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Islamic Infrastructure Finance and the Sustainable Development Goals

Edited & Compiled
Aamir Rehman
Senior Fellow, Richard Paul Richman Center for Business Law & Public Policy
Columbia University, New York, NY.

Center for Islamic Economics and Finance
College of Islamic Studies | Hamad Bin Khalifa University
P.O. Box 34110 Doha, Qatar

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BACKGROUND[1]

In 2016, the London School of Economics and Political Science and Hamad Bin Khalifa University (LSE-HBKU) organized a workshop on the topic of "Islamic Infrastructure Finance and Sustainable Development Goals." The event built on a tradition of similar workshops on Islamic finance held regularly at the LSE since 2007.

These annual workshops are a forum for in-depth and multidisciplinary discussion on some of the most pressing issues facing the Islamic financial sector. They are not meant to prescribe a particular course of action or reach definitive conclusions but to provide an open environment for discussion. The topic of each workshop is chosen based on a survey of the participants. Participants are then provided background information on the topic and requested to submit their comments. The comments received are compiled and distributed to all participants prior to the workshop. The workshop spans an entire day with several issues discussed in multiple sessions.

Following our workshop tradition, Sharia scholars, legal experts, bankers, professionals, and economists from different countries first submitted written responses, then gathered at the LSE campus in London on February 12, 2016, to discuss various aspects of Islamic infrastructure finance and sustainable development goals in detail. Thirteen written comments were received in advance of the event, providing a rich basis for the discussion in advance of the event.

The current document offers a short report from the event, conveying key themes and discussion points. The event was held under strict Chatham House Rules, enabling candid discussion and fostering debate. Remarks are thus not attributed to specific individuals.

OPENING

Role of the workshop

The organizers of the workshop opened the event with background on the forum and its place in the study of Islamic finance. It was noted that the workshop was initiated in 2007, and the current event thus marked the tenth convocation of the gathering.

It was also observed that the event plays a unique role both in the academy and in the industry. The sustained and committed leadership of the workshop organizers and moderator were noted, with appreciation, by the attendees.

Consistent features

Participants commented on the workshop's unique role in bringing together practitioners, Sharia scholars, legal experts, and economists for rich and candid discussion of critical issues. Attendees praised the candor of the event, which, under Chatham House rules, has allowed experts from a full range of disciplines to probe deeply and challenge one another's views in service of rigorous discussion.

Another consistent feature of the workshop noted was the public lecture that precedes it and is open to the general public. The public lecture has been seen to foster enthusiasm and interest among a range of attendees and especially among students and young professionals.

[1] Acknowledgements: This roundtable was moderated by Frank Vogel. The roundtable was organized by S. Nazim Ali, Hussam El-Khatib, Shariq Nisar, and Wijdan Tariq. This report is based on the excellent notes of Jennifer Schwalbenberg. The comments of Frank Vogel and other participants were also instrumental in preparing this report. The usual disclaimer applies. All errors that remain are the author's own.

Recurring issues

The organizers identified a set of five recurring issues that had been present in the workshop over the past decade irrespective of the discussion theme for that year. One such issue is what the very meaning and purpose of the Islamic finance industry are. Another is the matter of identifying (and balancing) short- and long-term objectives in advancing the industry. A third is the question of how the industry links to broader macroeconomic environments in which it operates. Fourth, the workshop has consistently considered pragmatic and commercial considerations facing the industry. Fifth, it has addressed questions of religion and ethics each year over the past decade.

ROUNDTABLE DISCUSSION

The roundtable discussion, over the course of a full day, explored three core themes: (1) infrastructure funding and the role of Islamic finance, (2) supporting the Sustainable Development Goals (SDGs) adopted at the United Nations in 2015, and (3) addressing practical impediments to applying Islamic finance for infrastructure funding and supporting the SDGs. The workshop closed with concluding remarks from participants on the path forward.

I) Infrastructure Funding and the Role of Islamic Finance

Defining "infrastructure"

The discussion began with an attempt to reach a shared working definition of "infrastructure" in the current context. Key features of infrastructure were cited as (1) being used for capital-intensive public works that bring social benefit, (2) adopting a project finance model, with recourse mainly to the project, and (3) often involving governments or public-private partnerships (PPPs).

