# *Islamic Project Finance and Infrastructure Funding in Thailand – Key Concepts and Structures*

*Stephen Jaggs*

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# Religious Principles and Background

- Body of Islamic law is known as Shari'a.
- Shari'a principles have shaped the way in which Islamic finance has evolved.
- Shari'a is derived from a number of sources including the Quran (which is the primary source), the sayings (*hadith*) and teachings (*sunnah*).
- Shari'a is not a codified body of law and is capable of development and interpretation
  - new issues usually resolved by a legal opinion (*fatwa*) from a religious scholar
  - opinion of Islamic scholars on different issues may vary (depending on which of the Islamic schools of thought they belong to)

# Key Principles and Prohibitions

- The charging of interest (*riba*) for the use of money is prohibited
  - interest is interpreted as any return which is predetermined, guaranteed or calculated other than by reference to profits actually generated
  - wealth should be invested in a productive enterprise so that the owner earns a return by sharing profits and assuming the risk of any losses
- Shari'a prohibits uncertainty (*gharar*) in contracts
  - sale of items whose existence or characteristics are not certain is not permitted
  - this means that a contract containing obligations to insure or indemnify another person or to grant an option to purchase an asset may be unacceptable
- Speculation or gambling (*mayseer*) is prohibited
  - contracts to insure for a profit are not permitted
  - the same may apply to dealings in futures and options to the extent that these are speculative
- Shari'a prohibits Muslims from using or dealing in certain commodities which are forbidden (*haram*, i.e., not *halal*)

# Shari'a Scholars

- Islam is not strictly an organised religion and therefore does not have a specific church with a unified set of views.
- Various scholars (based in Arabian Gulf, Pakistan or Malaysia) specialising in the application of Islamic principles to finance have developed reputations in this area.
- Islamic banks and institutions place reliance on their opinions in determining whether transactions are in compliance with Shari'a.
- Typically commercially astute and have exposure to issues through acting on several Shari'a boards for various banks (usually with education background in economics / finance).
- Weight is given to the identity of the scholars.
- They will provide a *fatwa* (opinion) that a transaction adheres to Islamic principles.
- Disclosure of proclamation or fatwa and identity of scholars issuing the *fatwa* are key to attracting potential Islamic investors.
- Can be employed on a transaction by transaction basis or through the establishment of a board.

# Project Financing Structures

- *Wakala (agency)*
- *Ijara (leasing)*
- *Wakala – Ijara*
- *Istisna'a (custom manufacturing)*
- *Istisna'a-Ijara*
- *Musharaka (partnership)*
- *Tawarruq (commodity murabaha) (cost-plus financing)*

