

The use of Cayman Islands SPVs in Shariah compliant aircraft financing

Islamic finance has grown significantly over the past few years into an estimated US\$2.4 trillion industry. While the use of Shariah compliant financing for the acquisition of aircraft is not a new development, aircraft leasing firms and operators are increasingly looking at Islamic finance as a source of funding for the acquisition of aircraft, whether that be via Islamic banks or through the issuance of Shariah compliant bonds (Sukuk) to raise funds via the debt capital markets. GURMINDER SANGHERA writes.



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We have seen a number of key players in the aviation industry, both in traditional Islamic finance centers — such as the Middle East — and outside, looking to the Islamic finance market in recent years and it would appear that an increasing number are seeking to follow suit. According to sources in the Middle East, Boeing Capital, the financing division of Boeing, is considering establishing a Shariah compliant funding platform as a means for its customers to fund the acquisition of its aircraft.

Islamic financing structures are well suited to asset finance, which has led to them fast becoming viable alternatives to conventional financing structures, particularly in the sphere of aircraft finance. While there are a variety of Shariah compliant financing structures that are used, this article will briefly look at the most commonly used structure in aircraft financing, the Ijarah lease, as well as the role of Cayman Islands companies in relation to the same.

Cayman Islands companies have become synonymous with Islamic aircraft financing transactions in recent years with some of the most high-profile Islamic aircraft financing transactions to date having been structured using one or more Cayman Islands 'orphan' SPVs.

What is an 'orphan' SPV?

Firstly, it is important to note that the company is referred to as an SPV because it is incorporated solely for the purpose of the financing to which it relates. The SPV is called an orphan because the legal title to its shares is held by a trustee on trust (usually for the benefit of qualifying

charities), rather than by a parent company. The trustee in this scenario is usually a third party trust company, which also provides independent directors to the SPV.

Why is an orphan SPV used in Islamic financing transactions?

Shariah scholars typically require the originator (or, in the case of an aircraft financing, the ultimate user of the financing (the 'end user')) and the SPV to deal at arm's length and this separation can be achieved by using an orphan structure. The orphan structure results in the SPV not forming part of the assets of the end user in the financing transaction, which is advantageous from the perspective of a creditor in the event of the insolvency of the end user.

What is an Ijarah lease?

In a typical Ijarah lease aircraft financing, the end user establishes an orphan SPV to hold the legal title to the aircraft and to act as the lessor. Upon acquiring the aircraft, the orphan SPV enters into an Ijarah lease directly or indirectly with the operator pursuant to which the orphan SPV leases the aircraft in return for lease payments. The lease payments received by the SPV are equal to the principal and profit payable by it under the Islamic financing used to purchase the aircraft. In some cases, a second orphan SPV is established to act as the lessee of the aircraft and, in turn, leases the aircraft to the operator.

The Islamic financing often takes the form of a Mudarabah arrangement, which is a form of partnership involving an investment management arrangement, but can also take the form of a Sukuk or other structure.

In a Mudarabah arrangement, an Islamic financier will enter into an investment agency agreement with an Islamic bank,

which acts as the investment agent and as an investor. The Islamic bank, in its capacity as an investor (the Rab Al Maal) enters into the Mudarabah agreement with the orphan SPV (as the Mudarib) and, in accordance with an investment plan, the orphan SPV uses the financing provided by the Rab Al Maal to purchase the aircraft.

In a simple Sukuk transaction, the orphan SPV will issue Sukuk to investors and use the proceeds of such an issuance to purchase the aircraft. The aircraft is held by the orphan SPV on trust for the investors. In accordance with the terms of the Ijarah arrangement, the operator pays lease payments to the orphan SPV in an amount equivalent to the amount payable to the holders of the Sukuk.

A typical Ijarah financing also includes undertakings by the orphan SPV to sell, and by the operator to purchase, the aircraft upon the repayment of the underlying financing or upon the occurrence of other specified events.

Why the Cayman Islands?

There are a number of reasons why the Cayman Islands have gained favor as the SPV jurisdiction of incorporation in the context of Islamic aircraft financing transactions, which include the following:

- firstly, the Cayman Islands is a 'tried and tested' jurisdiction with a sophisticated common law-based legal system, which appeals to debtors and creditors alike
- secondly, Cayman Islands SPVs are relatively inexpensive to incorporate and maintain and the incorporation process is speedy and efficient, and
- thirdly, a robust trust regime allows an originator to separate the SPV from its balance sheet which can be desirable from an insolvency and Shariah compliance perspective. ☺