The challenge of scale

Several participants stressed that infrastructure projects tend to be large-scale in nature, whereas the Islamic finance industry is relatively small. Further, the funding sources of the industry are short-term in nature—it was observed that 70% of the industry stems from retail banking, principally in the form of demand or short-term deposits. This situation creates a challenge in the form of mismatching assets and liabilities: infrastructure assets are long-term in nature; bank deposits are short-term liabilities.

A further challenge associated with scale is the matter of risk management: Islamic financial institutions rightly need to diversify their exposure and limit their concentration to a single project or sector. This impairs their ability to lead major infrastructure projects.

Participants considered ways in which Islamic finance has played—and can continue to play—an important role in infrastructure projects. The Islamic Development Bank, with its extensive portfolio of infrastructure financing, was cited as an example. Participants also cited examples of Islamic banks collaborating with one another and with other financial institutions, with such collaboration dating back over twenty years.

Interaction with conventional finance

A question posed to the forum was how Islamic finance is differentiated from conventional finance in the context of infrastructure. Numerous attendees emphasized that Islamic finance in fact collaborates with and complements conventional finance on infrastructure projects.

An example was cited of a project in which the Islamic finance tranche comprised 2% of the total transaction. In such settings, Islamic finance can require additional documentation and add complexity to the transaction despite being a small share of the total funding.

Attendees noted, nonetheless, that Islamic finance has been able to demonstrate both applicability to infrastructure funding (for example, the 100% Islamic financing of Madinah Airport) and the ability to effectively collaborate with conventional finance.

Sharia considerations

A Sharia scholar stressed that Islamic finance has developed a wide range of innovative structures to meet the needs of infrastructure projects while complying with Islamic law. He noted early innovations that have allowed Islamic finance to participate in common terms agreements with conventional finance—a major requirement to make viable a role for Islamic finance.

Another scholar questioned whether the industry might be trying to "run before it can walk" and thus risk ethical compromises. He noted that a great bulk of rulings allowing contemporary Islamic finance structures are based on minority ("dissenting") opinions of jurists, and that some structures that were meant to be exceptions have often become the norm. A participant later observed that we were "trying to build the plane while flying it."

In the same discussion, it was noted that the industry relies on "asset-based" rather than "asset-backed" sukuk, with only 2% of sukuk being asset-backed. Participants noted that the reason for this is commercial and demand-driven: such structures are being used because that is what the market wants. It was commented that developing even a sub-optimal (but nonetheless Sharia-compliant) structure is an important contribution because it allows Islamic finance to participate.

Participants questioned whether greater ethical differentiation could spark demand. A practitioner noted that clients don't always know what they want until they see it—innovations like the iPhone required vision beyond what customers immediately demand.

Modes and instruments

A practitioner asserted that equity participation in infrastructure offered a substantial opportunity, as (1) it offers attractive financial returns, and (2) it allows Islamic financiers to drive the decision-making on a project's capital structure and its use of Sharia-compliant debt.

Continuing the discussion on sukuk, participants stressed the importance of private sector issuances to broaden and deepen the market. It was noted that the legal environment for sukuk is not equally favorable in every jurisdiction, but progress is being made.

The role of takaful was mentioned by multiple attendees. Using takaful mechanisms for infrastructure projects can be important in reducing the risk of investing in infrastructure. It was further noted that takaful companies are natural investors in long-term assets like infrastructure, although their scale today is very small.

Emerging opportunities

Participants raised a number of emerging opportunities for consideration. One is the rise of green and ESG (environmental, social, and governance) bonds, which have grown to $80 billion and are attracting the attention of institutional investors in emerging markets. If these can be made Sharia-compliant, they can grow the Islamic finance industry.

Innovative initiatives in a range of countries—including Malaysia, the UAE, and Iran—were cited as noteworthy and as potential examples that could be grown and replicated.

II) The Sustainable Development Goals

Maqasid: need for precision

Several participants linked the SDGs with the *maqasid* (objectives) of the Sharia. A view voiced by multiple participants was that the maqasid need to be not only broad concepts, but also be applied concretely to specific goals. A migration was needed from “very vague concepts” to “faith-based economic concepts.” Without application, the maqasid might be only a “distraction.”

