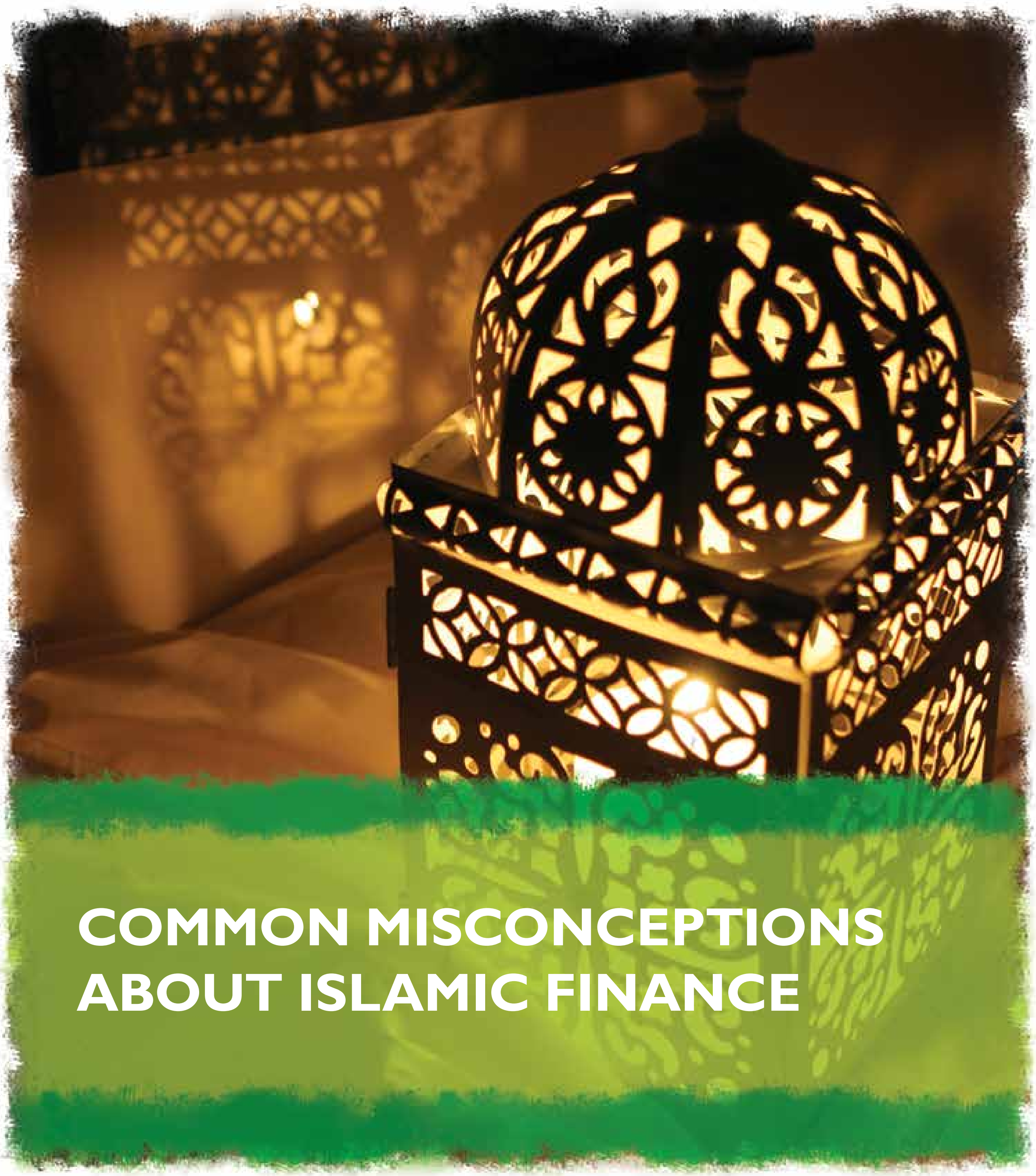


COMMON MISCONCEPTIONS ABOUT ISLAMIC FINANCE

DLA PIPER

IS ISLAMIC FINANCE ONLY AVAILABLE TO MUSLIMS?

No – Islamic finance has the potential to benefit everybody.

Islamic finance may be based upon Islamic principles (or *Shari'a*), but its application is not limited to Muslims alone. Islamic finance structures and products are often described as being asset-based (and derived from ethical and social values), but they do still share very similar economic objectives to conventional financing products and can therefore appeal to Muslims and non-Muslims alike.

Therefore, although the main market for retail and wholesale Islamic financial services in any country is the domestic and international Muslim community, Islamic finance can also provide an alternative source of liquidity and/or means of investment to all consumers and investors.

WHAT IS THE DIFFERENCE BETWEEN ISLAMIC FINANCE AND CONVENTIONAL FINANCE?

