

THE ISLAMIC FINANCE
AND MARKETS
LAW REVIEW

FOURTH EDITION

Editors

John Dewar and Munib Hussain

THE LAWREVIEWS

THE ISLAMIC FINANCE
AND MARKETS
LAW REVIEW

FOURTH EDITION

Reproduced with permission from Law Business Research Ltd
This article was first published in October 2019
For further information please contact Nick.Barette@thelawreviews.co.uk

Editors

John Dewar and Munib Hussain

THE LAWREVIEWS

PUBLISHER

Tom Barnes

SENIOR BUSINESS DEVELOPMENT MANAGER

Nick Barette

BUSINESS DEVELOPMENT MANAGER

Joel Woods

SENIOR ACCOUNT MANAGERS

Pere Aspinall, Jack Bagnall

ACCOUNT MANAGERS

Olivia Budd, Katie Hodgetts, Reece Whelan

PRODUCT MARKETING EXECUTIVE

Rebecca Mogridge

RESEARCH LEAD

Kieran Hansen

EDITORIAL COORDINATOR

Tommy Lawson

HEAD OF PRODUCTION

Adam Myers

PRODUCTION EDITOR

Robbie Kelly

SUBEDITOR

Janina Godowska

CHIEF EXECUTIVE OFFICER

Nick Brailey

Published in the United Kingdom
by Law Business Research Ltd, London
Meridian House, 34-35 Farringdon Street, London, EC2A 4HL, UK
© 2019 Law Business Research Ltd
www.TheLawReviews.co.uk

No photocopying: copyright licences do not apply.

The information provided in this publication is general and may not apply in a specific situation, nor does it necessarily represent the views of authors' firms or their clients. Legal advice should always be sought before taking any legal action based on the information provided. The publishers accept no responsibility for any acts or omissions contained herein. Although the information provided was accurate as at September 2019, be advised that this is a developing area.

Enquiries concerning reproduction should be sent to Law Business Research, at the address above.

Enquiries concerning editorial content should be directed
to the Publisher – tom.barnes@lbresearch.com

ISBN 978-1-83862-066-0

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following for their assistance throughout the preparation of this book:

ADNAN SUNDRA & LOW

AFRIDI & ANGELL

AL BUSAIDY, MANSOOR JAMAL & CO

ALLEN & OVERY SCS (LUXEMBOURG)

ANDERSON MÖRI & TOMOTSUNE

DE BRAUW BLACKSTONE WESTBROEK

MATOUK BASSIOUNY & HENNAWY

MILBANK LLP

MORALES & JUSTINIANO

OGIER

PILLSBURY WINTHROP SHAW & PITTMAN LLP

TROWERS & HAMLINS

CONTENTS

PREFACE.....	v
<i>John Dewar and Munib Hussain</i>	
Chapter 1 BAHRAIN	1
<i>Salman Ahmed and Eleanor Clot</i>	
Chapter 2 CAYMAN ISLANDS	11
<i>Anthony Oakes</i>	
Chapter 3 EGYPT	19
<i>Mahmoud Bassiouny</i>	
Chapter 4 JAPAN	22
<i>Naoyuki Kabata and Satoshi Kato</i>	
Chapter 5 LUXEMBOURG.....	28
<i>Frank Mausen, Christopher Dortschy, Evelina Palgan and Zofia White</i>	
Chapter 6 MALAYSIA	43
<i>Rodney Gerard D’Cruz and Murni Zuyati Zulkifli Aziz</i>	
Chapter 7 NETHERLANDS	71
<i>Omar Salah</i>	
Chapter 8 OMAN	78
<i>Mansoor J Malik, Asad Qayyum and Hussein Azmy</i>	
Chapter 9 PHILIPPINES	88
<i>Rafael A Morales</i>	
Chapter 10 UNITED ARAB EMIRATES	96
<i>Amjad Ali Khan and Rabat Dar</i>	

Chapter 11	UNITED KINGDOM	111
	<i>John Dewar and Munib Hussain</i>	
Chapter 12	UNITED STATES	122
	<i>Mona E Dajani</i>	
Appendix 1	ABOUT THE AUTHORS.....	129
Appendix 2	CONTRIBUTORS' CONTACT DETAILS.....	137

