

Sukuk and the Phillips Academy Endowment:
Ethical Investment Opportunities in Islamic Finance

Thomas J. C. Smyth

History/Social Science 522: Issues in Economics
Mr. Carroll Perry
31 May 2008

revised 7 July 2008

Leader

Islamic finance - investments and financial instruments that comply with Shariah¹ - is quickly changing from a religious or ethical fringe industry to a smart alternative investment. Of particular interest are sukuk, the Islamic alternative to bonds, which can yield significant benefits for both borrowers and lenders. The sukuk market increased in volume by 73 percent, to \$47.1 billion, in 2007;² sukuk issuances are expected to increase by another 30-35% in 2008.³ Sukuk have even entered North America as a sensible, innovative alternative to bonds or bank loans for businesses – as well as a promising, innovative product for investors, according to an organizer of North America's first sukuk, involving an oil and gas field in the Gulf of Mexico.⁴ Endowments of educational institutions are increasingly looking – or being pressured to look⁵ – at investments that are pro-actively ethical, keeping in line with their educational mission of, in Phillips Academy's case, teaching goodness as well as knowledge. Although Islamic finance faces challenges of standardization and a currency crunch in the Arabian Gulf, it also has significant potential for growth. Wealth continues to stack up in the Gulf Co-operation Council (GCC) region,⁶ and non-Islamic investors find Islamic financial products increasingly appealing. The growing markets of Islamic finance offer a lucrative financial

¹ Islamic law, as written in the Quran and interpreted by generations of Islamic scholars.

² "Global sukuk issues rise by 73% in 2007," ABQ Zawya, 11 February 2007, <http://www.zawya.com/printstory.cfm?storyid=ZAWYA20080211031941&l=031900080211>.

³ Maha Khan Phillips, "Islamic finance suffers from growing pains," Dow Jones Online Financial News, 30 June 2008, <http://www.efinancialnews.com/assetmanagement/index/content/2451040585>.

⁴ Christopher R. Smith, Director of Business Development, Siraj Capital, panel participant at the Islamic Finance World North America conference, New York City, 22 May 2008.

⁵ Carroll Bogert, PA '79, "Enjoy the Reunion. Skip the Check." The New York Times, 25 May 2008, http://www.nytimes.com/2008/05/25/opinion/25bogert.html?_r=1&scp=9&sq=harvard+endowment&st=nyt&oref=slogin.

⁶ Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates. Yemen is in negotiations to join. "Yemen Wants to Join GCC," *APS Diplomat Recorder*, 12 May 2005, http://goliath.ecnext.com/coms2/gi_0199-4297428/ARAB-AFFAIRS-Mar-7-Yemen.html.

opportunity for Phillips Academy's endowment as well as a proactively ethical investment that reinforces the school's core values.

Introduction to Islamic finance

A Brief History of Islamic Finance

Islamic finance began as a Shariah-based critique of Western banking, and now runs largely parallel to it. The Islamic banking typically replaces or supplements conventional financial instruments with Islamic ones. There are three major prohibitions in Islamic finance: against *riba*, or interest; *maysir*, or gambling; and *gharar*, which includes betting and deliberate deception.⁷ Examples of *riba* are conventional mortgages, bonds, and types of cash like commercial paper. *Maysir* investments in conventional finance include speculation, conventional insurance, and derivatives. *Gharar* applies to short selling, as well as derivatives (although both of these could become possible with new, controversial Islamic financial products).⁸ Of the wide spectrum of Islamic financial products, some of the most notable are *ijara*, where a bank makes a purchase on behalf of a consumer then leases the purchased item back for a period of time; *murabaha*, like *ijara* but the customer buys the asset from the bank over a series of payments; and *mudaraba*, an investment partnership that functions like a sweat-equity form of venture capital.^{9,10} *Murabaha* offers one of the clearest examples of Islamic finance's central premise: rather than paying the bank back for the use of its money, the customer is purchasing an asset from the bank. The benefit is that the bank is more inclined to make safe loans because it has a financial interest in the quality of the purchased asset and the customer's investment decisions. The vocabulary of Islamic finance can seem dizzying at first – for a newcomer to ordinary finance, doubly so – but quickly makes sense.

