

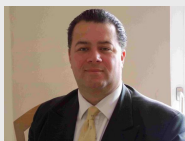
# CREDIT CONTROL



Invictus Risk Solutions LLP

## Islamic Finance – Still at a Crossroads

Paul C Rowland



**Paul C Rowland**  
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### Biography

*Paul C Rowland is a dynamic, highly driven, effective, and focused Insurance, Risk Management, and Securitisation Client Advocate and Broker Consultant who holds a BA (Hons) degree in History and Law from Lancaster University. Paul is an accredited Lloyd's of London broker and holds the ISO 9001 certification for excellent corporate compliance and governance.*

*He was awarded an MCIM from the Chartered Institute of Marketing in 2014 and an MCICM from the Chartered Institute of Credit Management in 2015 after an independent assessment of more than a decade of his work at an operational and senior management level; the Institute of Export and International Trade awarded Full Member status (MIEx) in 2022 to evidence the IOEI&T's assessment that Paul has reached eminence in the course of his employment and career in international business and in overseas related trade.*

*After 20 years of broking and underwriting on behalf of some of the industry's leading practitioners, Paul created Invictus Risk Solutions LLP (<https://www.invictusrisksolution.co.uk>) in 2015. The goal was to offer a single point of contact for a client advocate insurance, risk management, and securitisation "best in class" and "best in market" consultancy to support the risk transfer structure that a business and future investment funding requires.*

*Invictus stands out above its competitors through a long-term strategy which is to provide the correct risk transfer solutions to evidence an attentive, knowledgeable, proactive, and professional service. After two years of operation, Invictus received its first industry and peer award in July 2017. In the subsequent five years (accurate as of August 2022) Invictus has been humbled and privileged to win a total of 28 domestic and international industry and peer awards, with an additional 11 "Finalist" selections and a further 9 "Nominations". The most recent awards were presented during the COVID years of 2020–2022 that acknowledge and recognize the consistently high level of bespoke, knowledgeable, and skilful solutions offered as a trusted advisor by Invictus to its Clients during a very difficult financial and humanitarian environment.*

*Invictus is the only independent broker consultant to have been a three-time Finalist at the prestigious CICM British Credit Awards: 2022 – "Risk Management Achievement"; 2019 – "Managing Risk" and 2018 – "Risk Management Achievement of the Year".*

*Paul is a Global Advisory Executive "Recommend Expert" for Insurance & Risk Management and is actively engaged as the exclusive insurance partner for the PFX funding platform. Paul is a regular contributor to **CREDIT CONTROL JOURNAL** and **ASSET & RISK REVIEW**, has published articles in Business Money, Commercial Risks Africa & Europe, Insurance Times, Post Weekly, Reuters, and has recently completed a week long consultation with Atheneum Partners and McKinsey & Company regarding the current trends within the global Trade Credit Insurance, Political Risk and Surety markets.*

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## **Abstract**

*Keen observers of the financial press may recall that there was a clarion announcement at the World Economic Islamic Forum way back on 29 October 2013 by the then UK's Prime Minister, the Right Honourable David Cameron, when he stated that the UK was to become the first country outside of the Islamic nations to issue and launch an Islamic Gilt (a Sovereign Sukuk) to create a store of capital liquidity. Since then, much has happened in the market. In this article, the author looks back at the events surrounding the Dana Gas Ruling and its impact upon the UK's position as the Western World's leading centre for Islamic Finance and the wider Sukuk market.*

## **Introduction – the UK Government launches its first Islamic Gilt**

The importance of the UK Government's launch of its first Islamic Gilt back in 2014 was not the £200 Million store of capital liquidity it was hoped that this first Islamic Gilt would generate when it was subsequently launched; the importance was the breaking down of old boundaries and prejudices that would seek to foster a new period of co-operation across financial and religious boundaries to attract further Islamic investment.

Emphatically, David Cameron stated: "I want London to stand alongside Dubai as one of the great capitals of Islamic Finance in the World."

Clearly the economic and political agenda being pursued was to engage Islamic Finance to act as a stimulus to loosen the strict banking covenants that had continued to constrain and hamper the UK's resurgent economy.

In addition, The City A.M. reported the Chancellor George Osborne as having said: "Today's issuance of Britain's first sovereign Sukuk delivers on the Government's commitment to become the western hub of Islamic Finance and is part of our plan to make Britain the undisputed centre of the global financial system."

Subsequently, the UK Government raised £200 Million on Wednesday 25th June 2014 with the issuance of a five-year Islamic Gilt; this first offering attracted £2 Billion of orders generating ten times the threshold the UK Government was looking to receive.