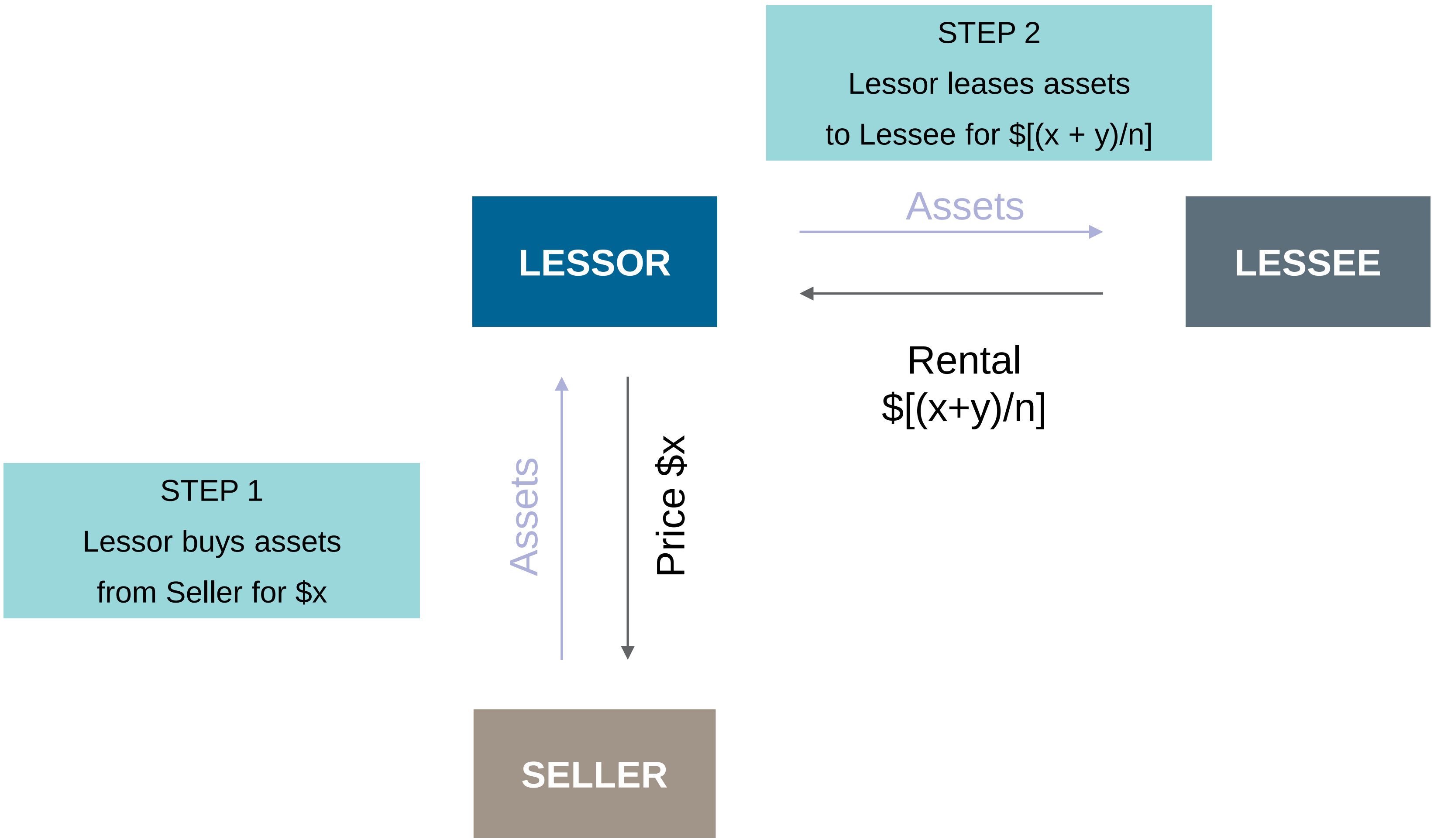
# Wakala (agency)

- **TRANSACTION**
  - a contract of agency in which one person (or persons) (*muwakkil*) appoint(s) someone else as its agent (*wakil*) to perform a certain task on its (or their) behalf
- ***WAKIL*** – person seeking finance
  - may contribute its own capital (as *muwakkil*)
  - may receive a fixed remuneration
- ***MUWAKKIL*** – financier
  - contributes capital
  - wakil invests capital, on behalf of *muwakkil*, in Shari'a compliant transactions
- ***PROFITS***
  - profits can be shared in any agreed ratio
  - ownership of the invested assets remains with *muwakkil* at all times
  - wakil may receive an incentive fee
- ***LOSSES***
  - losses are shared according to the share of contribution by each *muwakkil*
  - *muwakkils'* loss is limited to its share
  - wakil does not bear any of the loss attributable to invested capital

# Ijara (leasing)

- **TRANSACTION**
  - a known benefit arising from the use, possession and/or occupation of a specified asset is made available in return for a payment
- **ASSETS**
  - lessor must have full possession and legal ownership of assets prior to lease
  - the conditions of usage of the leased items must be stated (lease period, existence of asset, lessor's responsibility for maintenance and insurance, servicing)
- **RENTAL**
  - the amount and timing of the lease payments should be agreed in advance
  - can be fixed or by reference to a market rate
- **Option** to purchase or acquire leased asset :
  - sale undertaking (call option) – provides lessee with the option to purchase the leased asset at a pre-agreed residual value (*ijara wa iqtina*); or
  - structures under which the leased asset is transferred to the lessee at the end of the lease (*ijara muntahia bittamleek*)