⁷ Gulf Business Intelligence, *The Guide to Islamic Banking and Finance* (Bahrain: Dar Ahkbar Al Khaleej, 2008), 1.

⁸ *Glossary of terms used in Islamic banking*, Calyon, Credit Agricole CIB, <http://www.calyon.com/pdf-en/glossary-ibp.pdf>.

⁹ *Glossary*, Calyon.

¹⁰ Ayman Khaleq, Partner, Vinson and Elkins LLP, speaker at the Islamic Finance World North America conference, New York City, 22 May 2008.

In 1953, Islamic economists theorized a bank without interest, in keeping with the requirements of the Quran.¹¹ In 1975, Dubai Islamic Bank and the Islamic Development Bank (in Saudi Arabia) were founded using financial *murabaha*, cost-plus financing.^{12,13} Three of the most politically Islamic countries – Pakistan, Iran, and Sudan – announced in the 1980s that they would overhaul their entire financial system to “comply with Shariah rules and principles.”¹⁴

In the past decade Islamic finance – with its banks, investors, and regulators – has grown rapidly, also attracting non-Islamic investors. Today there are more than 500 Shariah-compliant funds around the world, with 153 of those launched in 2007. Ernst & Young, an accounting firm, predicts that there will be 1000 Shariah-compliant funds by 2010.¹⁵ Those funds, in aggregate, manage about \$500 billion in assets. Traditional Islamic banks hold about 75% of those assets; investment banks manage about 13%; and 12% are in sukuk and other assets, “clearly indicating that there is significant room for growth in alternative Islamic fund products.”¹⁶ It appears that Islamic finance is not just a fad.

Global sukuk - successes and challenges

Sukuk: different from bonds

Sukuk (suh-KOOK; plural), often incorrectly called “Islamic bonds,” are like a bond but use equity rather than debt, creating an ownership claim rather than a financial claim.¹⁷ The value of sukuk is based on the underlying assets, rather than simply being

¹¹ Gulf Business Intelligence, 136.

¹² Ibid., 137.

¹³ Ibid., 168.

¹⁴ Ibid., 137.

¹⁵ “Islamic investors ‘ignore’ important assets, *Reuters* through *Arabian Business*, 28 May 2008, <http://www.arabianbusiness.com/520533-islamic-investing-must-diversify-to-compete-report?ln=en>.

¹⁶ Christian Mouchbahani, CEO, Jefferies Middle East and North Africa, quoted in “Islamic Finance increasingly appealing to global finance industry,” *Arabian Business*, 27 May 2008, http://www.arabianbusiness.com/press_releases/detail/19799?ln=en.

¹⁷ Khaleq.

backed by collateral like a bond. Sukuk have “evidence of underlying assets and transactions,” rather than being a debt instrument, and requires the buyer's participation in risk, i.e. there is no guaranteed investment income because of the risk of the underlying assets.¹⁸ The attraction of sukuk is widening because of the difference in their risk profile from conventional bonds, i.e. investors cannot use them to bet on interest rate movements; their linkage to tangible assets minimizes speculative trading, with the financial crises that come with it; and sukuk market participants, because they are buying or selling assets, demand more information than typical investors.¹⁹ Shariah rules also prohibit sukuk, and Islamic banks, from investments in alcohol, weapons producers, gambling, tobacco products, etc.²⁰ Conventional banks and hedge funds, rather than Islamic investors, are the largest subscribers to sukuk.²¹ The primary investors in sukuk are non-Islamic banks in the Gulf and European banks.²² Around 60-70% of sukuk are in real estate, with infrastructure and shipping the next two largest categories.²³ Currently, there is a \$200 billion worldwide sukuk market, expected to grow by another \$50 billion in 2008, which will further develop capital markets for Islamic banks.²⁴ Sukuk can be listed on exchanges like Bahrain and the Dubai International Financial Centre (DIFC), although because very little trading in sukuk occurs through exchanges, the listings are largely “an academic exercise so far,” according to the managing director of one Islamic

¹⁸ Andreas A. Jobst, “The Economics of Islamic Finance and Securitization,” IMF working paper, International Monetary Fund, August 2007, 19.