The creation of this Islamic Gilt was the very first of its kind by the national Government of any G8 country; it is very rare in modern society that a government can be heralded as an innovative pathfinder and a lightning rod for change ... the UK had placed itself very firmly in this category.

By pursuing this path, the UK Government had sought to ensure that the City of London cemented its position as a center of Islamic Finance excellence on behalf of the wider UK economy and the nation's international partners; the goal of this proactive plan was to keep the UK at the forefront of the global race to corner as large a slice as possible of this strategically important arena that has continued to gain real momentum.

## The City of London

Since Roman times, the City of London has always been able to establish a role of being at the forefront of innovation to underpin the success and wealth of the UK's economy. Through its ability to attract investment, London has been able to project an image as a secure depository for wealth in times of crisis through its advantages of a business-friendly time zone, scale and the "can do" attitude of its deal makers.



When coupled with a robust commercial, legal, and regulatory structure, London has successfully continued to be held in very high regard as an economic powerhouse by the wider global business community that views the UK's business culture as providing a highly tolerant environment in which to operate.

The City of London has repeatedly performed well in the leading Accountancy firm PwC's "Cities of Opportunity Index" which is a study of the 30 most influential cities; London has been named as the World Capital for business, finance, and culture on several occasions ahead of New York, Singapore and Beijing.

Notwithstanding the above, and despite all of these unique selling points, the City of London's position as a leading center of financial excellence and innovation continues to come under repeatedly robust assault from countries such as Germany, France, Ireland, Luxembourg and further afield to Australasia; a threat that has been manifestly increased by the continued EU political shenanigans surrounding the UK's successful Brexit process."

By drawing upon its historical relationships with the Middle East, the City of London had sought to trump its competition and by actively relaxing its regulatory and tax frameworks to attract and accommodate the growing importance of Islamic Finance. Indeed, this policy proved very successful as London became the “go to” high caliber partner for Islamic investors with regard to Construction, Education, Energy, Healthcare, Infrastructure and Smart City Technologies.

### **London’s engagement with Islamic Finance**

A growing portfolio of professional London luminaries such as the Solicitor Norton Rose Fulbright and Banks such as Citi, Goldman Sachs, HSBC, Morgan Stanley, Standard Chartered and global information service platform Thomson Reuters all chose in the past five years to invest heavily in setting up specialist teams to assess and consult upon all aspects of Shariah Law through a framework of compliant procedures and protocols.



The goal was to create a broad appetite, capacity, licence and understanding to encourage, service and support a new generation of entrepreneurial, forward-thinking accountants, bankers, brand marketers, lawyers and property developers who would be able to structure deals that are compliant with Shariah Law requirements.

In addition, it was hoped that these same people would culturally and spiritually be able to engage with corporate brands who in turn were seeking market access and penetration to project their goods, products, and services into an increasingly wealthy global Muslim consumer audience.



### **So, what has gone wrong?**

Simply put, Dana Gas.

Contextually, under Shariah Law, Islamic Finance eschews the standard banking demands for the creation of a debt obligation with an entitlement to receive interest; instead, the investor has their ownership interests in an asset formally recognized which in turn allows them to draw upon any revenues generated by the value of those assets; 'no revenue = no return'; effective and simple.

Consequently, Islamic Finance had previously moved effortlessly through the global morass of collapsed banks and shredded sovereign wealth without apparent harm or blemish. The reason being is that it operates in a financial environment where individuals and institutions may only invest in products that are not speculative and are rooted in the real economy. In doing so, Islamic Finance has evolved into a product that offered balance, equitable risk share and fairness.

It can be argued that all of the above positivity has been placed in distinct jeopardy by the actions of Dana Gas and the legal action surrounding the case.

Dana Gas executed a US\$700 Million Sukuk debt dated the 8 May 2013 which became due to mature on the 31 October 2017 but was not repaid by Dana Gas as

it engaged in a legal battle with its bondholders and creditors to declare the bond unlawful and unenforceable while rejecting an offer by them to restructure the debt. As Dana Gas' original Sukuk was written under English Law the case was heard in London as to issues relating to the Sukuk bond's original purchase agreement.

Judge George Leggatt ruled on 17 November 2017 that Dana Gas' challenge to the purchase undertaking behind the bonds were "unfounded" and that the agreement was "valid and enforceable" and thus ruled that Dana Gas must repay bondholders because: "All the grounds on which Dana Gas has sought to challenge the validity and enforceability of the Trustee's rights under the Purchase Undertaking to oblige Dana Gas to pay the exercise price are unfounded."

However, Dana Gas lodged an appeal to the High Court ruling because it believed that the bonds were no longer compliant with Islamic law which removed the obligation to pay.