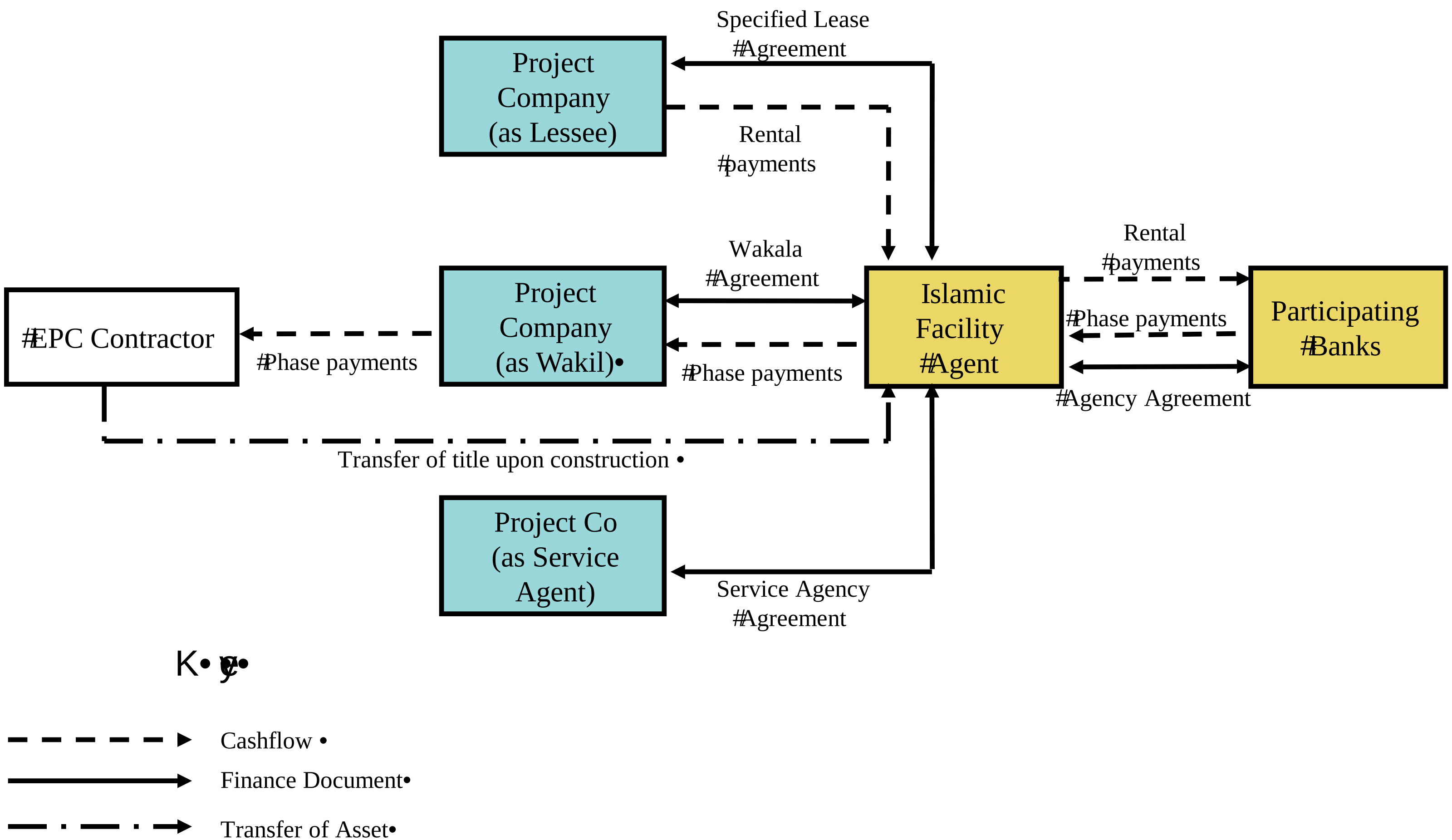
# Ijara (leasing) – continued



# Wakala - Ijara

- Combines a wakala (agency) structure with an ijara (leasing) structure
- Usually used in project financings for certain banks that prefer not to use an Istisna'a-Ijara structure (especially in Saudi Arabia)
- The banks appoint the project company as their wakil (agent) to construct project assets on their behalf and make payments through the project company for those assets
- The banks then lease the assets back to the project company using an ijara structure for rental income

