ISLAMIC FINANCE LAW

Georgetown University Law Center
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Professor Farhad Alavi
Managing Partner
Akrivis Law Group, PLLC

Professor Tonio DeSorrento
CEO
Vemo Education
Welcome to Islamic Finance Law. The course aims at providing a basic understanding of the principles of Islamic finance and the means to structure Shari’a-compliant transactions and products. This course does not intend to teach Islamic jurisprudence; rather it focuses on Islamic Finance Law as applied in consumer and commercial financial transactions.

As we progress, the course’s focus will shift to analyzing various Islamic finance and investment mechanisms through articles, case studies, and hypothetical scenarios of Shari’a-compliant cross-border transactions. In doing so, we will analyze the investment principles and their underlying agreements. We will also study the interplay between the various mechanisms, as well as the legal environments in which they are carried out.

In the final four classes we will focus on how these Shari’a-compliant transactions are employed in Islamic Finance capital markets, discuss further corporate governance issues, and analyze how the Islamic Finance industry might be employed to address the global challenges of the current world economic climate. Guest speakers may be added to the schedule, depending on availability.

This syllabus sets forth what we intend to cover. So assignments, in-class readings and schedules may vary, depending on current events, progress made and student interest. We will provide you with updated syllabi when we make changes.
II. Logistics

**Class Schedule:** Class will meet in Hotung 5013 on Mondays from 7:55-9:55 PM:

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<tr>
<th>Month</th>
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<th>Topic</th>
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<td>February</td>
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<td>Basics of Islamic Finance</td>
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<td>Overview of Industry; Guest Speaker</td>
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<td>No class – Pres. Day</td>
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<td>18 (Thursday)</td>
<td>Personal Banking</td>
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<td>Transactional Contracts</td>
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<td>Financing Contracts</td>
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<td>March</td>
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<td>Spring Break</td>
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<td>Intermediation Contracts</td>
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<td>Islamic Capital Markets &amp; Structured Products</td>
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Given the nature of our work, we may have an unexpected work-related issue arise that prevents one or both of us from making it to class. The class will be notified as far in advance as possible if a rescheduling or cancellation is necessary.

III. Materials

Due to the rapid development of the Islamic Finance industry, we will rely primarily on current articles, sample documents, recent court rulings, and case studies for our primary reading materials. These materials will be posted on our class courseware website and/or handed out before or in class. Power point presentations may be used from time to time that reflect diagrams of the various *Shari’a*-compliant structures being discussed.

Nevertheless, working through a comprehensive text is useful for building a solid foundation in terminology and the basic concepts of Islamic Finance. Students are required to buy a copy of *Introduction to Islamic Banking and Finance* by Brian Kettell. This book is somewhat light reading but provides the basic framework required for you to understand the lectures and other readings.

Other materials you may find useful include the following:


3. Islamic Law and Finance: Religion, Risk, and Return by Frank E. Vogel and Samuel L. Hayes III.

4. Proceedings of the Harvard University Forum on Islamic Finance (especially the Harvard University Forum on Islamic Finance (every spring)).

IV. Evaluation

You will be evaluated based on two factors:

**Class Participation** – In private practice, knowing the answer is only half the battle. Equally important is communication. Knowledge benefits no one if it is not shared effectively. Therefore, attendance and class participation is highly encouraged. Each class will provide a number of opportunities for you to contribute opinions, suggestions, and ask questions. We expect to engage in a number of practical discussions and exercises during the semester and we think these represent great learning opportunities. We want to learn from you. Class participation will constitute approximately 30% of your final grade.

**Take-Home Exam** – A 24-hour take-home examination will be available for pickup the week following the last class on April 29, 2016. You should pick up the examination in the Registrar’s Office during the week and return it 24 hours later. Although we retain the option to change the format of the exam based on the makeup and progress of the class, it is anticipated that the exam will consist of three or four essay problems, and you will be expected to select two or three to answer. The exam is intended to test your analytical skills in light of the materials covered in the course and your understanding of key Islamic finance principles as they relate to international transactions. As in real transactions, there most likely will not be one correct answer. Exams will be graded on thoughtfulness, ability to identify salient issues, and effectiveness in suggesting creative and Islamically-appropriate solutions to those issues. All papers should be typewritten. This exam will constitute approximately 70% of your final grade.

V. Office Hours

On request we will try to organize office hours for consultations. Also, we can answer questions by e-mail if you wish to contact us that way.

We will work off of the slides distributed in class. In this class we will introduce ourselves and ask you to tell us about you and your reasons for being in the course.

We will describe our goals for the course, grading, the textbook and readings.

