

## Islamic Finance *news* speaks to lawyer Ziad H. Dannaoui, from Alem & Associates, Lebanon

“Islamic banking in Lebanon has been growing in a slow but steady rhythm over the last couple of years,” claims Ziad H. Dannaoui, a lawyer with the Lebanese law firm Alem & Associates. “Recent regulations were issued by the Lebanese Central Bank, new Islamic banks were licensed and existing Islamic banks expanded their network of branches. These constitute relatively important developments considering the instable political situation that took Lebanon by storm since 2005, and constitute solid grounds to build on in the future when stability is restored.”

“In tandem with the above developments,” he continued, “L’ecole Superieure Des Affaires in Beirut launched an Islamic finance qualification program in cooperation with the Securities and Investment Institute, a program that will qualify professionals to answer to the needs of the Islamic banking sector in Lebanon and the Middle East.”

When questioned about the reasons behind the slower pace of growth for Islamic banking in Lebanon – when compared with its geographical neighbours, and also with expectations – Ziad commented: “Indeed it has been slower compared to the region. Many factors contributed to such slow pace, some of which are related to the demographic composition of the Lebanese society compared to the region, the lack of understanding of Islamic contracts by the general public, the legacy of conventional banks which is entrenched into the Lebanese business community, while other factors are related to the relatively thin specialized regulatory and supervisory framework, the lack of advanced corporate governance rules that entice investors to invest in Islamic banks, the relatively high taxes compared to the region, which impacts the flow of regional deposits, as well as the ability of the Lebanese Islamic banks to structure and sell Islamic products to the regional investor and to the non-existence of an Islamic money market.”

Ziad believes that the government have an important job to do in order to promote Islamic finance in the country. They have begun well, in his view: “Starting from the law regulating the establishment of Islamic banks in Lebanon back in 2004 and throughout the recent regulations and circulars regulating Islamic collective investment schemes, Mudarabah, Musharakah, Salam, Murabahah and Istisnah contracts. Such laws and circulars provide a complete platform for financial institutions and professional service providers to conduct Islamic banking activities in Lebanon.”

Examining at the laws in more detail, Ziad continues: “On the 11<sup>th</sup> February 2004, Law No. 575 regulating the establishment of Islamic banks in Lebanon was promulgated. The law provides the legal framework regulating the establishment of banks, of which the Articles of Association comprise an undertaking not to contravene, in the operations they carry out, the provisions of Islamic law (Shariah), particularly with the prohibition to pay or receive interest.”

“Except for specific exclusions cited in the law, Islamic banks are also governed by all legal and regulatory provisions in force in Lebanon, particularly those relating directly or indirectly to banks, including the Code of Commerce, the Code of Money and Credit and the Banking Secrecy Law.”

More recently, on the 9<sup>th</sup> December 2005, the Lebanese government enacted Law No. 705 regulating the securitization activities in Lebanon. Ziad explains that: “the law provided an advanced framework for securitization transactions (a framework which did not exist previously) which also applies, to the extent that it does not contravene the Shariah, to Islamic securitization funds.”

### “The new securitization law provided the platform for Sukuk issuances to originate from Lebanon. However, the main challenges and hurdles will be to originate Shariah compliant assets in Lebanon”

“The main benefits of the law,” he explained, “included the possibility to set the fund as an independent portfolio that does not have legal personality and that may be set as a special purpose vehicle (SPV) for the purposes of the securitization transaction; a simple mechanism to transfer rights over certain classes of assets that normally require registration, announcement and approval of the creditors (i.e. real estate, aircraft, motor vehicles, commercial establishments); substantial reductions on duties and taxes payable by the fund or the SPV as per the following:

- a 50% reduction on duties related to the transfer of real estate which the fund/SPV acquires or disposes of;
- a 50% reduction on duties for registering movable assets that the fund/SPV acquires or disposes of; and
- exemption from income tax on profits accumulated by the fund/SPV and on profits resulting from the liquidation of the fund/SPV.”

“The new securitization law provided the platform for Sukuk issuances to originate from Lebanon,” Ziad outlines. “However, the main challenges and hurdles will be to originate Shariah compliant assets in Lebanon, as well as to structure the issuance with rates that may compete with the cost of conventional financing that are offered in Lebanon.”

