

Has Islamic finance sneaked into the Square Mile through the back door?

Scholars in the Middle and Far East are now well known in English law firms. Edward Fennell reports

Here's a thought. If all the sub-prime deals in the US had been governed by Sharia there would have been no massive defaults and the credit crunch would never have loomed over our shopping expeditions.

Instead, Islamic law's requirements for prudent lending, the sharing of risk and a ban on the earning of interest would have insulated the borrowers and the world economy at large from the debacle of the past six months. And for that even the Archbishop of Canterbury's harshest critics might have been a mite grateful.

So how does Islamic finance — now increasingly practised by law firms in London and New York — fit into the heated debate about the relationship between the British legal system and religious codes?

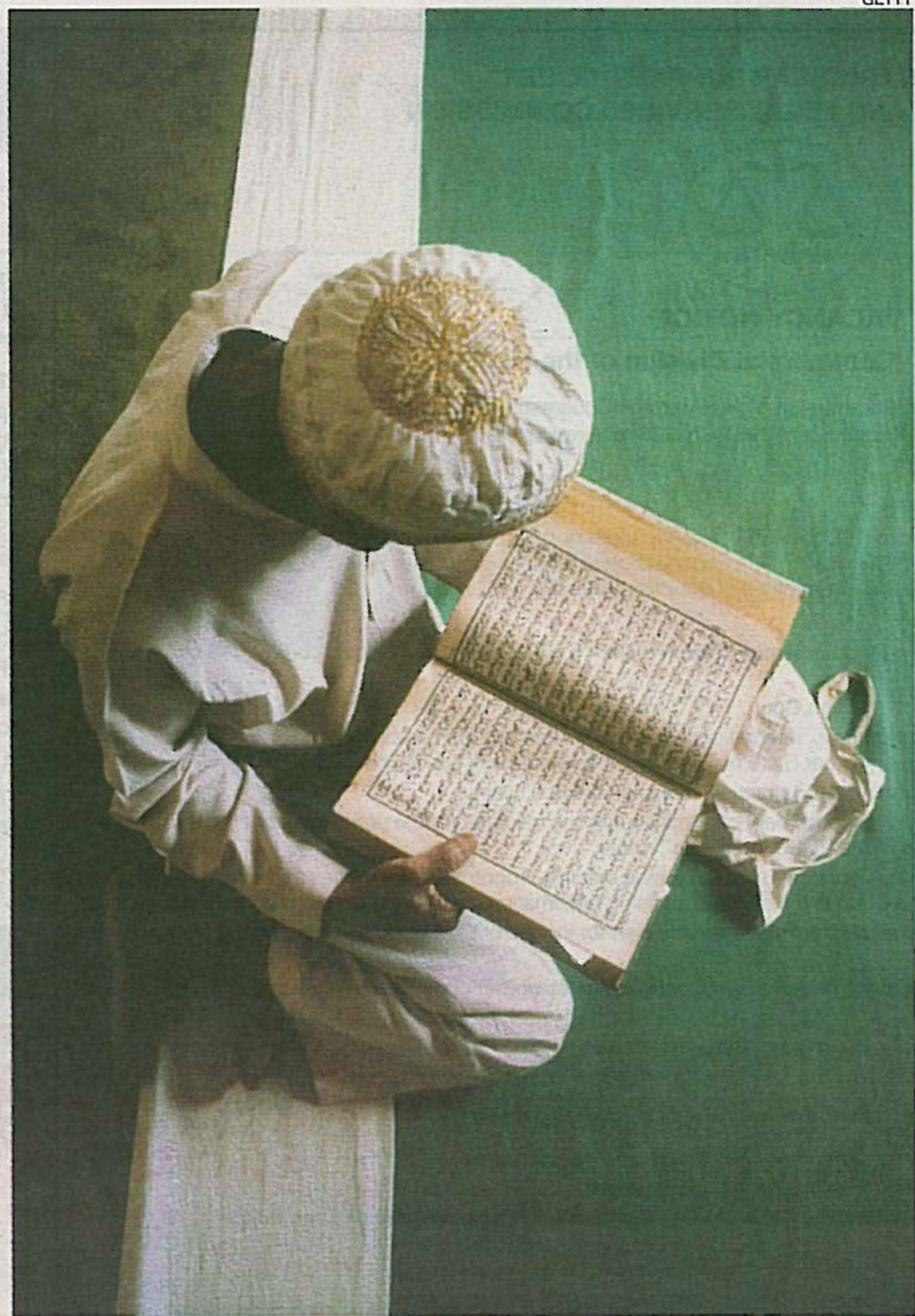
The Prime Minister in particular needs to have an answer to that. Last week he was quoted as saying that: "British laws must be based on British values and religious law should be subservient to British criminal and civil law." How come then that Gordon Brown, when Chancellor, wanted "to make Britain the gateway to Islamic finance and trade"? And, to support that, government introduced changes to the taxation regime to accommodate Sharia-compliant transactions.