Rather worryingly, Dana Gas had sought permission for more time and a further adjournment via a last minute anti suit injunction obtained by some Dana Gas shareholders from the Sharjah court in the UAE to prevent Dana Gas and the legal representatives of some of its creditors from participating in the London hearings; the Sharjah Court ruling was ignored by the London Court as being an act of deliberate frustration to prevent the case from starting in the UK.

Therefore, Dana Gas prepared for a hearing by a Sharjah UAE court on 25 December 2017 whose legal proceedings presented finality to the issues around a separate Mudarabah agreement by determining whether the very structure of the original Sukuk is permissible under Shariah Law and is valid or not.

It is important to remember that the entire global Sukuk investment market is utterly dependent on the rulings of Islamic scholars. Accordingly, if the manner in which the interpretation and consensus on which structures are Shariah compliant changes, this determines a borrower's obligation to honour its debt.

Dana Gas successful attempts to overrule the London court decision has had wide ranging implications on the Sukuk market. The reason being is that such a decision undermines the sovereignty of the legal system in which the facility was originally written – in this case, the form of investment management partnership known as Mudaraba was written under English Law.

As importantly, a reversal in Dana Gas' favour against a panel of global financial luminaries and Sukuk bondholder representing investors such as Blackrock, Deutsche Bank and Goldman Sachs, has set a precedent that issuers may argue that a change of Shariah compliant interpretation of Islamic finance post inception means that an instrument is no longer Sharia compliant or lawful in the UAE, whereas it was originally. The result of which sees some creditors worldwide to immediately enter into debt restructuring negotiations with the issuer of the Sukuk instrument instead of receiving a regular return on investment or the redemption of the debt at maturity.

In other words, there is the potential that tens of Billions of US\$\$s of supposedly Shariah compliant investments, held by some of the world's biggest financial institutions, may not be worth the paper they are written on – undermining the very foundation and integrity of the Islamic Financial market.



### **The additional impact upon the City of London insurance market**

The UK is the first western country to issue a Sukuk in 2014 and is host to the vast majority of Sukuks sold to global investors. The London insurance market has always prided itself on being able to create and deliver innovative products to help drive the profitability and growth of financial services firms, and it could be argued that the Dana Gas ruling will have a very adverse impact upon the fledgling specialist insurance market that currently services Shariah compliant transactions.

In particular, we could see vast swathes of Shariah compliant capital and liquidity be withdrawn from investment programmes, and the opportunity to source and engage underwriters able to offer their programmes through a Sharia compliant mechanism may be irreversibly lost. Accordingly, the ability to harness the London insurance market's appetite and capacity to generate a suite of solutions with regard to Property, Construction, Casualty, Marine Cargo, Trade Credit, Surety and Professional Risks (including Financial Institutions), will be lost.

## Dana Gas Repayment

On the 15 October 2020, Fitch Ratings in Dubai and London issued a news bulletin that Dana Gas had announced that it would repay the outstanding USD309 million Mudaraba Sukuk on the 31 October 2020.

Dana Gas made good on this promise using a combination of cash reserves and a new USD90 million bank loan. However, Fitch commented that the repayment: “leaves Sukuk legal precedents still lacking.”

Dana Gas issued the following statement on its website on the 2 November 2020:

*“Dana Gas fully redeems its Sukuk  
Sharjah, UAE; 2 November 2020:*

*Dana Gas PJSC (the “Company”), the Middle East’s largest regional private sector natural gas company is pleased to announce that it fully redeemed the \$309 million of the outstanding Sukuk. Receipt of the funds has been confirmed by the Principal Paying Agent, and the Agent will disburse these funds to the clearing systems on the 2 November, the business day following the scheduled redemption date of 31 October 2020. The funds should therefore be received by the clearing system participants on the next business day (3 November), although the timing of receipt for each ultimate holder will depend on individual arrangements with their brokers.*

*The Sukuk (with an original balance of \$530 million) was issued on 31 October 2017, with \$221 million of repurchases taking place during the last three years.*

*As per the announcement on 15th October 2020, the Company now currently has a \$90 million credit facility at the corporate level. Financing costs have been significantly reduced thereby increasing future profitability. Run-rate Sukuk profit payments at the time of issue of the 2017 Sukuk were \$21.2 million per annum given the 4% annual profit rate. Annualized interest cost on the \$90 million corporate facility will be slightly less than \$3 million per annum at the initial margin of 3% plus LIBOR.*

*Dr Patrick Allman-Ward, CEO of Dana Gas, said: “We are pleased to have settled all our obligations with our Sukuk holders as scheduled and have now significantly reduced our ongoing financing costs. We have a strong business model and substantial growth potential from our asset base which includes, (once the previously announced sale of our Egyptian assets completes), two world-class fields in the KRI and a highly prospective offshore block in Egypt.”*

The payment certainly resulted in good “PR” and the global sukuk market avoided the debilitating disruption of a public restructure. However, the long campaign by Dana Gas to have the sukuk declared unlawful, has established deep rooted concerns as to the contract certainty and legal enforceability of the sukuk market.