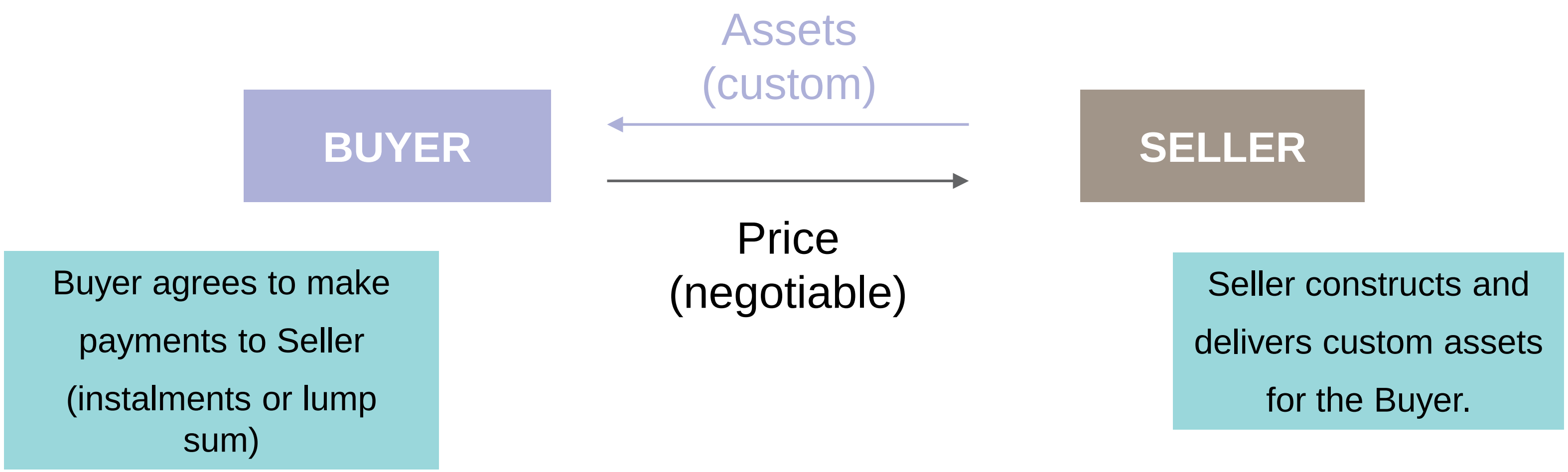
# Wakala – Ijara - continued



# Istisna'a (custom manufacturing)

- **TRANSACTION**
  - contract of exchange with deferred delivery, applied to specified made-to-order items
  - the contract is irrevocable after the commencement of manufacture, except where delivered goods do not meet the contracted terms
- **ASSETS**
  - the nature and quality of the item to be delivered must be specified
  - the manufacturer must make a commitment to produce the item as described
  - manufacturer must procure his own raw materials
- **PAYMENTS**
  - payments can be made in one lump sum or in instalments
  - instalments usually timed to match actual progress in achieving certain milestones in the manufacturing process

