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# Islamic Finance in the Gulf: A Practitioner's Perspective

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Thank you for this opportunity and welcome to all of you. Let me give you my opinion on Islamic Finance. Islamic Finance is here to stay. In 2007, *Shari'a* compliant assets have grown almost 30%, to \$500 billion. Islamic banks have reported an annual asset growth rate of 27%. The Islamic fund market has tripled in size over the past five years. Islamic funds have outperformed conventional funds in 2007. The Dow Jones Islamic World Index recorded an average gain of 17.2% and the global volume of *sukuk* issued has risen by 73%. The largest *sukuk* ever issued was the 3.52 billion Nakheel *sukuk*.

The DIFX, which is part of the DIFC, is the world's biggest source for Islamic bond listings. I'll talk to you later about the term, Islamic bond. It's not a favorite of mine, but for now, just pardon me for that.

I want to quickly talk a little bit about the world perspective, which has already been touched on by some of the prior speakers today. A lot of the capitals in the world are getting very interested in Islamic Finance. Singapore passed legislation in 2005 to enable banks to engage in non-banking activities. I was in Hong Kong late last year for a conference, and had a meeting with Donald Tsang, the Chief Executive, who said that he wants to see Hong Kong develop into one of the major Asian financial Islamic centers, so that they can serve as a conduit for Islamic investment into China. We've yet to see how that works but that is the intention.

Pakistan has had some *sukuk* issuances lately as well, and prior speakers have already spoken about Britain being at the cutting-edge as a non-Muslim country in passing enabling legislation.

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I want to spend a few minutes talking about what Islamic Finance is. You've gotten a quick synopsis of where we are today in the marketplace. Where has this come from? Where is this going? These are some very good questions and I just want to give you some of the facts and perhaps a personal perspective on Islamic Finance.

I'd like to share with you an interesting story that explains to me what Islamic Finance is. It's a story of a man who has three sons and to whom he gives each a sack of gold, and he says, "I'm going away for a few months and I'll see you when I come back." When he comes back, the eldest son has invested the sack of gold into a business and doubled it. Son No. 2 has invested into a business and lost it. Son No. 3, who thinks he's the smartest of them all, has actually buried the gold under the sand.

When the eldest son comes to him and says, "father, you'll be very proud of me, I doubled the money," he says, "well done, son. Here's another sack of gold." Son No. 2 comes to him with tears in his eyes and says, "father, I'm so sorry. I failed you. I invested it in a business and lost it all." The father says, "Never mind. Here's another sack of gold. You tried." Son No. 3 comes to him with a smile ear to ear and says, "father you'll be the happiest with me because I safeguarded the gift you had given me by burying it in the sand and here it is back." The father smacks him, takes the sack of gold from him and says, "you failed me because you did nothing with the gift I had given you".

Islamic Finance views conventional bankers as the third son that buries the sack of gold in the sand, because from an Islamic perspective, a person is intended to engage in productive society to a full extent. Lending money for interest is not viewed from an Islamic perspective as a productive use. In fact, in the *Qur'an*, it's very clearly noted that usury is condemned (*Surat al-Bakara* 2:275 - *Those that swallow usury cannot rise as if they have been prostrated by the touch of the Devil and hell fire is reserved for those that get into this area*).

Without becoming too religious, the point is, there are very clear issues with this prohibition and I don't think that perspective needs to be minimized. This is an issue. This is the core reason why we have today, to a large extent, a construction of avenues that approximate what the intent is meant to be. Now, I share a lot of the trepidations and concerns about the issues with Islamic Finance. I face these challenges almost on a daily basis, where structures come to me and they just don't look Islamic. However, the bottom line is there is a lot out there that does look Islamic and there's a lot out there that is getting there.

That last part is what I'd like to talk to you about. In particular, what I'd like to do is share with you, quickly, what Islamic Finance should be, from a theoretical standpoint, rather than explain to you where it falls short today.

I think we will all agree, most of us who've studied this, that the common definition of Islam, of course, is submission. Perhaps another nuanced definition is surrender. Another definition is acceptance. The whole idea is it is acceptance of the word or the message of God that Muslims believe—(and I'm a Muslim)-

was sent through the prophet to the people. The *Qur'an* was the message sent by God to people. The people that accepted this offer (message) became Muslims.