The out-of-court settlement by Dana Gas means that the creditors legal arguments for enforceability were left untested in the UAE legal system. However, by seeking

legal proceedings in the UAE courts to have their sukuk declared unlawful and unenforceable on the grounds that it was not sharia compliant, it is clear that the actions of Dana Gas, and its refusal to redeem its bonds when they matured, has dramatically impacted the risk management perspective of future partners vis-à-vis sharia compliance and credit risk.

Many holders of sukuk debt remain concerned that they in turn may not be able to declare a debt default because an obligor copies the actions of Dana Gas, for instance, by securing multiple layers of injunctions across global legal courts to prevent the enforcement of a claim pending the resolution of an “enforceability dispute.”



### **Is there a long-term solution?**

It is important to remember that Dana Gas' actions are not representative of the entire Sukuk market and the Islamic finance industry as a whole continues to operate and adhere to the highest internationally accredited standards.

The current 2021 – 2022 Sukuk bond market has an estimated outstanding value of circa USD390 Billion.

For the industry to continue, and not implode, there must be absolute and cast-iron confidence of investors in the integrity, legitimacy and validity of the Shariah compliant due diligence and resulting Sukuk structures. If not, such transactions will be viewed by non-Islamic investors as high risk and unappetizing if the opportunity remains for retroactive invalidation and the removal of distinct legal enforceability.

One can observe that there has been a series of low-level actions to restrain the efforts of obligors from avoiding the enforceability of their sukuk on sharia grounds. Such actions have been through the issuance of enhanced warranties and waivers clauses within the terms and conditions of the sukuk documentation; efforts to standardize the accounting and legal frameworks; the Accounting and Auditing Organization for Islamic Financial Institutions offering updated industry standards; Kuwait and the UAE have both established centralized sharia boards to create a standardized legal framework around Islamic finance transactions.



Notwithstanding the above, these actions are uncoordinated and inconsistent. Most importantly, there has been no centralized position agreed upon by the leading Islamic finance jurisdictions to offer the legal clarity, codification, harmonization and precedent for Sukuk-Al ijarah documentation that would consistently and directly determine a court's interpretations of creditors' rights, obligor's responsibilities, and the application of commercial and shariah law.

The greatest challenge must be to generate a consistent and unified consensus of Fatwas (decrees) to evidence that the regulation and infrastructure is Islamic compliant. This can and should only be driven by a single Board to be created and inserted within the Sukuk market and Islamic financial services domain with overall authority to educate and adjudicate on all Shariah related matters.

The only solution to this is through the creation of a single Shariah Board, perhaps in unison with the AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions). If this comes to pass the Shariah Board's authority and dispute settlement would be accepted by every issuer, financial institution and sovereign legal system wishing to participate in the Islamic Financial industry.

Certainly, I think that both commercially and culturally it is imperative that a centralized body for the Islamic finance industry is created. The reason being is that the moment the Sukuk market is determined by a patchwork of different regulators and scholastic interpretations which is generating different and conflicting applications.

In addition, the creation of a unified Shariah board on a national and international level will have the added benefit of immediately encouraging the further acceptance and development of Islamic finance instruments by standardizing the product management and service delivery. Thus, a consistent platform will be delivered from which the industry can attract a wide diversity of potential investors.

Regardless of the change and evolution of Shariah compliant interpretation, there must be consistency across the following three issues if the potential growth of the sukuk market is not to be irreversibly constrained:

1. The terms and conditions state that the profit rate is paid by the borrower regardless of performance in such a manner that is compliant with Islamic finance doctrine.
2. The terms and conditions state that the repurchase price is pre-fixed regardless of performance in such a manner that is compliant with Islamic finance doctrine.
3. The terms and conditions state that the calculation of payments is based on interest and not profit in such a manner that is compliant with Islamic finance doctrine.

Finally, the Shariah Board could issue a Fatwa (decree) evidencing that once a compliant seal of approval is placed upon a Sukuk, this enforces the generation of regular returns for investors and the borrowers' obligations to honour their debts without infringing Islamic law's prohibition on interest. Accordingly, the decision will remain valid for the life of the bond regardless of whether there is a subsequent shift in assessment and interpretation later on.