The class will discuss the assigned reading on the INCEIF and Guidance websites.
**Class 2 – Basics of Islamic Finance**

This is the foundation class where we learn about the people, the places and the religious, asset and ethical bases of Islamic Finance. It is important to invest time in learning the basic concepts and terminology that will be covered in this class, as well as in the preparatory readings. We will revisit this content continually as we venture into actual investment mechanisms. Questions may cross your mind as you prepare for class or during the course of class discussions. Please make a notation of your questions and ask them during class.

One of the challenges in the literature of Shari’a finance is the scarcity of guidance on how transactions are actually structured. Mr. Issa’s lecture is aimed at providing a window into how Islamic finance transactions are actually designed. A large part of transactional practice involves the use of adapting models and modules that are tailored to a transaction but based on boilerplate language which largely represent industry standards.

**Assigned Reading and Preparation:**

- Chapters 1-3 of *Introduction to Islamic Banking and Finance*

Supplemental readings to be provided one week prior to class.

**Class 3 – Overview of Industry and Guest Speaker Nabil Issa**

Now that we have a basic idea of what is meant by Islamic Finance, it is necessary to take a step back and look at the industry as a whole. What are the major institutions? Who determines what transactions are Shari’ah-compliant? Are there differences in Islamic Finance practice depending on what jurisdiction? This class will aim to provide the context in which Islamic Finance transactions are created.

Most notably, we will also have guest speaker Nabil Issa, Partner at King & Spalding LLP in Dubai and Riyadh, to address the class. He will discuss “Structuring Islamic Finance Transactions: A view from MENA.” Mr. Issa will offer his insights as to how deals are structured in the Persian Gulf region, and what the general palate of the market is there.

**Assigned Reading and Preparation:**

- Ricardo Baba, Chapter 23: Islamic Financial Centres, *Handbook of Islamic Banking*
- Kym Brown, M. Kabir Hassan and Michael Skully, Chapter 7: Operational Efficiency and Performance of Islamic Banks, *Handbook of Islamic Banking*
- Shayerah Ilias, *Islamic Finance: Overview and Policy Concerns*, 2010
**Class 4 – Corporate Governance, Regulation and Risk Management**

We will address what are the key *Shari’a* investment, regulatory and governance guidelines? A number of sub-questions can be derived from the above macro one, including, *inter alia*:

- What is the rationale behind the various criteria? How are they implemented in practice? Are they well-settled or are some of them controversial?
- How do the *Shari’a* concepts of permissible variance and purification operate?
- What are the different schools of Islamic jurisprudence and how do they impact the implementation of governance, transparency and accountability criteria in practice?
- Are there any juristic, legal or regulatory considerations that permit or prohibit an entity from investing in compliance with *Shari’a*?
- What are the political, tax, currency and other market, operational and legal risks of a *Shari’a*-compliant investment, and how may those risks be mitigated?
- Finally, who gets to declare by fatwa that a product is *Shari’a*-compliant in the first place and who give them the authority to do so? What are the roles and significance of AAOIFI, IFSB, Basel III, OIC and its Fiqh Academy, and the *Shari’ah* Board?

These and other issues will be explored.

**Assigned Reading and Preparation:**

- Habib Ahmed and Tariqullah Khan, *Chapter 10: Risk Management in Islamic Banking*, Handbook of Islamic Banking
- Volker Nienhaus, *Chapter 9: Governance of Islamic Banks, Handbook of Islamic Banking*

**Class 5 – Islamic Finance in the USA and “Micro-Finance”**

A useful way to build a practical understanding of Islamic banking products and how they feature in real life is to examine the basic banking products available in the context of personal banking (bank accounts, dealings with a broker, car and house loans, insurance needs, etc.). Once we finish this part of the class, we should be ready to start tackling international transactional considerations in a more corporate and sovereign sense (as opposed to an individual one).

(“Note: “banking” in the conventional sense does not exist in Islamic law – what exists is some type of participation in profit and loss. While we may economically end up in the same place, both form and substance, under *Shari’a*, are an integral part of understanding Islamic banking;
therefore, the emphasis is not just on what points A and B are but also on how to get from point A to point B.)

A key discussion point in the class will be inbound, Shari’a compliant investment in the United States – raising capital and structuring transactions.

**Negotiation Exercise:** At the end of class, we will assign students into groups for our negotiation exercise. We will also present the case and the parameters for discussion.