A participant noted that the SDGs were not developed by the religious sector—they were developed by civil society. It is thus not the province of religious scholars alone to develop concrete goals based on the *maqasid*—it is the work of multiple stakeholders. Another participant commented that a “bottom-up” approach to standards is needed, and that governments should not be expected to take the lead. A third participant noted that the Pope has been vocal on financial matters, and has been willing to publicly criticize banks for their ethical shortcomings. Whether Islamic scholars would do the same is a “political” question.

It was noted that the SDGs have provided a robust and concrete framework. The applicability of Islamic finance to the SDGs is (1) a way of articulating its social impact and (2) connecting Islamic finance more clearly to mainstream development finance. This was seen by some participants as an important step to advance the industry.

Importance of pragmatism

Participants commented on the importance of a pragmatic approach to ethical and ESG goals. One practitioner discussed a data-driven approach that analyzes social impact and demonstrates the long-term financial benefits of such investments. Such data could persuade investors to participate in Sharia-complaint ESG funds.

Another participant offered a series of questions to guide a pragmatic approach: “Is it affordable? Is this practical? Can it be scaled?“

Embracing the ESG approach

Participants expressed enthusiasm for the SDGs and for attention to ESG metrics. One benefit cited was linking Islamic finance more concretely to the global development agenda being pursued by multilateral financial institutions including the World Bank, the EBRD, and others.

Participants noted the importance of incorporating elements of the ESG approach that are not customarily considered in Islamic finance. Labor rights and a “living wage” were cited as crucial social concerns that should be incorporated when considering ethical acceptability. A participant commented that environmental and social issues are both important, and “there is a big risk of not thinking about these issues.”

II) Addressing Practical Impediments

Project-level constraints

In identifying impediments to applying Islamic finance to infrastructure and to the SDGs more broadly, participants began with impediments at the project level. These can include lack of familiarity with Islamic contracts, challenges generating cash flow, and execution challenges for financiers and for project operators. A participant noted that such constraints, while meaningful, can be surmounted. He noted that parties to infrastructure transactions are sophisticated and that creative structures and solutions can be formulated to address their needs.

Enabling environment

It was observed that macro and environmental factors play a crucial role. One participant detailed his collaboration with a multilateral development bank regarding Islamic finance regulations in a North African country. In addition to issues specific to Islamic finance, there exist broader issues of commercial law such as the bankruptcy regime and rules for SPV formation.

In-depth research

Several participants commented on the need for high-quality, in-depth research. One of the topics highlighted for research was bankruptcy regimes and Sharia compliance. Another topic was the introduction of Islamic finance regulations in civil law jurisdictions. A third was the area of tax. Participants underscored the challenges of research; one noted "when you get down into the dirt, it's really hard work."

Participants specifically referenced initiatives in Saudi Arabia that are engaging large numbers of young scholars and researchers in Sharia and commercial law. A Sharia scholar related his own experience of working under a senior scholar who "taught me in a year in a bank more than I learned in all my time in formal education in Sharia."

Academics noted the significant volume of interest in Islamic finance among doctoral students. A key challenge observed in this respect was a scarcity of properly qualified supervisors for such students' dissertations. It was noted that the inconsistent quality of supervision was a risk to the quality of research. A participant suggested that doctoral candidates be engaged in field projects with practitioners, which would enhance their capacity to conduct research on critical issues.

CONCLUSION

In concluding remarks, workshop participants were asked to comment on what needs to be done and who should take responsibility for undertaking the actions discussed.