PREFACE

We are honoured to present the fourth edition of *The Islamic Finance and Markets Law Review*. The chapters that follow describe the manner in which Islamic, or *shariah*-compliant, finance is practised in various jurisdictions throughout the world. Although each country will have variations, one of the most striking features of Islamic finance as a legal discipline is that it includes core concepts and structures that cross jurisdictional boundaries. Given the importance and ubiquity of these concepts and structures, a short introduction to them is in order.

i Sources of Islamic finance

Islamic, or *shariah*-compliant, finance is concerned with the conduct of commercial and financial activities in accordance with *shariah*, or Islamic, law. Islamic finance emphasises productive economic activity over pure speculation, and encourages transaction counterparties to share profits and losses to promote collaborative efforts. Islamic finance practices are based upon a central core constituting (1) the Quran, the holy book of Islam; (2) the Sunnah, words or practices instituted or approved by the Prophet Muhammad, including the Hadith, which are oral traditions regarding the words and deeds of the Prophet Muhammad, as compiled by the *Sahabah* (closest companions of the Prophet Muhammad); (3) *ijma*, or consensus of the independent Muslim jurists qualified to exercise *ijtihad* (a *mujtahid*) on a particular interpretation of *shariah*; and (4) *qiyas*, which is interpretation by analogical reasoning where one situation is measured against another by the *mujtahids*, in each case subject to and in accordance with the Quran, Sunnah and *ijma*. The principles derived from the application of *ijma* and *qiyas* to *shariah* form the body of jurisprudence known as *fiqh* (understanding and knowledge applied to any branch of knowledge). The body of rules that underpin the derivation of *fiqh* is referred to as *usul al-fiqh*.

Certain *shariah* principles may be ambiguous, not least because of the numerous exegeses of the Quran, the voluminous Hadith and the *mujtahids* involved in the practice of *ijtihad*, interpreting *shariah* in different (yet equally permissible) ways because of the interpretation methodologies they may apply. This means that often there can be different legal opinions (*fatawa*) on the same aspect of *shariah*. This difference of methodology for interpreting *shariah*, and the body of *fatawa* derived thereby, is one reason why there have developed several schools of thought or *fiqh* (*madhabs*) to which a *mujtahid* would ordinarily be aligned. The renowned *madhabs* are *Hanafi*, *Maliki*, *Shafi'i* and *Hanbali*.

ii Principles of Islamic finance

Akin to Western legal systems, in Islam there is a presumption that everything is permissible (*halal*) unless there is an express law that rebuts that presumption by declaring it as forbidden (*haram*). Islamic financiers are therefore expected to carry out their activities subject to, and in accordance with, *shariah* principles. The pertinent *shariah* principles that relate to Islamic finance include:

- a *Riba* (translated literally, excess): although *shariah* scholars debate the precise definition of *riba*, essentially it represents unearned excess or profit charged in connection with a transaction, and derived by the mere passage of time. This is generally thought to include a prohibition against charging interest in connection with the use of money. The philosophy behind the absolute prohibition of *riba* (which has the effect of rendering any contract harbouring *riba* as being void), is that *shariah* regards money as having no intrinsic value in itself (unlike commodities such as gold, silver, dates and wheat) and is merely a means of exchange to procure goods and services. Money cannot therefore derive a profit either from the exchange of money of the same denomination or as a result of the passage of time, as is the case with interest.
- b *Gharar*: this refers to undue uncertainty in a transaction. For example, the sale of an object that a seller does not yet possess is considered to include *gharar*, because it is uncertain whether the seller will be able to obtain the relevant object and complete the sale transaction. Some *shariah* scholars assert that *maysir* and *gharar* prohibit life insurance contracts and financial derivatives.
- c *Maysir*: this refers to impermissible speculation, meaning investments that depend chiefly upon chance for their outcomes. The prohibition of *maysir* does not prevent parties from taking on risks normally connected with business transactions.
- d *Qimar*: this refers to transactions tantamount to gambling.

Two other relevant *shariah* principles are the prohibition on investing in, or being involved with, *haram* products and activities (such as alcohol and gambling establishments) and the prohibition on becoming unjustly enriched.