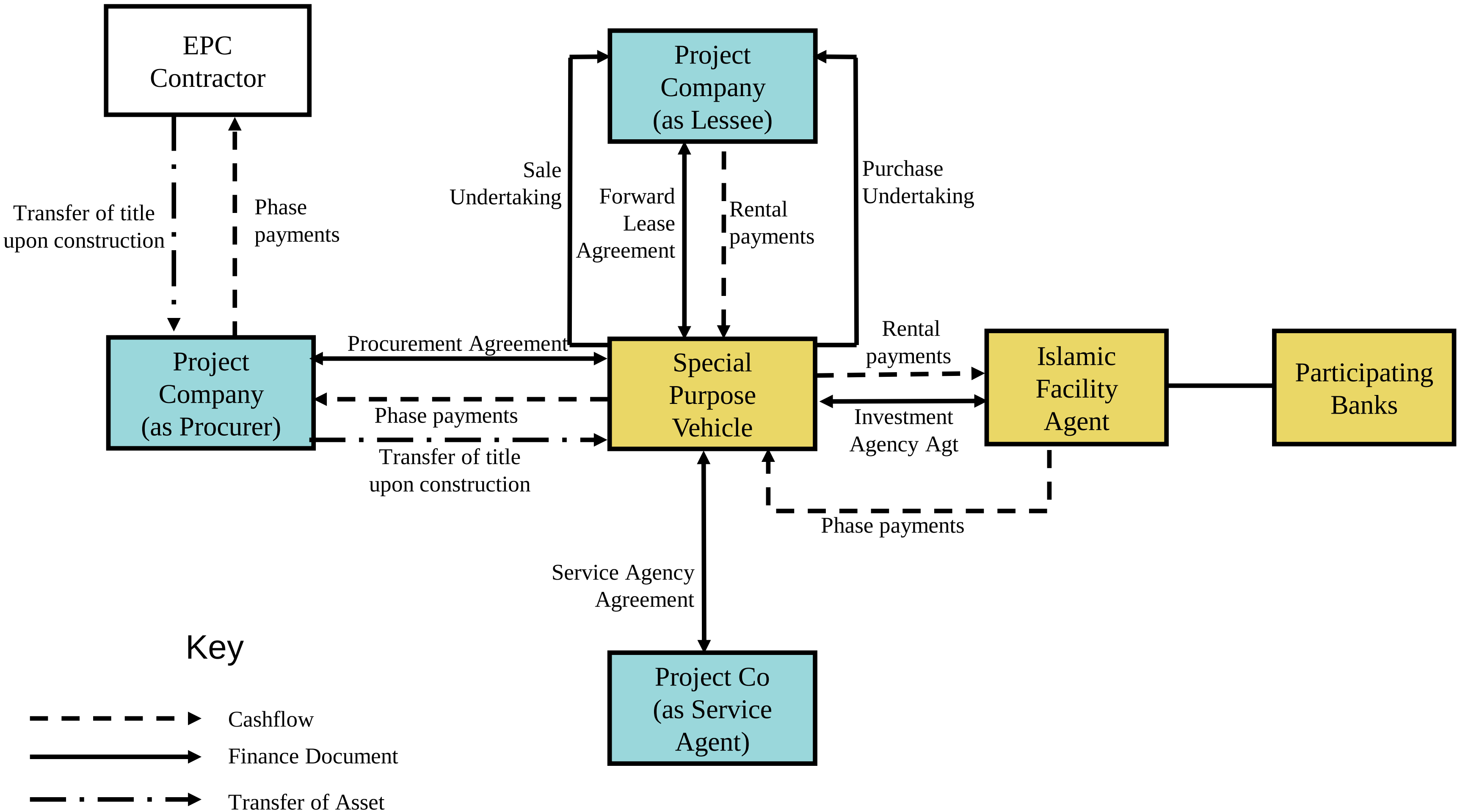
# Istisna'a (custom manufacturing) – continued



# Istisna'a - Ijara

– Combines an istisna’a (custom manufacturing) structure with an ijara (leasing) structure
– Usually used in project financings
– Under an istisna’a agreement the banks require the project company to procure certain project assets and sell these to the banks for an agreed price
– The banks then lease the assets back to the project company using an ijara structure for rental income