In legal terms, this can be an offer and acceptance. It's a contract; a spiritual covenant. So what is Islamic Finance? Islamic Finance is conducting finance in accordance with the principles of Islam. In short, it has been described by many as, again, theoretically and practically speaking, the intent of banking or financing with a conscience. In some respects it's a spiritual endeavor. Somebody shared earlier that it was about doing something and making money. There's no harm in making money, but you need to make money the right way.

So if I'm a Muslim (banker or not) and someone comes to me, and says, I need \$100,000, and you can have \$200,000 back tomorrow and I have a house worth \$1 million and you could take a mortgage on this house so you won't have any risk, I can't participate in such a transaction. Not because it doesn't make economic sense, but because it doesn't make spiritual sense. Now if you follow the rules, the idea behind Islamic Banking is that we give up on certain material gain in consideration for spiritual gain. In some respects, I think that modern day Islamic Financiers that follow the spirit of Islamic banking are not too different from the ancient day Nazarenes.

I don't know if you know the story of the Nazarenes, but they were an ancient Hebrew sect that never cut their hair and never drank alcohol. As a result they weren't very popular because they didn't look cool and because they had long hair and they didn't hang out and party with everyone. So, they were sort of shunned. But they didn't care. Why? Well, because they chose apartness from people for closeness with God.

Now, is this what is happening in the Islamic Financial world today? No, not for a large part. But this is what is meant to happen. This is the way it is meant to be. In some circumstances, I worked on structures and we have come up with products that get close to the intent. So that's progress, not perfection.

The intention is to engage the Islamic financier effectively as a partner, co-owner. Remember, you can't lend money for interest. The idea is that you become a partner and you share in the profits. You take genuine risks. The issue in Islam has never been getting a return on your money in as much as it has always been not taking a risk for that return.

We've talked about, generally, *haram* products and not investing in certain areas. The point I want to share with you is that there are some very specific no-no's under Islamic Financing that you can't do. But let's remember that there is a fundamental rule in *Shari'a* jurisprudence, which is that anything which is not expressly prohibited, is permissible. This gives birth to innovation and that's how we can go ahead and actually create a lot of innovative products, provided of course we don't forget the fundamental rule I shared with you, which is, that if you are replicating conventional loan profiles in Islamic garb, that is deception. No matter how you slice it.

At the end of the day, the critical analysis must be as to whether or not the conventional risk profile has in fact changed or metamorphosed into something that's different. And depending on the nature of that change, the risk profile will have changed into something that may be more or less Islamic looking.

I want to spend a little bit of time and just share with you quickly, what some of those forbidden conditions, in fact, are so that you get a sense as to how limited the no-nos are under Islamic Finance.

I've shared with you this point already, that getting interest on your loan is clearly impermissible. Getting into speculative transactions is impermissible. This has already been shared but transactions involving certain goods, gambling, drugs, alcohol, gaming, are also impermissible. So basically, if you're investing Islamically into these areas, you just carve out a whole bunch of things you can't do.

I don't know if some of you have had the chance to work with the International Finance Corporation, but I was seconded to them for a while in Hong Kong, and they have something called the prohibited list. This prohibited list basically says that you cannot enter into gaming; you cannot do investments in alcohol and arms production, etc. It's a mandate that excludes certain activities. Essentially, there's a *haram* list under Islamic Finance and certain activities are just carved out of the realm of what is able to be financed.

Of course, uncertainty is considered a problem under Islamic Finance. You cannot sell fish out of the sea. Why? Well, you don't know if you're going to catch them. Do you think you can sell copper out of a copper mine? What about oil out of the oil well? Yes. Well, I think you can see where I'm going with this, that Islamic jurisprudence evolves depending upon the circumstances. If I were a fisherman in Alaska and I had a bunch of trout swimming upstream and grizzly bears were getting fat from that trout, I'd make the argument that maybe you can sell fish out of the water if you haven't caught them, because you're definitely going to catch them. My point is, Islamic law evolves according to circumstances of the context and also with reason, provided the principles are held true to.

I want to share with you a little bit about some very basic principles about Islamic law. I think this will give you a quick sense as to where some of the ideas come from and how you implement them into society today. You can give loans under Islam. The issue is you can't give them for interest. You can never give them for any kind of benefit, whatsoever.