The principal difference between Islamic and conventional finance is in the approach and not necessarily in the financial impact; otherwise there are many similarities between the two modes of financing.

The key difference is that Islamic financing is asset-based in its approach, not currency-based. As such, the rate of return is based on an underlying asset or investment as opposed to "interest" on money loaned. If *riba* (i.e. interest or usury) is involved, then the transaction is considered to be *haram* and not compliant with Islamic principles. The rationale behind this is that money is only a means of exchange and should not have its own intrinsic time cost or value.

However, those Islamic principles do not prevent the funder in an Islamic finance transaction from making a "profit" or "return" on its asset or investment. A number of contemporary structuring techniques (or Islamic contracts) have developed which allow Islamic bankers to structure transactions and products in a way that closely replicates the economics of conventional loans and products.

Another key difference is that Islamic finance is often said to promote a risk-reward approach to certain aspects of a transaction. In other words in order to justify a return or reward an Islamic investor must invest and assume certain risks inherent in that investment. However, these risks tend to be heavily mitigated in practice (we discuss this further below).

IS ISLAMIC FINANCING MORE RISKY THAN CONVENTIONAL FINANCING?

No, not necessarily.

As with conventional financing, different financial strategies and risk management tools are applied to accommodate the risk appetites of users of Islamic finance. Where Islamic finance requires an underlying asset or investment, the risks which may be associated with that asset or investment tend to be heavily mitigated in practice – either by combining structuring techniques in a way that 'neutralises' or insures against those risks, or otherwise by ensuring that the risk ends up being broadly the same as what you would find with a comparable conventional financing product.

Islamic finance products and transactions, by avoiding uncertainty (*gharrar*) and speculation (*maisir*), restrict the availability of certain products or investments and therefore prevent consumers and investors from being exposed to risks that are inherent in certain complex conventional financing products (such as CDOs and CDSs).

IS ISLAMIC FINANCE MORE EXPENSIVE THAN CONVENTIONAL FINANCE?

No, not necessarily.

The cost of financing is typically linked to the risk exposure or 'credit' involved. Where a financier considers that it is taking a greater risk, a higher rate of return would be charged. This is no different for the financier on an Islamic finance transaction.

Historically, because Islamic finance has been operating in a largely niche market, the limited competition has meant pricing could be marginally higher. However, as competition has increased (particularly with international banks operating through "Islamic windows") and as Islamic product ranges have improved, the Islamic finance industry is now very much a global phenomenon – more able to compete with conventional financing. In the Middle East for example, where the Islamic finance sector is well developed, products are extremely competitive.

Similarly, as financial institutions and customers become more familiar with Islamic finance product structures and documents becomes more standardised, the cost of Islamic products is likely to reduce further.

ISLAMIC FINANCE IS BASED UPON *SHARI'A* OR ISLAMIC LAW – WILL IT THEREFORE FALL OUTSIDE OF THE JURISDICTION OF THE COURT SYSTEM?

No, an Islamic finance contract will usually contain exactly the same kind of choice of law and jurisdiction clause that you see in conventional loan documentation. Indeed, it is open for the parties to agree in an Islamic finance contract that any disputes shall be resolved under the laws of a particular country and for the courts of that country to have jurisdiction. Arbitration provisions are also quite common.

In many ways, *Shari'a* can be considered to play a role only at the outset of an Islamic finance transaction – through ensuring that the structure and the documentation comply with *Shari'a* principles. A *Shari'a* supervisory board or committee (comprising of scholars) will normally carry out a review and make recommendations before approving that structure and documentation. This may result in a formal approval (or *fatwa*) being issued. Thereafter, the signed documentation will govern the contractual relationship between the parties and any disputes will be resolved in the manner agreed between the parties. This is often exactly the same as you would see in a conventional loan document.

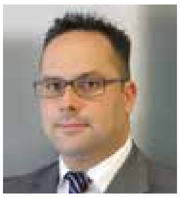
WHY ISLAMIC FINANCE?

Simply put, because of demand!

Islamic finance is potentially a huge market. The ratings agency Standard & Poor's has forecast that the industry could potentially control up to US$4 trillion of assets.

At DLA Piper, our team can provide expert advice on a broad range of Islamic transactions including: bilateral and syndicated Islamic financings, co-financings, project finance transactions (including complex multi-sourced financings), the financing of real estate development, trade finance, asset finance, debt restructurings and debt capital markets. Our Islamic finance practice also extends to assisting our clients in relation to Islamic investment funds, private equity, takaful and Islamic structured products. We have worked on some of the leading Islamic transactions in the Middle East region, covering many different sectors.

KEY CONTACTS



Paul McViety
Legal Director, Islamic Finance
Dubai
T +971 4 438 6260
paul.mcviety@dlapiper.com

Debbie Barbour
Partner
Abu Dhabi
T +971 2 494 1524
debbie.barbour@dlapiper.com

www.dlapiper.com