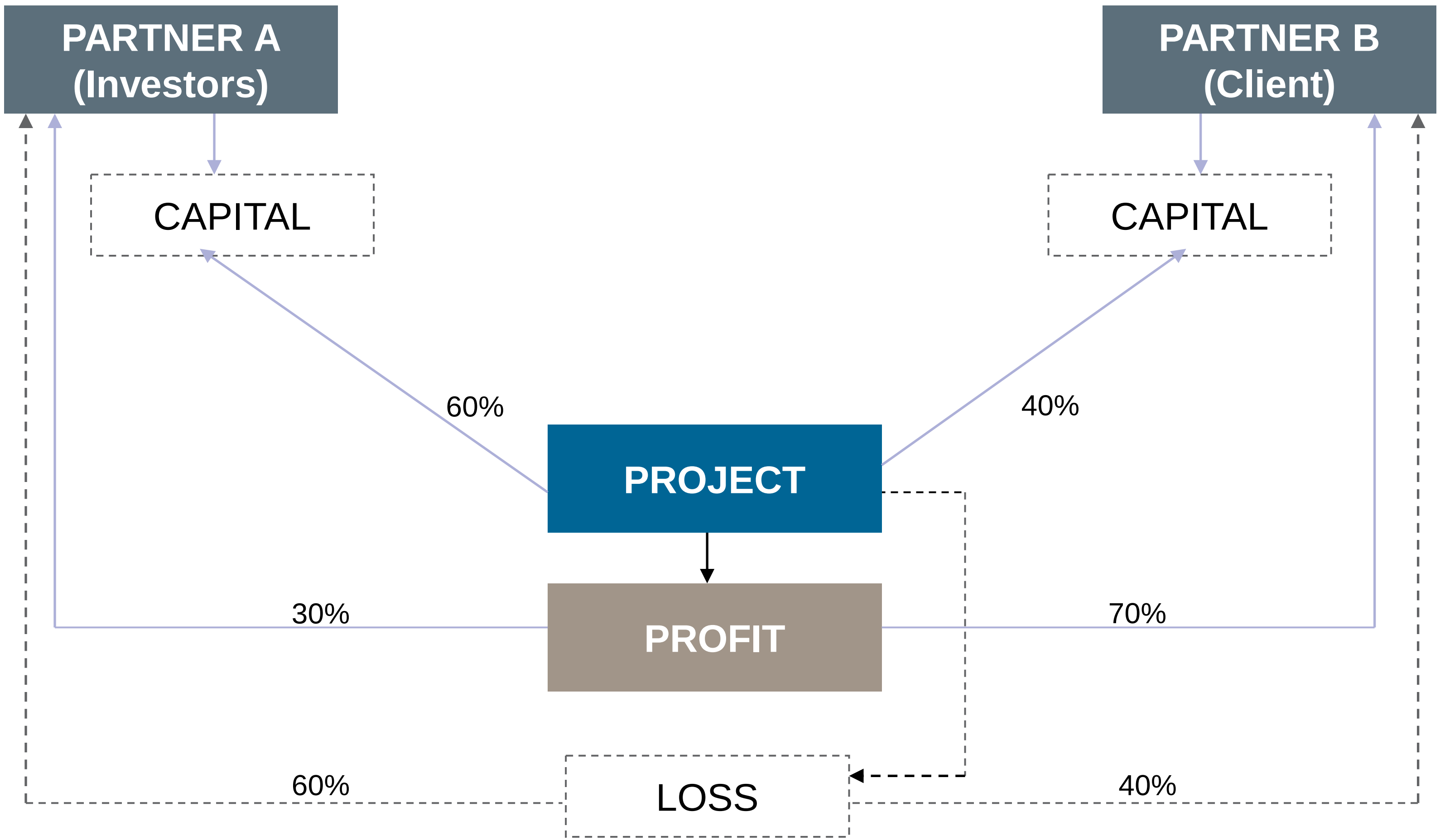
# Istisna'a – Ijara - continued



# Musharaka (partnership)

- **TRANSACTION**
  - sharing of ownership in a property or sharing by contract in a specific endeavour
- **CAPITAL CONTRIBUTION**
  - all partners contribute capital
  - partners have management rights, but are not obligated to exercise them
  - partners must receive accounting and other information on business activity
- **PROFITS**
  - contributions are subject to profit sharing in an agreed ratio between the partners
  - profits may not be an agreed fixed amount determined at the outset
- **LOSSES**
  - losses are shared according to the financing share of each partner
  - losses may not be limited to a partner's capital contribution
- "Diminishing" *musharaka* can be used to structure a financing transaction where the client buys back the financier's share in the *musharaka* at periodic intervals for a pre-determined price.