¹⁹ Ali Arsalan Tariq, “Managing Financial Risks of Sukuk Structures,” dissertation, September 2004, 55.

²⁰ Phillips, “Islamic finance suffers from growing pains.”

²¹ Sheikh Nizam Yaqubi, speaker at the Islamic Finance World North America conference, New York City, 22 May 2008. Sh. Nizam is an Islamic scholar based in Bahrain and a Shariah Advisory Board member for several companies, including Arab Banking Corporation Islamic Bank, the Dow Jones Islamic Index, Bahrain Islamic Bank, Citi Islamic Investment Bank, Capital Management House, according to “Sharia’a Board,” Capital Management House, <http://www.capitalmh.com/sharia.htm>.

²² David Testa, CEO, Gatehouse Bank, panel participant at the Islamic Finance World North America conference, New York City, 22 May 2008. Gatehouse was the fifth Islamic banking institution in London to be proved by the UK’s Financial Services Authority.

²³ Khaleq.

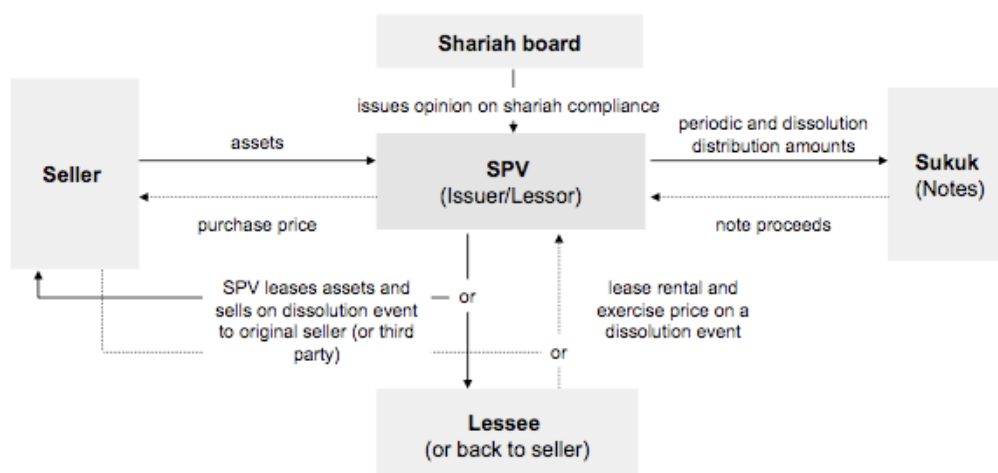
²⁴ Isam Salah, Partner, King & Spalding LLP, panel participant at the Islamic Finance World North America conference, New York City, 22 May 2008.

bank.²⁵

The evolution of sukuk

Creditworthy nations like Malaysia and Bahrain initially propelled the sukuk market, and as they enticed investors who wanted to buy into sovereign credit, the risk associated with the underlying assets became incidental because of the size of the issuing governments. The credit risk lay with the country, not the assets.²⁶ This is still largely true today as private companies issue sukuk, although there is a commitment on the part of many Islamic bankers and especially Shariah advisers to move toward asset-backed rather than asset-based sukuk.²⁷ Islamic investors, bankers, and Shariah advisers are pressuring banks to make the sukuk market truly asset-backed and move away from simple, fixed-income instruments.²⁸

The concept of an ijarah sukuk transaction.



from Andreas A. Jobst, "The Economics of Islamic Finance and Securitization," IMF working paper, International Monetary Fund, August 2007, 19.

²⁵ Naveed Khan, Managing Director, Arab Banking Corporation Islamic Bank, email to author, 17 May 2008.

²⁶ Jobst, 23.

²⁷ Sh. Nizam.

²⁸ Khaleq.

