

Syndicated Islamic Finance

By Asim Iqbal

As the global credit crunch has dried up liquidity in conventional markets, corporations will have to look for alternative sources of finance to fund their investments and projects. Syndicated Islamic finance may emerge as a potential alternative liquidity source.

The syndicated Islamic finance market is growing at unprecedented levels. This year, there have been approximately 28 syndicated Islamic finance deals with a total value of US\$15.2 billion. As the market appetite for ever larger Islamic finance transactions increases, so does the need for banks to club together their financing, structuring and advisory skills.

Syndicated finance provides a mechanism for banks to effectively pool their balance sheets to provide finance for high-value transactions, while at the same time diversifying some of their risks. As Islamic finance transactions become bigger and more complex, syndicated finance will become an increasingly important financing mechanism for Islamic bankers.

A syndicated loan involves a group of banks working together to provide funds to a borrower. Typically, one bank will act as the lead bank or mandated lead arranger (MLA; however, on larger deals there are often multiple MLAs), which will be responsible for syndicating the loan. Syndication allows participating banks to reduce their individual exposure and therefore, lower the risks associated with the loan.

Syndicated Islamic finance functions in a similar way to its conventional cousin; however, as with most of Islamic finance, there are some nuances. The majority of Islamic finance scholars in the Middle East are of the opinion that when the lead bank looks to syndicate the debt, it must sell it down at par, so it cannot sell the debt at a discount or a premium. The lead bank is, however, allowed to charge an administration fee for managing the syndication process.

Syndication process

Popular Islamic finance products used in syndicated Islamic finance are Murabahah and Sukuk. However, most mainstream Islamic finance products can be syndicated. Murabahah is an agreement where a bank purchases an item for a client and then sells it to him on a cost-plus basis. The bank declares its cost and profit to the client, who then typically pays on a deferred basis.

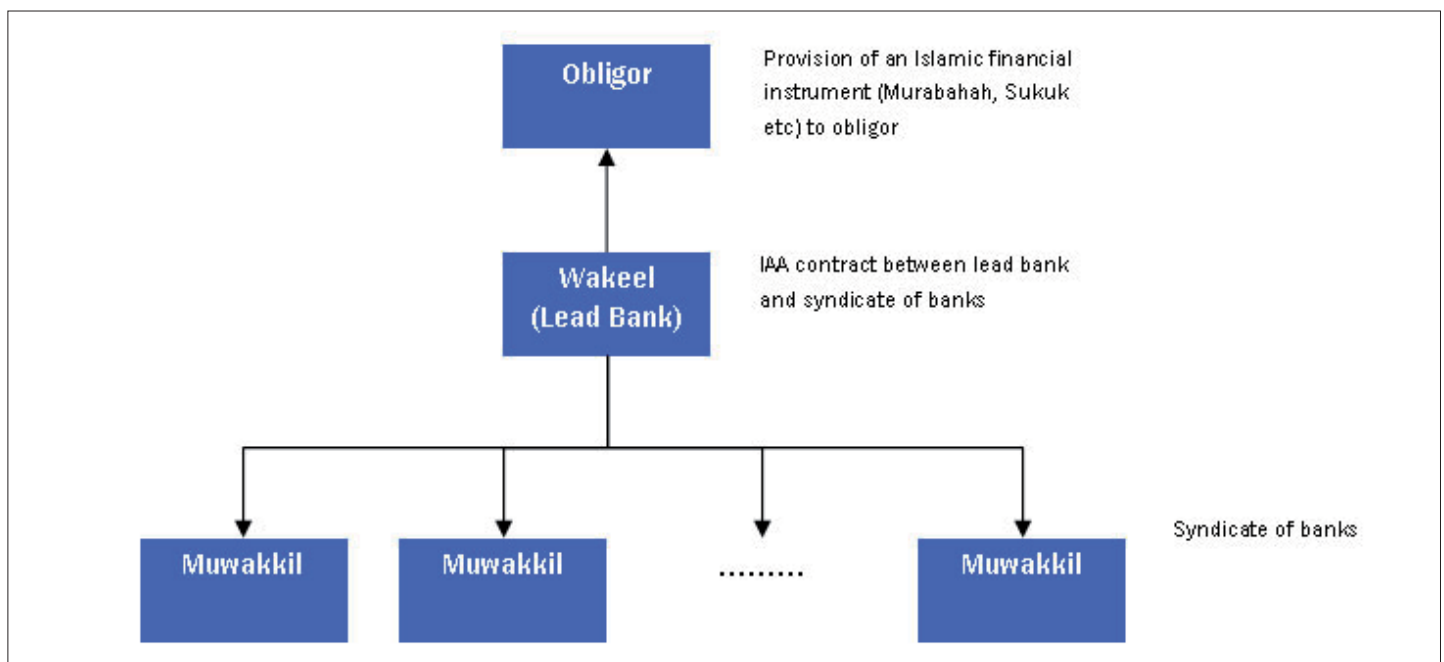
Sukuk is a form of Islamic bond, generally an asset-based investment, where investors own an undivided interest in an underlying tangible asset on which they receive a proportionate share of the investment return.