**Assigned Reading and Preparation:**

- Chapter 5 of *Introduction to Islamic Banking and Finance*
- Rodney Wilson, Chapter 25: Islamic Banking in the West, *Handbook of Islamic Banking*
- CGAP, “Islamic Microfinance: An Emerging Market Niche”
- IFAD, “Islamic Microfinance: Unlocking new potential to fight rural poverty”

Optional supplement: State Bank of Pakistan Guidelines for MF business by Financial Institutions

**Class 6 – Transactional Contracts: Bai, Sarf, Shirkah, Ijarah, Adl and Rahn**

We will discuss the type of scenarios under which international contract transactions utilize Islamic financing. Our discussion will include concepts such as sale (bai), exchange (sarf) partnership (shirkah) and ijarah (right to use). We will study the various applications of *Ijara* finance in different jurisdictions with particular emphasis on lease-to-own arrangements (manufacturer finance), operating leases (equipment lease arrangements), and asset-based real estate and other project financings and securitizations. We will also examine the concepts of *adl* (trust) and *rahn* (collateral pledge).

**Negotiation Exercise:** The second half of class will involve the actual negotiation component of the negotiation exercise. The two sides should prepare a term sheet and work on it. We expect that the Leads of both sides will send us their final term sheet no later than 24 hours before our next class so that we can discuss in Class 7.

**Assigned Reading and Preparation:**

- Chapters 6 and 7 of *Introduction to Islamic Banking and Finance*
- Islamic Securitisation, Abradat Kamalpour and Michael JT McMillen (Global Securitisation and Structured Finance 2007)
- Opportunities in Islamic Securitization, Asim Hameed Khan (Business Recorder 2010)

**Class 7 – Financing Contracts: Murabaha/Tawaruq, Istisna and Ja’ala**

We will discuss scenarios under which international institutions utilize Islamic financings. Depending on the nature of the particular transactions, it is important to structure the best product. We will examine the following Islamic finance mechanisms, among others:
(1) Murabaha (cost-plus trade financing): we will analyze bilateral and multilateral murabaha finance arrangements, including the controversial concept of Tawwaruq.

(2) Bai mu‘ajjal
(3) Ijara
(4) Istisna
(5) Istisna – Ijara
(6) Ja’ala
(7) Bai Salam

Negotiation Exercise: We will spend the first 30 minutes discussing the term sheet prepared in the negotiation exercise.

Assigned Reading and Preparation:

▪ Chapters 4 and 8 of Introduction to Islamic Banking and Finance
▪ Ridha Saadallah, Chapter 12: Trade Financing in Islam, Handbook of Islamic Banking

Class 8 – Intermediation Contracts: Sharikah, Mudaraba, Musharaka and Wakala

We will discuss Islamic finance intermediation contracts – that is, a contract where an intermediary reports to a principal investor the opportunity for concluding a contract or provides intermediate services for concluding a contract in exchange for a fee.

(1) Sharikah, Mudaraba and Musharaka (partnership): we will study these structures, each of which functions as a partnership arrangement that involves an allocation of profit and loss between the financier and the borrower.

(2) Trust Structures
(3) Security Structures
(4) Governing Law

A Wakala agreement is another type of intermediary contract. A Wakala is a contract of agency where a depositor authorizes an agent to invest his funds in shariah-approved assets. This is an investment product, which functions in the same way as a Mudaraba. The difference between the two is that with a Mudaraba all the profit is divided between the parties, while with a Wakala the investor receives only the agreed ratio against investment. Anything made above that ratio is kept by the financial institution and not given to the investor.

Assigned Reading and Preparation:

▪ Review Chapters 5 and 6 of Introduction to Islamic Banking and Finance
Class 9 – Social Welfare Contracts: Takaful and Re-Takaful (Insurance)

In this class, we will consider the validity and viability of social welfare contracts, including takaful and re-takaful, qard-al-Hassan (a gratuitous loan), the use of a waqf trust, zakaat and awkaff.

Assigned Reading and Preparation:

▪ Chapter 10 of Introduction to Islamic Banking and Finance
▪ The way forward for Takaful: Spotlight on growth, investment and regulation in key markets (Deloitte)

Class 10 – Capital Markets and Structured Products: Sukuk

We will try in classes 10 and 11 to draw an analogy between conventional structured products and their Islamic equivalents. We will begin by discussing sukuk, or asset-backed instruments that are treated by many in the industry as being akin to conventional bonds, and how they can provide a “wrapper” around the various finance instruments we have discussed thus far and in the context of a securitization. We will discuss why a number of conventional structured notes are not Shari’a-compliant, and instead address two equivalents that are, namely:

(1) Bai Al-Arboon as a means to structure an option to purchase a basket of equities or commodities, through analyzing the case study of an investment fund launched by a Saudi Arabian bank that traded in a Shari’a-compliant basket of global equities; and

(2) Waad structure as a means to structure a promise to generate return. It is important to note that these structures are not set in stone. In fact, the controversy surrounding the degree of their compliance (assuming the issue of compliance can be viewed as one that is not black or white) is useful as a means to give added insight to the industry and its growth prospects.