Challenges

Islamic banking markets can help to fill the gap in liquidity caused by the worldwide credit crunch, as Islamic banks have hardly been touched by the subprime mortgage crisis.²⁹ However, the sukuk market has faced troubles of its own in recent months, with a nearly full stop in Gulf sukuk issuances. There is a restricted appetite on the part of investors for hard-currency assets, especially dollar-denominated assets. But Gulf countries are still saying that they will not de-peg their currencies from the dollar, because most of these countries' imports of raw supplies for massive infrastructure projects are made in dollars.³⁰ Many banks do not want dollars, making the sukuk slowdown more of a currency problem than a credit problem. But bankers are seeing the first "signs on life" of the sukuk market returning.³¹ Some recent sukuk issues have been in the U.A.E.'s currency, the dirham, in which "issuers and investors both have taken refuge."³² Much of the region's liquidity outside of the central banks is shifting from the dollar into GCC currencies, because of the dollar's weakening and an expectation that GCC central banks will be forced to break the dollar peg soon, especially because of rapidly rising inflation.³³

The lack of liquidity in the secondary sukuk market also presents a problem for investors and reduces investor appetite for longer-term sukuk issuances. Sukuk are largely illiquid because of "the structural mismatch that Islamic liabilities far exceed tradable Islamic assets. Most Sukuk issues are held to maturity by subscribing investors," according to one Islamic bank director.³⁴

The pricing of these assets is still unreliable, because of LIBOR fluctuations;

²⁹ Naveed Khan, conversation with author, 22 May 2008.

³⁰ Smith, 22 May 2008.

³¹ Testa.

³² Khan, email to author, 17 May 2008.

³³ Ibid.

³⁴ Khan, 17 May 2008.

currency problems; a lack of standardization in what is still a relatively small market; and the mis-application of standard bond pricing models. Also, different banks can have wildly inconsistent pricing for sukuk depending on how the banks themselves have been affected by the credit crunch.³⁵ The standard bond-pricing models overprice sukuk because these models factor in short-selling, which is not permitted under Shariah.³⁶

Currently the sukuk market (like conventional bonds in the Gulf) is relatively short-term, a sign that the market is still developing. Most sukuk are for 3 - 5 years, with the longest at about 7 years.³⁷ There has been a recent trend toward the lengthening of maturities, with most at 5 years, but “until the market stabilises this trend might be put on hold.”³⁸ This may change thanks to the growth of the Islamic mortgage industry, as securities appear with 20 - 30 year repayment on underlying assets.³⁹ There are not enough issuances yet to create a consistent secondary market, in which sukuk holders can trade ownership of sukuk after they are initially bought from the issuer.⁴⁰

Another problem is that Shariah boards at different banks have issued contradictory rulings on the permissibility of different types of sukuk.⁴¹ The Accounting and Auditing Organization of Islamic Finance Institutions (AAOIFI) is working to standardize sukuk structures, and currently recognizes 14 different types of sukuk.⁴² Greater standardization will be critical to success as the sukuk market grows in the next few years.

The North American sukuk market and East Cameron Partners

³⁵ Smith, 22 May 2008.

³⁶ Jobst,

³⁷ Christopher R. Smith, Director of Business Development, Siraj Capital, phone conversation with author, 29 May 2008.

³⁸ Khan, 17 May 2008.

³⁹ Smith, 29 May 2008.

⁴⁰ Sh. Nizam.

⁴¹ Ibid.

⁴² Jobst.

The North American sukuk market is in its first stages of development. There are two advantages for North American issuers of sukuk: for some, the pricing is superior that a normal bond issue. For other firms, especially those with business interests in the Gulf, a sukuk issuance offers a public relations value to investors and clients.⁴³

The first sukuk in North America, for \$166 million, was issued in 2006 by the East Cameron Gas Company and involved the securitization of hydrocarbon sales from two fields off of the Louisiana coast. In the deal, two special-purpose vehicles were created: one issuer SPV (special-purpose vehicle), which was funded by a purchaser SPV. The purchaser SPV receives a fractional interest in the gross product of oil and gas from these two fields, free of production expense, until a stated quantity is delivered. (For legal purposes, this is defined as overriding royalty interest - ORRI - which is considered interest in real property.⁴⁴) The risks associated with owning this property include hurricanes in the Gulf of Mexico and potential inaccuracies in reserve reports.