To appreciate the full impact of Sharia on City law and business you have only to go to Clifford Chance where Islamic finance is an important activity. The firm was named Euro-money Islamic finance firm of the year in 2007 and it has scores of lawyers both in the Middle East and in London practising Sharia. Habib Motani explains: "Doing deals that are Sharia compliant is a standard part of what we do. It's part of the mainstream."

But does this mean that there is now a rival jurisdiction operating in London? Has Sharia sneaked into the Square Mile by the back door while the good Archbishop waits befuddled at the front? Well, in the spirit of Canterbury unclarity, the answer is Yes (and a little bit No). What is clear is that transactions hatched in London by UK lawyers are being reviewed by Sharia scholars in the Middle and Far East who judge whether or not they comply with Islamic law. If they do not, they do not go ahead. So in practice the jurisdiction of Sharia is now well established in Britain.

On the other hand, these transactions must also comply with UK law. Davide Barzilai, of Norton Rose, says that the great strength of English law is its flexibility, constantly evolving and adapting to meet new circumstances and demands from its users. Hence it would be perfectly permissible under the Arbitration Act 1996 for a Sharia council to be recognised as the body to arbitrate a dispute using Sharia principles and its decisions to be respected in an English court — provided, that is, it abides by English legal principles. "What such a council would not be able to do is to make awards that are in breach of English law," Barzilai says.

Whether this constitutes a "market" of jurisdictions, in the terms used by the Archbishop, is a moot point. What it does demonstrate is the enormous flexibility of English law based on the pragmatic principle that you can do most of what you want to do provided you are inventive enough about your approach. For example, Hassan Khan, of The Khan Partnership, has recently chalked up a number of successes for Chinese clients breaking into the Mid-



Prudent lending and shared risk: lessons the West could learn from Sharia

dle East by using Sharia-compliant deals under English law.

The only obstructions to the development of Sharia lie in its own limitations. For example, according to Martin Mankabady, of LG: "There has been little growth in Islamic insurance because insurance companies rely for their stability on broadly based portfolios of investments including sectors such as alcohol, gambling or armaments which are forbidden by Sharia." Sharia deals are also likely to be slightly less profitable than the Western norm because — as with ethical investments or organic produce — a premium is attached to complying with a restrictive code.

The other brake on Sharia, its critics

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say, is that the scholarly experts are often inconsistent with the result that parties in a transaction are never quite sure where they stand. That is where a firm such as King & Spalding comes in useful. According to Jawad Ali, a partner, it has a reputation as a safe pair of hands in developing original and innovative business structures and transactions that are Sharia compliant as determined by the recognised Sharia scholars. "There is a growing 'circle of consensus' among Islamic scholars who will agree in most cases," Ali says. "The challenge is that while Western banking goes back hundreds of years, Islamic finance in the West is only about a decade old. This means it is still breaking new ground. There may be occasional uncertainties but these are now settling down fast." The continued growth of Sharia-based deals it seems is now, in the Archbishop's phrase, "unavoidable".