In fact, the son-in-law of the Prophet, Ali, had given a loan to a wealthy merchant. After he had given this public loan, he was approached by the merchant at a promenade, who then offered Ali a ride in his chariot. Ali publicly refused him. A few days later they met at a public function and the merchant went up to him and said, hey, you kind of disrespected me by publicly refusing to give me a ride. What happened? Ali said, I didn't mean to disrespect you. But look, I had given you a loan and you were going to give me a ride and I don't

want people to get the perception that you were giving me any benefit for the loan I had given you.

Now this is an extreme illustration, but it proves the point that if I give a loan to person A, I cannot derive any benefit from that loan, whatsoever. There's a verse in the *Qur'an* that says, if you can forgive even the principal of that loan, so much the better for you, if you only knew. Obviously you can't run a conventional banking system on these principles. But that is the Islamic theory behind loans.

Let's talk a little bit about some other constructs. How do you do business? What can you come up with? Well, you can enter into partnerships. That is a fundamental underpinning of Islamic legal theory. The idea is that if I lend you money, I care only about the return of that money to me. If you do not repay me upon agreed term, well, guess what I'll do? I'll push you into bankruptcy, take those assets and I don't really care about you or your employees. If you are a partner with me, I will tie my rope with you and I will be less willing to get rid of you. This is the entire construct behind *musharaka*.

So *musharaka* is effectively a partnership. Put very simply, it is a general partnership whose rules are very simple: profits are generally shared by pre-agreement; I cannot accord a higher share to the silent partner, other than his contribution of assets warrants. Now this varies jurisdiction to jurisdiction, but I'm giving you Islamic Finance boiled down to its simplest form to convey the essence to you. There are tons of exceptions to each of these principles. Losses as well as profits must be shared pro-ratum. *Musharaka* is a very simple, general partnership. You can imagine the practical application of this.

Now that I've given you the highlight points, I want to move on. With *mudaraba*, we've already talked about the basics. *Mudaraba* is a limited partnership, put very simply. The origin of this was when a well-known Iraqi trader got funds that belonged to an orphan and basically was given these funds to manage. So he was this Donald Trump-type guy, who, basically every time he touched something, it turned to gold. He was going to take these funds, use his intellect and undertake a business venture. Persons approached the Prophet, peace be upon him, and asked, is this behavior okay? Can you have a person using their intellect if it's somebody else's money and agreeing to split the profits, according to a certain percentage?

It is reported that this arrangement was validated. This is the perfect marriage, it is said, of intellect and capital. This marriage created this construct of a limited partnership under Islamic law. It is used very often in a lot of different sorts of arrangements. This is a partnership in profit, not in liability. One party provides the capital, the other party provides the expertise. There are a number of principles but the general rule, of course, under Islamic law is that the *mudarib* cannot really guarantee the return, but is only liable upon negligence.

Now I want to share something with you, that if you see these rules that I'm sharing with you and you take a look at some of the transactions out there in the market, you're going to be disappointed, because you're going to see breaches

of some of these rules. This is part of the problem in Islamic Finance. Constructs are used but they are broken because the spirit of the construct has not been used. This is something that I think we just have to continue to work with. The bottom line is that there is a lot of variation in the transactions out there.

There are many different views on Islamic Finance. Malaysia has a very permissive perspective. Almost anything that can be put into a contract becomes sanctified by the two parties themselves as being inherently Islamic, which is an interesting perspective. In the Gulf and in Saudi Arabia, in particular, there is not surprisingly a more rigid scrutiny that's applied to the Islamic Financing structures. I would say some of the more, perhaps, genuine Islamic structures come out of Saudi Arabia, in particular.

Let's talk a little bit more about a *murabaha*. This has early been described as a very simple contract. It was meant to be, basically, a sale of commodities. So if I'm a wood merchant in Turkey and I need to buy wood to produce tables, I can't go to a bank to borrow money to buy goods, so I just go to the wood broker and I say, sell me 1,000 lira of wood and even though I don't have 1,000 lira to pay you today, I'll pay you a year from now and I'll pay you 1,100 since I don't have 1,000 right now.

People argue, isn't that kind of like interest? Well, I see the argument. I understand the point, but the fact of the matter is that it has been clearly counted as trade, because the underlying product is a commodity. It's wood. I buy the wood today, I use it, and I go ahead and pay for it a year from now as a deferred payment.