The East Cameron sukuk achieved quasi-mezzanine status – comparable to private equity or hedge fund debt - and garnered an S&P rating. It satisfied Shariah with its simultaneous risk and reward opportunities for investors. It brought sukuk into a new sector in North America, oil and gas.⁴⁵ The approximately 10 investors in the sukuk were about three-fourths non-Islamic, and these investors said that they were interested in the sukuk primarily because it was a new asset class. The \$166 million sukuk's largest investor held \$30 million while the smallest held about \$5 million.⁴⁶

Islamic finance was an attractive alternative source of financing for East Cameron because they had previously had difficulty getting reasonable financing. Before East

⁴³ Christopher Messina, Managing Director, Mannahatta Partners, panel participant at the Islamic Finance World North America conference, New York City, 22 May 2008.

⁴⁴ There were two ORRI's in the deal: "Purchased" and "Contributed." "Purchased" is when an investor buys a revenue stream - a percentage of the oil and gas that comes out of the field. "Contributed" is akin to a trade, where a percentage of the revenue stream is exchanged for more physical capital, like drilling equipment.

⁴⁵ Khaleq.

⁴⁶ Smith, 29 May 2008.

Cameron's sukuk issuance, they were financed by a loan at 18% from Macquarie, an international investment bank, which also demanded 50% of the fields' equity. The sukuk allowed East Cameron to retain all of its equity at the end of the payments, at an interest rate within 100 basis points of that offered by big private equity firms and hedge funds.⁴⁷

A sunny sukuk future

Two or three more North American sukuk are expected this year, and leaders in Islamic finance talk excitedly about the prospect of the United States government issuing a sukuk in the next 5 to 10 years.^{48,49} But sukuk offerings in the United States will also be difficult if the dollar will continue to weaken.⁵⁰ Across the pond, the United Kingdom is seriously considering a sovereign sukuk offering, spurred by increasing investment in Islamic finance by London-based banks.⁵¹ Additionally, one of the next sectors primed for sukuk issuances is the shipping industry, although valuation questions remain.⁵²

Banks in the Gulf, Europe, and now North America hope to further innovate the sukuk market. One new type of sukuk is more like an IPO or a bond issue by a private-equity firm. This sukuk issuance is intended to raise money to buy a privately held company. When the company is taken public, investments in the sukuk are converted into tradable shares in the new company.⁵³

The future of Islamic finance – challenges and prospects

Two paths lie before Islamic finance: to remain a niche market or to explode into the financial mainstream.

⁴⁷ Ibid.

⁴⁸ Khaleq.

⁴⁹ Smith, 22 May 2008.

⁵⁰ Jobst.

⁵¹ Smith, 29 May 2008.

⁵² Messina.

⁵³ Khaleq.

The growth of Islamic banks in the next few years depends on several tasks within the banks: creating new Islamic banks that, through increased volume and diversification, deepen the capital markets, and increasing regulation and standardization, especially of Shariah rulings. Islamic banks must expand on their parallel banking systems, e.g. build Islamic finance-specific technology for processing transactions rather than going through conventional banks. In their small but growing group of financiers, Islamic banks must also be wary of conflicts of interests, especially on Shariah boards (where Islamic scholars, of which there are few, often serve on several boards at once).^{54,55}

Islamic banks must also diversify their own holdings. Sukuk, commodities, and Islamic Real Estate Investment Trusts (REITS) are all under-utilized by Islamic funds, which are mostly overweight in equities compared to the allocation of conventional funds. (This has depressed investor appetite in Saudi Arabia after its 2006 stock market crash.)⁵⁶

Outside of the banks, Islamic financiers must educate and negotiate with government regulators to clear some of the complexity of Islamic financial instruments; and educate investors, especially non-Islamic investors, to spark interest in Islamic finance. A sukuk issuance can be difficult for investors ingrained in the conventional financial system. But these are not just “Islamic bonds.” Sukuk represent a wholly new class of investment, which many investors look to for their diversity and incomplete correlation with conventional bonds.

⁵⁴ Ibid.