In practice, Islamic financial institutions and investors typically engage *shariah* scholars to establish investment guidelines and parameters for investment activity, in a manner consistent with the sources of Islamic finance, *madhabs* and Islamic finance structures referred to above. Efforts have been made to increase uniformity among these *shariah* advisers, in the hope of creating a more standardised market. For example, the Accounting and Auditing Organization for Islamic Financial Institutions, a non-profit industry-sponsored organisation, issues non-binding *shariah* standards developed in consultation with industry practitioners. Other influential bodies include the Fiqh Academy of the Organization of the Islamic Conference, the Shari'ah Supervisory Board of the Islamic Development Bank and the Islamic Financial Services Board in Kuala Lumpur. These bodies, and individual *shariah* scholars, provide the context for Islamic finance generally. The degree to which their rules are incorporated into legal regimes varies between jurisdictions.

iii Basic Islamic finance structures

Although structures differ across national boundaries, the basic structures outlined below tend to be widely used by market participants. Profit and loss sharing forms the bedrock of Islamic finance since Islam perceives that the ideal relationship between contract parties should be that of equals in which profit and losses are shared. *Shariah* by no means prohibits

the making of profit, but it does scrutinise the basis upon which profit is made as, for example, charging interest could exploit the client in a time of hardship whereas the financier's wealth is increased by no effort of his or her own. Islam instead empowers the financier to derive a profit by investing money or another consideration directly (or indirectly through a joint venture arrangement, for example) in real assets using one or more of the Islamic finance structures discussed below. The financier will then generate a profit and recoup the principal sum invested in the asset by exercising his or her rights as an owner; using, leasing or selling the asset. Here, unlike conventional finance, the money itself has not yielded the profit; instead the assumption of the risks and responsibilities as owner of the asset, or as a partner in the venture, has yielded the profit made by the financier. This highlights the preference of Islamic finance for equity over debt and seeking to deal in tangible assets. This also explains why Islamic finance can be used as a form of both asset-backed financing and asset-based financing.

Combinations of the following Islamic finance structures can be used in project finance and other structured transactions. For example, a *mudarabah* or *musharakah* could be used to invest in a venture to commission the manufacture of an asset under an *istisnah*, which once constructed can be leased through an *ijarah*.

Ijarah (lease)

The *ijarah* is a form of lease financing whereby the usage (usufruct) of an asset or the services of a person are leased by the lessor to the lessee for rental consideration. The *ijarah* can take effect as an operating lease, with the asset returning to the lessor at the end of the lease term, or akin to a finance lease, with title to the asset being transferred to the lessee at the end of the lease term or ownership units being transferred to the lessee during the term of the lease (an *ijarah wa iqtina*). Although *shariah* does not permit a forward sale, the *ijarah* can become effective at a future date provided the rent is only payable after the leased asset is delivered to the lessee. This type of forward lease is called an *ijarah mawsufa fi al-dhimma* and is most prevalent in the project financing context.

Istisnah

An *istisnah* is used for the manufacture or development of an asset. Under this structure, one party engages a counterparty to construct an asset in accordance with agreed specifications, and agrees to purchase or lease the asset upon completion. The manufacturing party must finance the manufacture or construction of the asset, although it may require a down payment or progress payments from its counterparty, or both. The manufactured asset must be accepted by the counterparty if it meets the given specifications. Once the asset has been constructed, title to the asset must be transferred by the manufacturing party to the counterparty, who will then either sell the asset or lease the asset to a counterparty pursuant to an *ijarah*. This structure may be employed for project finance, among other purposes.

Murabahah

A *murabahah* is an asset purchase transaction, in which a party purchases an asset from a third party at the request of its counterparty, and then resells the asset to that counterparty. The sale price payable by the counterparty equals the original acquisition price paid by the first party plus an agreed return (i.e., cost-plus), and is payable on a deferred basis. Under this technique, the counterparty is able to acquire an identified asset, but pay the purchase price

for it over time. A *murabahah* can be used to finance the acquisition of a variety of assets and its versatility makes the structure a favourite among market participants.