Let's talk a little bit about *Ijara*. I want to share this with you because I think you'll find, if you study Islamic project financings at all, you'll see that this is a corner stone of most all Islamic project financings. Of course, as some of you will learn in law school or by looking at some project finance lawyers, when a conventional borrower does project financing, or finances a project, they will lend money to a project and take security over those assets. They will be a provider of debt. They will have a secured interest in certain assets. If the project company doesn't pay them back, they will enforce security and basically take those assets. In project financings, they will also have step-in rights so they can step in and operate the business and basically end up paying themselves off through a power purchase agreement or some other sort of an off-take agreement.

An Islamic project financing necessarily has to be different, because in an Islamic project financing, the Islamic financier cannot lend money to the project. So how do they do this? They purchase certain projects' assets, either through an SPV, or directly. Mostly through SPVs. These project assets are then leased to the project company and the project company pays your return. This return approximates what would be the return on their investment. There are generally purchase undertakings that enable the sale of the project assets back to the project company from the financiers.

Now there have been a number of projects that have been done this way, where on an ongoing basis, a percentage of the ownership in the project was sold by the Islamic financiers to the project company, so that over time the share of the project company was gradually reduced. And the rental amount simply represented what would be normally interest or a return on the loan.

Are there issues with this? Yes, there are. But, when you own a project asset under Islamic law, you take the project risk for that asset. So there is a change in the conventional risk profile. There is a change in the quantum of risks. Islamic bankers take more project risk than conventional bankers. In one of the big deals I was working on, the Western Banks that were involved in this project went to great lengths to develop intercreditor arrangements. Now some of you who are studying Islamic project finance will well understand that once you have an intercreditor arrangement, and if you have an Islamic bank that shares in the intercreditor arrangement and gets money back through the intercreditor arrangement, which of course means money back from the debt portion, you have effectively wiped out the Islamic risk because you're not meant to alleviate your risk.

We've had situations where Islamic banks said we don't want the benefit of the intercreditor arrangement because we want to take Islamic risk. That's very interesting. Because that sort of action suggests that they need to make sure that they're actually taking risk rather than pushing it away. These are sort of very positive developments, in my view.

Now, I'll talk a little bit about *sukuk*. *Sukuk* of course are issuer certificates that represent an undivided share in the ownership of tangible assets, which should not be receivables. They are often called Islamic bonds. When you can look at the market and look at some of the structures, I can see why you would call them Islamic bonds, because they look pretty similar to bonds. However, in theory, the term Islamic bond is an oxymoron. You cannot have anything in Islam that pays an interest or a return on a debt. So they ought not to be called Islamic bonds.

The general rules are simple. They need to be backed by tangible assets. Some suggest that you could have services underneath *sukuk* and I don't have any issue with that. I think that could be viable. Of course there is a prohibition that is well established in *Shari'a* that you cannot trade debt, which is a very interesting prohibition. In other words, if person A owes me \$100, I cannot sell the \$100 loan to somebody else. This is conceptual Islamic finance law. The reason is that debt is a very personal thing. If I give somebody a loan, I should not be able to sell it to somebody else.

But I'll ask you an interesting question and I'll share something with you. If person A owes me \$100 and I owe person C \$100, person A that owes me \$100, I can actually unilaterally assign person A \$100 directly to person C. And can anybody tell me why that is? If person A owes me \$100 and I owe person C \$100, you can't trade the debt, but there's an exception to this. I can unilaterally assign the debt owed to me by person A, directly to person C. Any ideas why?

The reason is because from an Islamic perspective, I am reducing the quantum of debt in the world--so I'm doing something impermissible, but it serves a greater permissible purpose. I'm reducing the quantum of debts from two, into one.

The point I raise is simple, that if you issue *sukuk*, an Islamic instrument that represents an underlying receivable, you have a problem. You can't, you really shouldn't do it. Now does it mean that you don't see *sukuk* out there that has underlying receivables? No. I've seen them. Maybank in Malaysia issued subordinated *sukuk* based on receivables.

These are the principles of Islamic Finance, which I'm sharing with you, that speak to the way that it ought to be done. If you go out there into the market and apply them, quite frankly, you will find Islamic Finance falling well short of the mark.