⁵⁵ Wayne Arnold, “Adapting Finance to Islam,” *The New York Times*, 22 November 2007, <http://www.nytimes.com/2007/11/22/business/worldbusiness/22islamic.html?scp=2&sq=nizam&st=nyt>.

⁵⁶ “Islamic investors ‘ignore’ important assets, *Reuters* through *Arabian Business*.

Currency problems: the slow decline of the dollar

Also outside of Islamic banks' purview is the currency crunch, which more than the global credit crunch has dampened enthusiasm for Gulf investments, including Islamic investments.

Gulf nations are reconsidering their currency pegs to the dollar (and some investors are betting that they are strongly considering breaking the pegs).⁵⁷ But the building boom is still strong in the UAE and Saudi Arabia, and most of the raw materials for construction are imported and paid for in US dollars. These imports are a major factor in keeping Gulf currencies (besides Kuwait's) pegged to the dollar. Barring a significant deterioration in the value of the dollar, Gulf countries will likely stick to the dollar peg for a few more years.⁵⁸

Some Gulf investors have turned to the EIBOR (Emirates Interbank Offered Rate) in the past six months because of the LIBOR's inaccurate representation of the true, underlying interest rate market. (EIBOR is used when the sukuk is dirham-denominated; the LIBOR is for dollar-denominated sukuk.⁵⁹) But in recent months the LIBOR spread with the ECB's and Fed's interest rates has diminished, pointing to a normalization of the inter-bank lending markets in Europe and elsewhere. Now that the initial stimulus for using the EIBOR has evaporated, the choice between EIBOR and LIBOR (for Islamic financial instruments like sukuk offered by Gulf banks) represents a more fundamental question facing the entire Gulf region: how long should it piggyback, financially, on the EU and United States, and when should it use its own parallel interest-rate measure? This question underlines the fundamental premise of Islamic finance, which delicately balances Shariah compliance with a Western financial system desperate for returns.

⁵⁷ Joanna Slater, "Investors Bet Persian Gulf Will Loosen Dollar Pegs," *The Wall Street Journal*, 27 May 2008, <http://online.wsj.com/article/SB121184187238821161.html>.

⁵⁸ Smith, 29 May 2008.

⁵⁹ Khan, 22 May 2008.

The Phillips Academy endowment: ethical investing and Islamic finance

How to get in

Siraj Capital is an Islamic asset-management fund that specializes in hospitality and tourism in the Gulf but also is building North American investments. Their investments in the Gulf include construction projects, a Holiday Inn Express hotel chain aimed at the growing number of business travelers, and housing for immigrant laborers. Siraj offers funds that invest in all of these, with much of the value coming from real estate and hotel revenue.⁶⁰

Siraj also structured the first sukuk in North America, that of East Cameron Partners. Following this success, Siraj is creating a \$100 million oil and gas fund targeting North American assets. Investors will buy in primarily in amounts of \$5 - 10 million, and the fund will lend to U.S. small- and medium-size oil and gas exploration and development companies.⁶¹

Phillips Academy could buy into one of these funds, or invest directly in a sukuk offering from a private company or government. Islamic finance offers a solid investment opportunity in the GCC and also an innovative financial product in North America.

Ethical investing

The phrase “ethical investing” not only appears in press releases from the Yale Corporation and Phillips Academy's Board of Trustees but also in brand-new Dow Jones and S&P indices.⁶² Dow Jones' Islamic Market Index measures proactive investment opportunities, while the Trustees' recent decision to divest from Darfur is reactive. Both proactive and reactive investment decisions are necessary to seriously uphold the responsibility to invest ethically. To date, Phillips Academy has not fully considered

⁶⁰ Smith, 29 May 2008.

⁶¹ Ibid.

⁶² The Dow Jones Dharma Global Index, which measures "the performance of stocks on a global basis in accordance with Dharmic religious traditions," is up 18.54% in the five years to March 31, 2008, according to the index's promotional flyer published by Dow Jones.

proactive ethical investment opportunities. Islamic finance offers one such option. Of course the Trustees must balance the push for ethical investing with a need for solid returns in fast-growing markets, perhaps as part of a shift in the endowment to a 15% allocation in emerging markets.