We will explore whether, how and to what extent Shari’a is consistent with the trading of stocks (including short sales), exchange-traded funds (ETFs), commodities, swaps and other derivatives (including hedging with a Tahawwut Master Agreement).

We will discuss what happens in a bankruptcy or default scenario, and how restructuring may be achieved using Islamic finance structures.
Finally, we will address the structural and “due diligence” challenges and alternatives utilized in private equity and venture capital. We will discuss recent efforts by international players to attract investments into global buyout funds from Islamic and non-Islamic investors through parallel or feeder-type investment vehicles. We will be interested to hear your views as to the disconnect between the Shari’a-compliant nature of venture capital and private equity investments, in theory, and the stage the industry has reached in practice.

**Assigned Reading and Preparation:**

- Said M. Elfakhani, M. Kabir Hassan and Yusuf M. Sidani, *Chapter 16: Islamic Mutual Funds, Handbook of Islamic Banking*
- Sam R. Hakim, *Chapter 11: Islamic Money Market Instruments, Handbook of Islamic Banking*
- 2015 Thomson Reuters Overview

**Class 11 – Capital Markets and Structured Products (cont’d): Waad; Arboon; Derivatives; REITS; Private Equity; Venture Capital**

We will try to draw an analogy between conventional structured products and their Islamic equivalents. We will begin by discussing *sukuk*, or asset-backed instruments that are treated by many in the industry as being akin to conventional bonds, and how they can provide a “wrapper” around the various finance instruments we have discussed thus far and in the context of a securitization. We will discuss why a number of conventional structured notes are not Shari’a-compliant, and instead address two equivalents that are, namely:

1. **Bai Al-Arboon** as a means to structure an option to purchase a basket of equities or commodities through analyzing the case study of an investment fund launched by a Saudi Arabian bank that traded in a Shari’a-compliant basket of global equities; and

2. **Waad** as a means to structure a promise to generate return. It is important to note that many of these structures are not set in stone. In fact, the controversy surrounding the degree of their compliance (assuming the issue of compliance can be viewed as one that is not black or white) is useful as a means to give added insight to the industry and its growth prospects.

We will explore whether, how and to what extent Shari’a is consistent with the trading of stocks (including short sales), ETFs, commodities, swaps and other derivatives (including hedging with a Tahawwut Master Agreement).

We will discuss what happens in a bankruptcy or default scenario, and how restructuring may be achieved using Islamic finance structures.
Finally, we will address the structural challenges and alternatives utilized in private equity and venture capital, which are often viewed as the most “Islamic” of the various Islamic finance and investment mechanisms. We will discuss recent efforts by international players to attract investments into global buyout funds from Islamic and non-Islamic investors through parallel or feeder type investment vehicles. We will be interested to hear your views as to the disconnect between the Shari’a-compliant nature of venture capital, private equity and derivative investments, in theory, and the stage the industry has reached in practice.

**Assigned Reading and Preparation:**

- Shaykh Yusuf Talal DeLorenzo, *The Total Returns Swap and the “Shariah Conversion Technology” Stratagem*
- Clifford Chance, LSE Islamic Finance and Derivatives Seminar (2013)

**Class 12 – Case Studies**

**Assigned Reading and Preparation:**

- Introduction to Islamic Project Finance (Clifford Chance)
- MIGA and Islamic Finance – Doraleh Container Terminal Case Study, Djibouti (April 2008)

**Class 13 – Future of Islamic Finance and Course Wrap-Up**

At this stage, we should all allow ourselves to be creative. Focus will be on attempts to develop a workable structure and bringing it to fruition and the practical problems in doing so. We will then open the floor to discuss scenarios like unmet consumer use cases, clean energy in the U.S., public-private partnerships in developing markets, capital markets reform and ethical investment funds. We will be interested to hear from you – what did you learn from this course that you feel can have an impact on your practice as a lawyer, your job as an investment banker or your interactions with other professionals, and what are your questions, thoughts and even reservations and concerns? Under what set of circumstances would you advise a client to use an Islamic finance structure rather than, or in combination with, a conventional financing?

**In-Class Topics:**
(1) Discussion of an attempt by a European entrepreneur to seek Islamic financing for wind farm projects in Italy. Focus will be on attempts to develop a workable structure and bringing it to fruition and the practical problems in doing so.

(2) Open the floor for scenarios like clean energy in U.S. public-private partnerships in developing markets, capital markets reform and ethical investment funds.

(3) Comparison/contrast of conventional financing and Islamic financing.

Assigned Reading and Preparation:

- Chapter 9 of Introduction to Islamic Banking and Finance
- Mohammed Ibrahim and Shahul Hameed, IFRS vs. AAOIFI: The Clash of Standards? International Centre for Education in Islamic Finance