Now, I want to talk a little bit about *takaful* because I think any very basic Islamic Finance presentation would not be complete if I didn't share with you a little bit about what Islamic insurance is, because some of the market numbers I think you will find very interesting—\$2 billion a year in premiums, expected to go up to \$10 billion in seven or eight-years. I have some real serious issues with the conceptual underpinning of how *takaful* insurance has been constructed in the market.

Suffice it to say that what is meant to be is very interesting and I'm sure some of you might know how conventional insurance started. Lloyds sitting in a coffee shop in England. I never understood why he was in a coffee shop, first of all. I thought they had teashops in London. But, he's in a coffee shop and they're talking about how one out of ten ships, bound for the U.S., sinks. They decided that each of the other nine ship owners sitting at the coffee shop table will throw in a ninth of their goods to defray the loss of the ship owners whose ship went down in exchange for the same protection.

That's the whole idea behind conventional insurance. It's a mutual arrangement amongst ten people that effectively defrayed the risk of loss if an event of loss occurred at a future point in time. This is exactly the conceptual underpinning behind Islamic insurance and that's how it's supposed to work.

It becomes a little complicated when you bring an insurance company into the fray, but that's how an Islamic insurance product is meant to work and there are various verses in the *Qur'an* that I can quote to you, my favorite being the one where the Prophet, peace be upon him, told an Arab who left his camel untied, "you can trust in the will of God but please tie your camel first." I think these are some very good practical points that come and support our point about how *takaful* is very much a permissible form of insurance.

Now of course you'll have different perspectives on various aspects of this, but without getting into the controversy, some of you might be interested as to how *takaful* is different from conventional insurance. And some of the major points of difference between *takaful* and conventional insurance are that in a *ta-*

*kaful* contract, if Hamada drives a Maserati and pays me \$20,000 a year for the insurance premium, drives for five-years and doesn't bang-up that car, then he's paid me, as the insurance company, \$100,000. If I'm an Islamic insurance company, well guess what? He's in luck. Because I should refund to him a good portion of the \$100,000.

If I held on to it, that would be unjust enrichment for me. So there is an obligation on the Islamic insurance company to remedy an unjust enrichment aspect. I'm entitled, as the Islamic insurance company, to take a reasonable healthy profit, but if I take too much, I'm playing in the speculative arena. This is where I think Islamic insurance differs greatly from conventional insurance. The other aspect is the spiritual obligation on an Islamic insurance company to actually make claims. I'm not sure what your experience has been with insurance companies, but the ones that I have dealt with in the U.S. weren't exactly gunning to pay me. In fact, they found every possible way not to pay me. Does this mean that this is how Islamic insurance companies will work? No it doesn't. I'm sharing with you how the conceptual underpinning of this idea is meant to be. Because, again, you're linking another aspect of a societal religious obligation on the top of a contractual obligation.

In terms of Islamic investment funds, the basic rule is, remember the prohibited activities I talked about? Well, you can't do those activities and the manner in which you invest in these companies is also regulated. There have been some rules that seem to have been developed as to what these regulations are. I think they are very individualistic and quite frankly, I'm not sure what that scholarship bases itself on. Suffice it to say that we're working with a number of different entities and coming up with interesting structures for real estate funds and advising as best as we can as to create a structure that does not violate fundamental Islamic precepts.

That's it for the presentation. I will leave it open for questions. Thank you.

**QUESTION ONE:** The way that business is done in Islamic Finance, there are a lot of constraints and so forth. A lot of money comes from the Gulf in terms of Islamic Financing. How is the practice done there?

**MR. AGHA:** Basically, there's a wide variety of perspective on this, even within the Gulf. First of course you have the strategic investors in the Gulf. The Abu Dhabi Investment Authority purchased, what was it, \$7 or \$8 billion of Citibank? That had nothing to do with being an Islamic investment. It had everything to do with being a strategic investment.

So you have one aspect of strategic investors, people that are looking to buy the best assets at the best price. Then you have Islamic banks and Islamic investors. If these Islamic banks and investors are from outside of Saudi Arabia, they will generally have a more permissive approach in the underlying structure that they will choose. If you take the different countries in the world and you rate them from one to ten, I would put Malaysia on a ten, in terms of permissiveness, Saudi Arabia at about a one, GCC countries at about 4.5, Dubai exception, maybe five, London, believe it or not, at about six, Pakistan, maybe at 9.5.