Participant responses underscored the issues cited previously, with three additional themes emerging:

1. The opportunities and challenges pertaining to Islamic finance, infrastructure funding, and addressing the SDGs are complex and nuanced;
2. Advancing these opportunities and addressing the challenges is the collective responsibility of the industry's stakeholders (practitioners, legal experts, Sharia scholars, academics, industry organizations, etc.); and
3. The workshop attendees remain enthusiastic about directly participating in advancing research and practice on the issues discussed

APPENDIX I: LSE WORKSHOP THEMES

The LSE Workshops on Islamic Finance have been organized in conjunction with Harvard Law School (2007-2014) and HBKU (since 2015), with themes as follows:

2007	Tawarruq: A Methodological Issue in Shari‘a -Compliant Finance
2008	Sukuk: Economic and Jurisprudential Perspective
2009	Islamic Economic and Islamic Ethico-Legal Perspectives on the Current Financial Crisis
2009	Microfinance: Toward a Sustainable Islamic Finance Model
2010	Islamic Financial Ethics and Ethical Governance
2011	Reappraising the Islamic Financial Sector
2012	Islamic Financial Intermediation: Revisiting the Value Proposition
2013	Insolvency & Debt Restructuring in Islamic Finance
2014	Use and Abuse of Limited Liabilities
2015	Revisiting Islamic Securitization and Structured Products
2016	Islamic Infrastructure Finance and the Sustainable Development Goals
2017	Fintech and Islamic Finance: Applying *Hiyal* and *Makharij* and other Islamic Principles

APPENDIX II: WORKSHOP ATTENDEES

MODERATOR
Frank Vogel, *Founding Director*, Islamic Legal Studies Program, Harvard Law School, USA

ORGANIZERS
Convener**:** S. Nazim Ali, *Director*, Center for Islamic Economics and Finance, Qatar Foundation, Qatar
Husam El-Khatib, *Senior Legal Consultant*, DLA Piper, Riyadh, Saudi Arabia
Shariq Nisar, *Adjunct Professor*, ITM, Mumbai, India
Wijdan Tariq, *Senior Researcher*, Hamad Bin Khalifa University, Qatar Foundation, Qatar

SHARIAH SCHOLARS
Shaykh Nizam Yaquby, *Independent Shariah Scholar*, Manama, Bahrain
Shaykh Esam Ishaq, *Independent Shariah Scholar*, Manama, Bahrain
Dr. Osama Al Dereai, *Shariah Scholar & Managing Director*, Bait Al Mushura, Doha, Qatar
Mufti Barkatullah, *Independent Shariah Scholar*, London, UK
Shaykh Haithem Tamim, *Independent Shariah Scholar*, London, UK
Akram Laldin, *Professor* , International Islamic University Malaysia, Kuala Lumpur, Malaysia
Muhammad Nurullah Shikder, *Head of Shariah Advisory*, Gatehouse Bank, London, UK

ACADEMICS
Habib Ahmed, *Professor*, Durham Business School, Durham University, Durham, UK
Iqbal Asaria, *Adjunct Professor*, The City University, London, UK
Mohammed Abdel-Haq, *Director*, Center for Islamic Banking, Bolton University, Bolton, Lans. U.K
Siraj Sait, *Director*, Centre for Islamic Finance, Law and Communities, University of East London
Rula Al Abdulrazak, *Senior Lecturer*, University of East London, London, UK

FINANCIAL PROFESSIONALS
Harris Irfan, *Managing Director*, Rasmala Plc, London, UK
Aamir Rehman, *Managing Director*, Fajr CapitalGroup, Dubai, UAE
Majid Dawood, *Chief Executive Officer*, Yassar Ltd, Dubai, UAE
Michael Gassner, *Head of Islamic Finance* - Bank J Safra Sarasin, Geneva, Switzerland
Omar Shaikh – *Executive Board Member*, Islamic Finance Council UK, Glasgow, UK

LEGAL PROFESSIONALS
Michael J.T. McMillen, *Partner*, Curtis, Mallet-Prevost, Colt & Mosle LLP, New York, USA
Neil Miller, *Partner*, Linklaters, Dubai, UAE
Richard de Belder, *Partner*, Dentons UKMEA LLP, London, UK
Farmida Bi, *Head of Islamic Finance*, Norton Rose Fulbright LLP, London, UK
Craig R. Nethercott, *Partner*, Latham & Watkins LLP, London, UK
David Eisenberg, *Partner*, White & Case, London, UK
Huma Sodher, *Ph.D.c*, Law School, Bangor University, Bangor, Wales, UK
Sajjad Khoshroo, *Associate*, White & Case and D.Phil. candidate, Oxford University, UK
Jennifer Schwalbenberg, *Associate*, Reed Smith LLP, London, UK