Despite the good work that the regulators have done over the past years, there is still much to be done in order to improve the environment for the benefit of Islamic finance. The small size of Lebanon’s economy, Ziad believes, “limits the horizon for expansion of the Islamic banking business at a large scale. However, considering the abundance of highly qualified professionals, the quality educational system, professional firms, IT infrastructure, and western quality of life, Lebanon may play a regional role in Islamic banking. Definitely, an offshore banking regulation will provide Lebanon with a springboard for

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the industry to go to the next step, especially if it is coupled with a clear, efficient and transparent dispute resolution system that mitigates the local legal risks.”

### “Spread awareness of the Islamic products; sell the industry as a balanced and ethical banking that is relationship oriented with competitive rates”

Moving on from regulators to the specific work that Alem & Associates is doing in the Islamic finance arena, we talk to Ziad about the active role that the firm is taking in Islamic finance. “Our team advises and adds value to key players in the Islamic finance arena in Lebanon and the GCC. We also carve innovative structured finance solutions within complex regulatory frameworks in the region, paving the road ahead of investors, arrangers, and even regulators to expand the practice and market share of Islamic finance.”

“Spreading awareness of Islamic banking and its main contracts constitutes a cornerstone in our strategy to expand our practice both horizontally and vertically. Clients and business owners require guidance and constant information streams to better understand Islamic finance and to show it on their radar as an alternative financing mechanism that may compete with the conventional methods that they normally utilize. Our lawyers, through workshops, work groups and in-house presentations, answer to such needs and provide a reliable source of information to business owners.”

Alem & Associates is working with the authorities in order to improve the situation for Islamic finance. “We recently submitted to the International Finance Corporation (IFC) a detailed report including a review of the legal and regulatory framework pertaining to bank corporate governance in Lebanon (which applies to both conventional and Islamic banks) and proposing the creation and amendment of existing laws and regulations in this respect. The report was issued in June 2006 by the IFC. The findings of our report would positively contribute to the Islamic banking industry in Lebanon through introducing higher transparency levels and more protection to the shareholders and the depositors.”

For the future, the firm has plans to consolidate the practice in 2007, “by creating a bigger team that will service our regional presence. We believe that such consolidation will provide our clients with the chance to use our understanding of the region and the possible alternatives that may be offered to investors as well as arrangers to accomplish efficient and innovative structures and products.”

“We strongly believe that Islamic finance has passed the ‘pilot’ stage and is now only meant to grow in the region as well as in Asia, Europe and North America. Therefore, our strategy for the practice

is to capitalize on the increasing flow of cross-investments between the Middle East and Asia by providing investors on both ends with harmonized legal service in both GCC and Asia. The road map towards executing our strategy has been recently set and the prospects are looking really positive.”

Touching once again on the firm’s geographic expansion plans, Ziad reveals: “Alem & Associates recently entered into an association with the Law Office of Al Tayyar in Saudi Arabia whereby we have been active in the field of structuring Sukuk, Islamic funds, setting up of Islamic leasing companies and Takaful businesses. In addition to our existing associations with firms in Syria and Jordan, we received our in-principle license from the Dubai International Financial Center (DIFC) and we are planning to be directly present in Dubai soon. Bahrain and Qatar are also on our radar and will be part of our plans for 2008.”

Ziad believes that the following factors will be key drivers of growth in the Islamic finance industry, going forward: “Development of the practice, understanding of people and of the products, the perfection of the product to compete with conventional products, more business groups going Islamic, regional capital markets, potential sophisticated products (hedge funds, index funds), the trusted regulators in the region establishing Islamic finance at a credible level, higher income in the region, development and growth, oil prices, cross-investments in Asia, the fact that Islamic finance is more fair, and finally, faith.”

We asked Ziad what he expected to see in the future of Islamic finance, and which products would feature heavily over the coming years. His response was: “Islamic hedge funds, development of Islamic money markets – Islamic equivalent of debt markets – and Islamic mortgage facilities will probably constitute the main areas where the development of the industry will evolve.”

Ziad’s tactics for attracting non-Muslims to Islamic finance products is simple: “Spread awareness of the Islamic products; sell the industry as a balanced and ethical banking that is relationship oriented with competitive rates.” ☺

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