To syndicate Islamic finance, banks typically enter into an investment agency agreement (IAA), which relies on the principle of agency. The lead bank will enter into an IAA with the banks participating in the syndicate (it is often the case that the lead bank will also be part of the syndicate).

The lead bank acts as the wakeel (the agent) and the banks participating in the syndicate act as muwakkils (the principal) in the contract. The wakeel is the managing agent of the funds and the muwakkils are the providers of the funds.

The IAA will stipulate the conditions of the participation and describe the underlying contract documents to be entered into by the wakeel, the purpose for which the funds should be employed and the obligations of the parties involved. In this structure, the wakeel has the relationship with the obligor and is responsible for monitoring and managing the transaction. The muwakkil's relationship is with the wakeel and so will not normally have direct contact with the obligor on issues relating to the transaction. Below is an outline structure of the IAA contract:

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Syndicated Islamic Finance (*continued...*)

Overview of Syndicated Islamic Finance Markets

An assessment of Islamic MLA market activity shows that the leading MLAs of Islamic financing are Calyon, Saudi Hollandi Bank, Samba Financial group and Banque Saudi Fransi, each with 9% share of the market. However, there is growing interest from banks in Japan, Hong Kong and Singapore.

One of the largest syndicated Islamic finance deals so far this year was the US\$2.88 billion syndicated Islamic finance facility to Mobily in March. The syndicate of banks comprised ABN Amro Bank NV, Calyon, Banque Saudi Fransi, National Bank of Abu Dhabi, The National Commercial Bank, Saudi Hollandi Bank and Samba. The transaction was complex as it involved using the telecom operator's airtime as the underlying asset, a feature not previously seen before in Islamic finance. The syndicated facility also had one of the lowest costs of Islamic financing ever granted to a telecom operator in the Middle East and Africa.

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In September, Kuwait's telecoms giant Zain (previously known as MTC) signed two Islamic syndicated facilities worth a total of US\$7.39 billion via bookrunners BNP Paribas, Calyon, Citigroup and Samba. The two-year US\$4.89 billion Murabahah guarantee facility will help pay for the license it won to operate Saudi Arabia's third mobile network, while the two-year US\$2.5 billion Murabahah facility will be used to refinance Zain's US\$1.2 billion Murabahah facility signed in December 2006 and for general corporate purposes.

Impact of credit crunch

The subprime issue in the US has had a global effect on liquidity, causing many conventional banks to tighten their lending criteria. Syndicated Islamic finance could become a mechanism for tapping alternative sources of liquidity in the current credit environment.

The Islamic finance market is currently riding a wave of liquidity after a quadrupling of oil prices in the last six years. Due to the Shariah issues

associated with investing in subprime debt, many Islamic banks have stayed away from the area and so, coupled with rising oil prices, have been quite well insulated from the effects of the credit crunch.

Khairul Nizam, a senior financial analyst with the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), said that: “Exposure to the subprime market in the US is probably non-existent among the Islamic banks because mortgages are not supposed to be traded on Islamic principles. So, the Islamic banks would have stayed away from these because of Shariah issues rather than credit issues.”

Over the coming months, companies in Saudi Arabia are looking to raise US\$6.25 billion to finance a new phase of projects in the world's top oil exporter. Saudi Basic Industries Corp (SABIC), Saudi Arabian Mining Co and Chevron Phillips Chemical Co are all seeking cash for projects, primarily in infrastructure.

The size and similarity of these projects could make it hard for them to compete for conventional funding, in current market conditions. These projects may therefore find alternative sources, such as Islamic finance, appealing as they are not affected by the credit crunch.

Joseph Rodriguez, head of specialized finance at Saudi lender Al-Rajhi Banking & Investment Corp, has said that the key to securing financing will be the kingdom's appetite for debt that complies with Islamic law.

Conclusion

Syndicated Islamic finance has strong growth potential now and for the foreseeable future. Two underlying forces are increasing the appeal of this area of Islamic finance. The first, paradoxically, is the fallout of the subprime crisis, which has caused a tightening of global credit in conventional financial markets. This has resulted in a need to tap new sources of liquidity, Islamic finance being a prime option.

The second is the growing requirement for larger and more complex Islamic funding. The billion-dollar infrastructure deals in the Middle East and the push for more innovative products necessitate club and syndication deals for both funding and pooling of resources. ☺

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Asim Iqbal is a manager in PricewaterhouseCoopers LLP, specializing in infrastructure and project finance. He is a member of its Islamic Finance Network (led by Mohammed Amin, a partner of PwC) and can be contacted by telephone at +44 20 7212 3636 or via email at asim.iqbal@uk.pwc.com

Next Forum Question

With the persistent lack of professionals in the Islamic finance industry, how do financial intermediaries retain their key personnel?

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