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ETFs launches Shariah-compliant ETCs Mushtak Parker | Arab News

LONDON: Another sign of the steadily growing sophistication and maturity of the rapidly-growing Islamic finance industry is the recent launch in London by ETF Securities (ETFs) of what it claims to be "the world's first Shariah-compliant, precious metal, exchange-traded commodity (ETC) platform" based on physical platinum, palladium, silver, gold and a basket of the above metals.

The exciting thing about Shariah-compliant ETCs, said Sameer Meralli, head of sales for Middle East and North Africa at ETF Securities, is that they are a purer form of Islamic commodity transactions, for instance compared with Murabaha (cost-plus financing). In an ETC, investors do not have to worry about margins, delivery or the underlying assets.

"In Shariah, the common issue of a commodity Murabaha contract is that it cannot feasibly be structured for gold and silver. With the ETFs physical precious metals ETCs, the nominate transaction is an entirely different structure. In purchasing the security, the investor obtains an allocated physical entitlement to the underlying bullion and his return is tied directly to the spot price of that precious metal less the management fee," he explained.

An ETC, according to Meralli, formerly with Goldman Sachs and Deutsche Bank, is very similar to an ETF (exchange-traded fund). However, it is a security structure not a fund. "Conceptually, an ETC offers investors a simple, efficient and cost-effective way to access commodities via a priced security listed on a regulated exchange. ETCs trade and settle the same as equities. ETCs are open-ended and can be created and redeemed to demand. ETCs are simple to access as they are traded in three currencies (euros, US dollars and sterling)," he explained.

ETF Securities pioneered ETCs way back in 2003 and today has over 120 ETCs listed on major European exchanges, which provide exposure to commodities in precious metals, industrial metals, agriculture, livestock, and energy. ETCs track the Dow Jones AIG commodity indices or the spot bullion markets, and currently trade on the London Stock Exchange, Euronext Paris, Euronext Amsterdam, Borsa Italiana, and Deutsche Borse (Xetra).

Indeed, the Shariah-compliant ETC platform, according to ETF Securities managing partner, Hector McNeill, was developed in response to growing demand for Shariah-compliant ETCs from investors in the GCC countries, North Africa and Asia. The Shariah-compliant ETC market, according to McNeill, has grown to \$2.6 billion in the last 14 months and in July 2008 alone the trading volume reached \$2 billion on the above five stock exchanges in Europe on which they are currently traded.

"This is an exciting new development for Islamic investors to gain access to our entire physical precious metals platform which includes gold, silver, palladium and platinum. This development recognizes the rising importance of Islamic investors and their appetite for ETCs, which were designed to be simple and accessible tools for all types of investors. Shariah compliance further extends the global reach of ETCs," explained McNeil.

According to ETF Securities, all of the physical precious metal ETCs are backed by allocated metal - uniquely identifiable bars and ingots which carry no bank credit risk. The bars and ingots are held in trust in London by custodian HSBC Bank NA (USA), the leading custodian for ETCs in the world.

The metals held with HSBC conform to the rules of good delivery of the London Bullion Market Association (LBMA) and the London Platinum Palladium Market (LPPM). Securities are only issued once the metal is confirmed as being deposited into the company's bullion account with the custodian. Consistent with allocated gold, no precious metal is borrowed, loaned out and nor does it earn any income.

The five ETCs that are Shariah-approved are specifically the ETFS physical precious metals products - the ETFS physical gold, ETFS physical silver, ETFS physical palladium, ETFS physical platinum, and the ETFS physical precious metals basket (an aggregation of the four precious metals). Each of these securities, said Meralli, are backed by physical allocated metal held by the custodian, and are designed to track the spot price of the underlying physical bullion less the management fee.

"Three weeks ago, after an extensive approval process, the Shariah Advisory Board at Al-Qalam Group approved the product as being fully Shariah-compliant. Since the security is backed by physical allocated bullion, which is held in trust on behalf of the security holder, the underlying transaction enables investors to obtain a spot return on the basis of a precious metal that they actually hold (in a vault in London or Zurich to be exact). The logistics of this transaction are in pure concordance with Shariah financial tenets," he explained.

The ETC platform comes only a few weeks after the establishment of another investment platform - the Al-Safi Trust alternative investment platform which was established jointly by Barclays Capital and Shariah Capital Inc., through which the world's first Islamic fund of hedge funds was launched, after the Dubai Multi Commodities Center Authority (DMCC), an agency of the Dubai government, announced that it was seed investing a total of \$250 million - \$50 million each in five hedge funds through the Al-Safi platform comprising long-short equity funds focusing on energy, resources and soft commodities.

It also follows the launch of a number of Shariah-compliant exchange-traded funds (ETF) over the last year, the most recent of which was the Daiwa FTSE Shariah Japan 100 ETF launched in April 2008 by Japan's Daiwa Asset Management Co. Ltd. off the FTSE Japan Shariah 100 Index.

In general, ETCs give investors a greater choice to implement different investment strategies with the choice of physical, long, forward, leveraged and short exposure to a wide range of commodity sectors. Not all these strategies would be suitable for Shariah-

compliant ETCs, where any securities must ideally be backed by allocated physical assets before they can be traded.

ETF Securities claims that the potential for ETCs in the Islamic investment sector is huge and that the ETC platform holds a wide appeal across a range of diverse investors such as institutional investors, Islamic banks, alternative asset managers, family offices, and government offices.

Given that according to the LBMA, the average daily turnover of gold and silver in just London is more than 300 million ounces, investors can get an idea of the kind of scale the ETC market offers.

Interest from institutional clients in the Middle East region has been quite strong. Many investors are looking to diversify in an asset class that holds low correlation to equities, bonds, and hedge funds. Given the strong bull run in commodities over the past several years, ETCWS according to Meralli, have gained a high degree of interest from the region. Within these commodity classes, many investors in the MENA and Asian region have expressed interest in a variety of individual commodities ranging from oil to natural gas to gold to grains.

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