Unethical investments – heavy usury, predatory lending, a system of making money off of money - led to the subprime mortgage crisis that has blown up over the past year. Much of the financial wizardry that securitized and then manipulated subprime mortgages - e.g., special investment vehicles (SIVs) - was designed to create value out of the repackaging rather than the underlying assets.⁶³ Conventional banks in the Gulf, like so many banks around the world, were hit hard by the drop in subprime mortgage value; but Islamic banks were untouched. Arab Banking Corporation Islamic Bank was unaffected by the subprime crisis because it had no exposure to un-Islamic subprime assets. However, its parent bank, Arab Banking Corporation, wrote down nearly \$500 million in subprime mortgages, which were held as part of a conventional investment banking strategy.^{64, 65}

Assuming that institutional investors like Phillips Academy commit to a serious program of pro-active ethical investing, the question is what to invest in. Sukuk and other Islamic financial instruments offer a less risky investment opportunity than, for example, a green-tech company. Even if a green-tech company has a promising idea, it has no significant collateral or assets (besides, perhaps, the innovation of its management). If this sort of company issues a 5 - 7 year bond, the payments are backloaded, because it could take two years or more to ramp up production. The companies that Islamic funds pick for investment offer tangible assets up front, like real estate or oil reserves, and therefore pay

⁶³ Testa.

⁶⁴ Joel Bowman, "Subprime crisis hits more Gulf banks," *Arabian Business*, 3 March 2008, <http://www.arabianbusiness.com/512685-gulf-banks-hit-by-subprime-crisis?ln=en>.

⁶⁵ John Irish, "Arab Banking profit falls on US writedowns," *Arabian Business*, 4 February 2008, <http://www.arabianbusiness.com/510139-arab-banking-profit-falls-on-us-writedowns?ln=en>.

a more reliable, regular rate.⁶⁶

Synergy with the curriculum

As Phillips Academy expands its education outlook to the entire globe, its Investment Office must also look farther afield. This year, Phillips Academy introduced an Arabic class for the spring term. Taught by a Fulbright scholar from Iraq, students learned the alphabet and conversational phrases spoken by 250 million people around the world (and recognized by more than a billion).⁶⁷ Perhaps shifts in curricula also correlate to market movements; the massive oil wealth building up in the Middle East has spurred an enormous wave of growth, along with an increasing number of investment opportunities available to foreign investors. In recruitment, too, Phillips Academy has been slow to attract students from the Middle East. Summer trips with PA students also have neglected travel to the Middle East. Synergies exist with a new expansion – for the endowment, in the curriculum, and in recruitment - from Andover to Arabic-speaking nations.

Ethics and modernization

Islamic finance is both a by-product of and a reaction against modern banking; it protests the dog-eat-dog securitization practices and other financial mechanisms that alienate the customer from the bank, or, in a recent example, the subprime mortgage borrowers from the holder of the actual mortgage. But Islamic finance also must be competitive with conventional finance and offer returns to serious investors, especially as it expands to a non-Islamic audience. Ultimately, Islamic finance proves that the ethical injunctions of Shariah can go hand-in-hand with superior returns and smart, mutually beneficial investments.

⁶⁶ Smith, 29 May 2008.

⁶⁷ Tore Kjeilen, *Arabic*, Looklex Encyclopaedia, 2008, <http://i-cias.com/e.o/arabic.htm>.

Similarly, Phillips Academy's endowment should seek not just to balance but to conjoin the school's values of honesty and non sibi with Exeter-beating returns. Subprime mortgages were not just unethical; they lost a lot of money for a lot of people. For Phillips Academy, Islamic finance offers an alternative investment that fits into the school's plans to increase its emerging market allocation and also re-vamp its moral education class ("Life Issues"). Investing ethically can be the best way to make money.

Bibliography of Works Cited

This non-standard bibliography reflects the common use in the Middle East of addressing others by their first names rather than last name. E.g., instead of Mr. Khan, one would say "Syed Naveed." Many thanks to Syed Naveed for teaching me this lesson, among many others, and giving me access to the people most informed of Islamic finance. This paper would not have been possible without his help.