Anyway, my point is that you can play with this and you can place countries on this line with regards to certain aspects of what they will accept and what they will not accept.

Now remember, the permissiveness of the Malaysian perspective, which is generally if two parties to a contract determine that something is Islamic, that renders it as Islamic, is on one extreme end. The other perspective is the Saudi perspective, which is that something is Islamic only if there is conformity with the basic principles both in substance and form. For the most part, you have exceptions even in that, because you have, for instance, the reverse commodity *murabaha*, *tawarruq*, which is frankly, in my opinion, pretty much a disguised loan no matter how you do it.

But the bottom line is, some scholars have in fact said, it's okay. Just let me back up for a second. Remember, I was talking about what a *murabaha* is? So I, being a Turkish wood broker, purchase wood for 1,000 lira. If I purchased this wood now and I have this wood in my hands, and I suddenly go into work and realize my workers are going to leave me because I don't have money to pay them, I have legal rights to sell this wood. So I have a deferred obligation to pay 1,100 lira, I sell it today for 1,000 lira. I have now monetized the wood to 1,000 lira. Well, that transaction is essentially a *tawarruq*. Done in that manner there is nothing un-Islamic about it.

The problem, of course, is when you do the *tawarruq* with the full intent of doing transactions off the record, or of paper transactions that may or may not occur, well, that really isn't an Islamic transaction. So depending on where you sit in which jurisdiction, different scholars will take a different view as to whether or not the *tawarruq* is permissible. This is a very controversial sort of task.

But it really is only circles within circles; scholars have different perspectives on different ideas. I think Sheik Hussain Hamid Hassan has said that if you do the *tawarruq*, there are certain rules you have to adhere to. Different scholars say you can't do it under any circumstances.

The point is there is a very active tension. It depends if you take a top down approach or a bottom up approach. In other words, if you go to the market and see what has been done, for many years a lot of Islamic Finance has been done that is effectively paper form over substance. Now there is an almost urge to move away from that, as it appears to me, but how far they go depends between different countries in those jurisdictions.

Coming back to your question. I would say that the Gulf is generally more conservative in Islamic structures than the rest. It's sort of very curious to me how Hong Kong comes out in all of this, whether or not they take a Malaysian perspective or end up being closer to a London view. But I think it is pretty fluid. For example, in Dubai, we have Noor Islamic Bank, which has just come up. They opened a few months ago. We helped them with their first large deal. They are positioned to develop into the largest Islamic bank in the world. Their *Shari'a* board is commercial while also being *Shari'a* concerned.

Again, remember that these *Shari'a* boards are very much influenced by memos like the one that was sent out by Sheikh Taqi Usmani pointing out the big problems with *sukuk* structures. I wouldn't be surprised if issues are raised with commodity *murabahas*, and then it's going to cause another tremor. So you'll see perhaps more alignment within the principles of Islamic Finance. Remember, there is no requirement that just because a structure has been done in the past, that that structure will be considered viable a year from now.

**QUESTION TWO:** What are the main concepts behind Islamic insurance?

**MR. AGHA:** The concept behind Islamic insurance is that it is a mutual arrangement. So technically speaking, the notion of an insurance company becomes kind of superfluous, right? Because if all of us in this room are agreeing to defray the risk of each other, then we're all technically in a contract with each other. At its core, Islamic insurance is about people mutually agreeing to obligations between each other and amongst themselves. Now we all know that is not the way insurance works and in this world, you are not all going to sit down and do this.

Generally, how the structure, if that is what you're asking, is created, is that all of us will enter into policies directly with the insurance company. The insurance company will be appointed through an agency arrangement and it will be vested with certain rights and obligations on our behalf. So we will have a contractual arrangement with them, and there will be arrangements that will appoint investment fund managers. It's quite complex, but that's essentially how you create the underlying structure.

Now I shared with you earlier that there are some issues in insurance, and there are. The way that a lot of insurance has been structured has been on the basis of a *taburru*, or a donation. Quite frankly, I have deep philosophical issues with this, because if you give a premium to someone and call it a donation, then under Islamic jurisprudence you have no right to receive anything in exchange for a donation. When you give somebody a donation you relinquish any and all rights that you have in relation to those funds that you give up.

