products
    • Similar market with similar demands

• Certification

• Oversight of ongoing operations
  • Increased Transparency
Shariah Supervision

- **Purpose:** Credibility and Authenticity
- **Function:** End-to-end lifecycle oversight with adherence to international Shariah Standards
- **Composition:** Shariah scholars w/specializations
  - Three scholars at least
  - Selection criteria
    - Local, regional or international representation
    - The Wall Street Shaykhs
      - Working the network
- **Popular Option:** Shariah Advisory Firms
  - Choose-n-chase or plug-n-play
Modern Islamic Finance

Post WWII independence leads to new nationalisms and the popular revival of indigenous institutions.

Islamic banks open in Asia and Europe. Real Estate, leasing and commodities.

Conventional banks open “Islamic windows”

Islamic banks and finance houses open in ME

First Structured Products

Dow Jones Islamic Market Index Equity funds immediately grow from 6 to 80
to the Present

Islamic Indexes delist Enron, Worldcom, Tyco - months before their falls

Sukuk, Islamic bond-like securities, first issue

Shariah Compliant PE deal for Caribou Coffee

First Compliant ETFs and REITs

Compliant PE deal for Aston Martin

Rated Sukuk based on US assets

First Sukuk - value of issues doubles each succeeding year until 2008

First compliant hedge fund

First compliant hedge fund platform

Compliant assets on the LME total US$100 Billion
Sukuk stats & Facts

• In 2007 the global market doubled to exceed US$60 Billion
• By 2010 the global market will exceed US$100 Billion
• Sukuk are global, attracting issuers worldwide
• Growth is fueled by investment and development needs in the Gulf and Asia
• When present credit market conditions are corrected, Sukuk will return to double digit growth
• No secondary market as yet as all sukuk are oversubscribed by investors who buy and hold

Investment Fund FACTS

• Assets held by Muslim investors exceed US$1.6 Trillion
• By 2010 that number will rise to US$2.7 Trillion
• Annual revenue pool for Islamic asset management will exceed US$2 Billion in 2010
• Islamic Funds will grow from 500 in 2007 to 950 in 2010
• Key markets remain underpenetrated

Source: Ernst & Young Islamic Funds and Investments Report 2008
Performance?

- Dow Jones Islamic Indexes have grown from one index in 1999 to over 75 today
- First Islamic Hedge Fund Index launched in Jan 09
- Today FTSE, S&P, MSCI all have Islamic indexes
- No Bear Sterns, Lehman, Wachovia, or any other bank or insurance company to drag down the NAV
- Morning Star ratings; Lipper, Raging Bull Awards
Credit Crisis?

- Subprime home financings? No, but…
- CDOs? No, but…
- Derivatives? No, but…
- Leverage? No, but…
- Madoff? No, but…
Vulnerabilities

- Over exposure to real estate and commodities
- Lack of diversification
- Lack of tools for risk management
- Over dependence on conventional sources of credit
Opportunity

- To learn from our own mistakes and those made by others
- To share our experience… Sukuk
- To rethink the goals of Islamic Finance and focus on the ways and means of achieving them
- To emphasize the moral and ethical aspects of business and finance
- To develop the human resources necessary for real progress
Thank You

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