Ali Arsalan Tariq. "Managing Financial Risks of Sukuk Structures." Dissertation. September 2004.

Andreas A. Jobst. "The Economics of Islamic Finance and Securitization." IMF working paper. International Monetary Fund, August 2007.

Ayman Khaleq, Partner, Vinson and Elkins LLP, speaker at the Islamic Finance World North America conference. New York City, 22 May 2008.

Carroll Bogert, PA '79. "Enjoy the Reunion. Skip the Check." *The New York Times*, 25 May 2008. http://www.nytimes.com/2008/05/25/opinion/25bogert.html?_r=1&scp=9&sq=harvard+endowment&st=nyt&oref=slogin.

Christian Mouchbahani, CEO, Jefferies Middle East and North Africa, quoted in "Islamic Finance increasingly appealing to global finance industry." *Arabian Business*, 27 May 2008. http://www.arabianbusiness.com/press_releases/detail/19799?ln=en.

Christopher Messina, Managing Director, Mannahatta Partners, panel participant at the Islamic Finance World North America conference. New York City, 22 May 2008.

Christopher R. Smith, Director of Business Development, Siraj Capital, panel participant at the Islamic Finance World North America conference. New York City, 22 May 2008.

Christopher R. Smith, phone conversation with author, 29 May 2008.

David Testa, CEO, Gatehouse Bank, panel participant at the Islamic Finance World North America conference. New York City, 22 May 2008.

Dow Jones Dharma Global Index, promotional flyer, Dow Jones.

“Global sukuk issues rise by 73% in 2007.” ABQ Zawya, 11 February 2007. <http://www.zawya.com/printstory.cfm?storyid=ZAWYA20080211031941&l=031900080211>.

Glossary of terms used in Islamic banking. Calyon, Credit Agricole CIB. <http://www.calyon.com/pdf-en/glossary-ibp.pdf>.

Gulf Business Intelligence. *The Guide to Islamic Banking and Finance*. Bahrain: Dar Ahkbar Al Khaleej, 2008.

Isam Salah, Partner, King & Spalding LLP, panel participant at the Islamic Finance World North America conference. New York City, 22 May 2008.

“Islamic investors ‘ignore’ important assets.” *Reuters* through *Arabian Business*, 28 May 2008. <http://www.arabianbusiness.com/520533-islamic-investing-must-diversify-to-compete-report?ln=en>.

Joel Bowman. “Subprime crisis hits more Gulf banks.” *Arabian Business*, 3 March 2008. <http://www.arabianbusiness.com/512685-gulf-banks-hit-by-subprime-crisis?ln=en>.

John Irish. “Arab Banking profit falls on US writedowns.” *Arabian Business*, 4 February 2008. <http://www.arabianbusiness.com/510139-arab-banking-profit-falls-on-us-writedowns?ln=en>.

Maha Khan Phillips, “Islamic finance suffers from growing pains,” Dow Jones Online Financial News, 30 June 2008, <http://www.efinancialnews.com/assetmanagement/index/content/2451040585>.

Naveed Khan, Managing Director, Arab Banking Corporation Islamic Bank, conversation with author, 22 May 2008.

Naveed Khan, Managing Director, Arab Banking Corporation Islamic Bank, email to author, 17 May 2008.

“Sharia’a Board.” Capital Management House. <http://www.capitalmh.com/sharia.htm>.

Sheikh Nizam Yaqubi, Shariah scholar, speaker at the Islamic Finance World North America conference. New York City, 22 May 2008.

Tore Kjeilen. *Arabic*. Looklex Encyclopaedia, 2008. <http://i-cias.com/e.o/arabic.htm>.

Wayne Arnold. "Adapting Finance to Islam." *The New York Times*, 22 November 2007. <http://www.nytimes.com/2007/11/22/business/worldbusiness/22islamic.html?scp=2&sq=nizam&st=nyt>.

"Yemen Wants to Join GCC." *APS Diplomat Recorder*, 12 May 2005. http://goliath.ecnext.com/coms2/gi_0199-4297428/ARAB-AFFAIRS-Mar-7-Yemen.html.