Then it becomes a purely volitional undertaking on the part of the insurance company, as to whether they want to pay you back or not. Sure there are reputational issues, but without getting into the various aspects, the answer to the structural question that you asked is that it's meant to be a fundamentally mutual arrangement between people in the way that I guess a mutual company would work in the U.S. But the insurance company comes in the middle of those participants (as opposed to the insured) to manage the underwriting and the claims-paying.

**QUESTION THREE:** What is the difference between conventional and Islamic insurance?

**MR. AGHA:** Practically, the insurance policy that you will enter into is going to look significantly different. The wording is going to be significantly different. The practical difference for you as an insured, at the end of the day, is

that you will have a theoretical right to receive back from the insurance company a refund of the premiums in the event you have not suffered an eventive loss.

So like I shared with you, if Hamada's Maserati is not damaged five-years from now, well, guess what? He can expect the refund of his premium. Now I know that some insurance companies have no-claims bonuses. If you don't get into an accident, you get a premium rebate. The idea here is not that different. The difference is, of course, under Islamic insurance, you've got to get the money back otherwise it calls into question the entire construct that has rendered the contractual arrangement between the parties.

**QUESTION FOUR:** There's something that's interesting that I never quite understood, in terms of the way the Saudis have tried to get some conflict resolution mechanism, dealing with Islamic Finance to be dealt with administratively, instead of going to *Shari'a* court. Can you elaborate on that, how it was done?

**MR. AGHA:** If I am a lender lending \$5 billion to a project in Saudi Arabia, conventionally, I will expect to be able to enforce a money judgment. The only way in which that is going to happen is if there is a quasi-judicial authority that can enforce awards reflecting interest payment.

The SAMA Committee in Saudi Arabia has this authority and has primary jurisdiction in all disputes that relate to disputes between a bank and its customer. In fact, it is generally understood that Islamic Financings would also go to the SAMA Committee for adjudication.

Now why is this relevant? Because in the next ten-years \$690 billion worth of assets are going to be constructed in Saudi Arabia. In the Middle East, \$1.5 trillion of project financings are going to happen in the next ten years. And I can tell you something else, which is what a lot of us believe, that of these projects, most of them will have a strong aspect of Islamic Financing. So it doesn't take a lot to figure out why Islamic Financing is going to continue to grow, perhaps too fast, and face real challenges.

**QUESTION FIVE:** I just wanted to ask you to discuss more about how you go about approaching clients, if and when something is done in an un-Islamic fashion?

**MR. AGHA:** I think you're sort of hitting the toughest part of my job. In many respects, the reason why I got into Islamic banking, frankly, was because I wanted to really work in a field where I could apply what I had learned. I had studied *Shari'a* for quite a few years, as well as other religions. I really wanted to apply it into the context of Islamic Finance. So for me, when a client approaches me, my first point of inquiry is, can we do this genuinely Islamically?

To be honest with you, a lot of times we're not approached for that. We're approached to do things in a way that meet commercial parameters that will also pass *Shari'a* board muster. That's a fact. Now as a lawyer, can I turn around and say, sorry, we're not going to do this? I can't. So we do the best we can. But

quite frankly, my preference is to work with Islamic banking clients that want to start from a genuine compliance standpoint. That's how it works.

I'm just giving it to you straight. These are the issues and I think there's a lot of pressure out there, to just get the deal done. I think what is not helpful, as has already been pointed out today, is that there is a glut of deals out there in the market that have been done the wrong way. Remember, under Islamic Finance there is no concept of precedence, generally speaking.

So these are some of the issues that we face and some of the issues that we deal with. But my sense is that in the last couple of years something appears to be changing. There is almost a beginning of what I would call an awareness of genuine compliance. Is it getting there? Not yet, but it appears to be rising. When I'm approached by a client with respect to perspectives, I will always share with them what the structure is; there's a lot of stuff they can do. It's just very difficult when the client, for example, wants to have reliable returns. That aspect becomes very difficult when you want to have an interest rate return, or you want to have exactly the same commercial risk profile of a conventional loan and you want to achieve it through Islamic means. Because quite frankly, you can't make an apple into an orange, right? I mean the whole idea of Islamic financing is it's not meant to be a risk-free return. It's certainly not meant to be a risk-free guaranteed return of a certain percentage. So, when you try to achieve that, you're breaking the parameters of what is permissible under Islamic finance. And as lawyers we have, perhaps, limited room to maneuver in this area but we have to do what we are mandated to do.