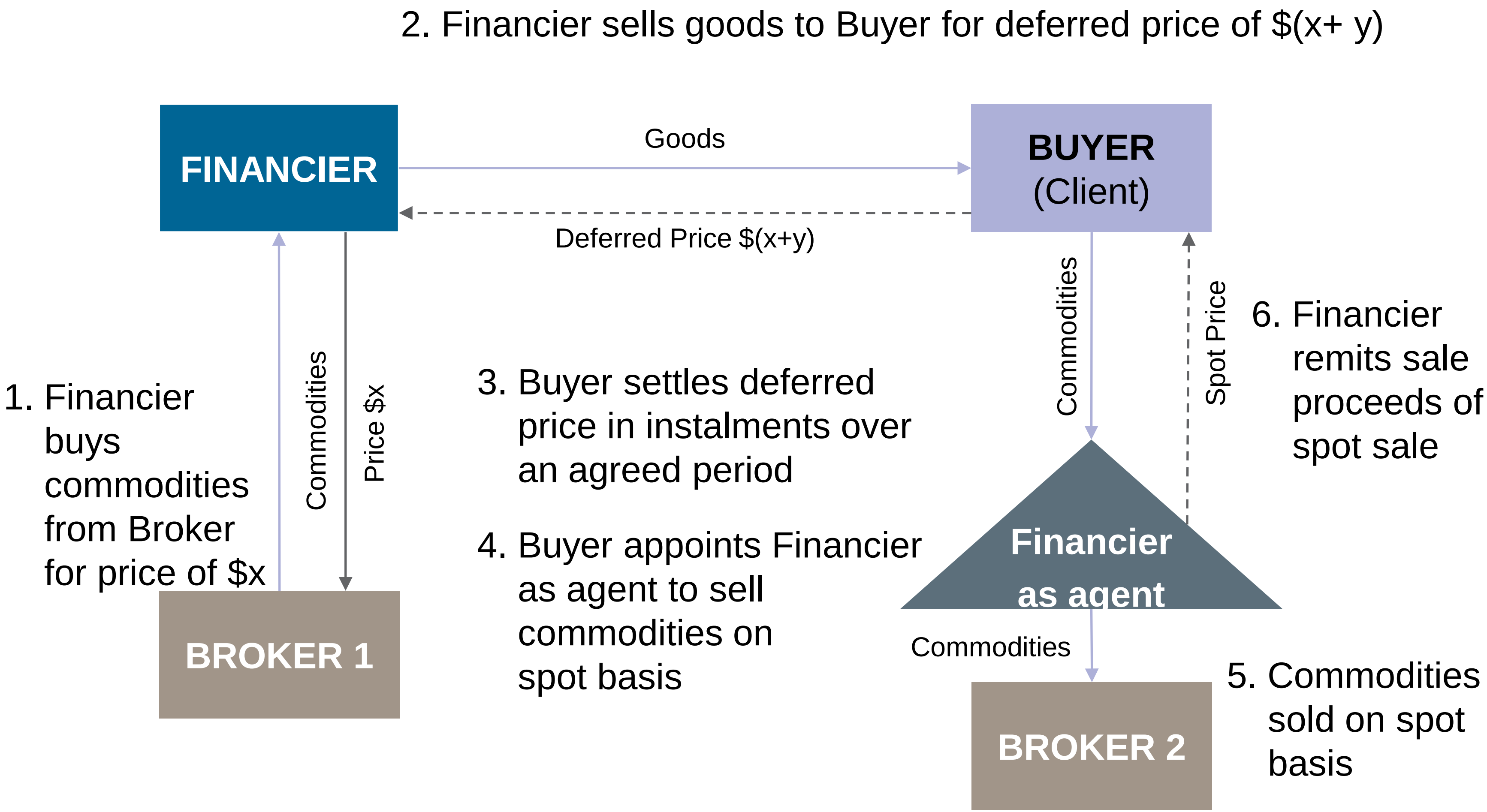
# Musharaka (partnership) – continued



# Murabaha (cost-plus financing)

- **TRANSACTION**
  - buyer purchases items from a seller at a specified profit margin payable to the seller
  - typically used to facilitate short-term trade transactions
- **ASSETS**
  - the assets must be in existence and under the ownership and in the physical or constructive possession of the seller at the time of contracting
  - the financier maintains ownership of the purchased items until delivery and bears all the costs and risks of ownership until delivery
  - in the event of default, the financier only has recourse to the assets financed and no further mark-up or penalty may be applied to the sum outstanding
- **PROFITS**
  - profit margin may be agreed as a percentage of cost or as a fixed amount
  - the end user and financier must pre-agree and specify the mark-up
  - profit margin can not be a reward for the use of the financier's money
  - if the financier avoids taking any risk and does not perform any service other than providing money for the transaction, deal becomes akin to charging interest

# Tawarruq (Commodity Murabaha)



# Questions?

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