Mudarabah

A *mudarabah* is an investment fund arrangement, under which one party (the *rab-al-mal*) provides capital to an enterprise while a second party (the *mudarib*) contributes work. The *mudarib* manages the enterprise's capital, and in doing so usually has wide discretion. In return, the *mudarib* often earns a fee. The *mudarabah* parties also share any profits of the enterprise according to agreed percentages. However, only the *rab-al-mal* bears the risk of losing money on the enterprise. Guarantees of the capital by the *mudarib* are not permitted as this would depart from the principle that the *rab-al-mal* bears the risk of any loss. In *Dana Gas PJSC v. Dana Gas Sukuk Ltd & Ors* ([2017] EWHC 2928), Dana Gas attempted to (but ultimately was unable to) render its *mudarabah sukuk* unenforceable on a number of grounds, one of which was that the *sukuk* were not *shariah*-compliant because they featured what appeared to be a guarantee from the *mudarib* of the face amount of the *sukuk* contrary to the risk-sharing methodology reflecting a traditional *mudarabah*. The *mudarib*'s risk should solely be that its time and effort will not produce a return. Among other uses, a *mudarabah* may be employed for investment funds that make *shariah*-compliant investments.

Musharakah

A *musharakah* is a partnership arrangement in which transaction parties contribute cash or property, or both, to a collective enterprise. The parties share profits according to agreed percentages (as with a *mudarabah*), but also share losses in proportion to their capital investments. All *musharakah* parties may exercise control of the *musharakah*, although in practice there is usually a designated control party. Under diminishing *musharakah* (*musharaka muntahiyah bittamleek*), one or more of the *musharakah* parties has the ability to buy out the interests of the other *musharakah* parties over time for an agreed price. The *musharakah* structure is considered the most ideal for sharing profit and loss.

Sukuk

Although *sukuk* (plural of *sakk*) are often referred to as 'Islamic bonds', they are more akin to Islamic trust certificates representing an undivided beneficial ownership interest in an underlying asset where the return is based on the performance of that underlying asset. A *sukuk* issuer pays an agreed amount of the revenue produced by the *sukuk* assets to the *sukuk* holders. A distinction is made between asset-backed *sukuk*, which provide *sukuk* holders with a claim to the subject assets, and asset-based *sukuk*, which derive cash from the assets, but do not grant *sukuk* holders direct rights in the assets. *Sukuk* do share certain features with conventional bonds, such as being in certificated form, being freely transferable on the secondary market if the *sukuk* is listed, paying a regular return, and being redeemable at maturity, but conventional bonds are also tradable debt, which *shariah* prohibits.

iv Conclusion

Islamic finance has grown rapidly during the past 20 years, in terms of the number of market participants, structuring expertise and transaction types. Islamic finance is vibrant and has proven its competitiveness with conventional financing products, often featuring alongside, or as an alternative to, conventional financing products. The chapters in this book illustrate

the dynamic manner in which Islamic finance has adapted and continues to develop globally, and we recommend them to you.

We would like to thank the writers who have taken the time to contribute their insights on Islamic finance practice, and to the editors who made publication of this book a reality.

John Dewar and Munib Hussain

Milbank LLP

London

September 2019

BAHRAIN

*Salman Ahmed and Eleanor Clot*¹

I INTRODUCTION

Bahrain's financial sector is well developed and diversified, consisting of a wide range of conventional and Islamic financial institutions and markets, all of which are subject to a sophisticated legal and regulatory framework.

Bahrain (through the Central Bank of Bahrain (CBB)) has one of the most comprehensive regulatory regimes for regulating *shariah*-compliant activities in the world. Oman and Pakistan are close competitors, though Malaysia is generally regarded as having the most comprehensive. The difference is that Oman and Pakistan have separate legislation dealing with *sukuk* issuances (as does Jordan), but other legislation in those jurisdictions either does not fully cater to non-commercial banking and capital markets activities or is quite nascent.

The CBB's legislative model differs from Oman and Pakistan in that it is less prescriptive and allows financial and other institutions to align their businesses with rapidly fluctuating global trends. This means the CBB maintains an open dialogue with all its licensees and regularly seeks their (and other market participants' input) on legislative updates and further regulation. This is one of the features that distinguish CBB's approach to regulation from the rest of the regulators in the Gulf Cooperation Council (GCC).

The term 'Islamic finance' or 'Islamic banking' in Bahrain has wider application than just applying to commercial banks and includes non-deposit-taking investment or merchant banks and private equity institutions operating in a *shariah*-compliant manner. The CBB licenses each of these institutions appropriately in accordance with their proposed activities. The ambit of this chapter does not include a discussion on each of these licences, as this information is available on the CBB's website.²

II LEGISLATIVE AND REGULATORY FRAMEWORK

i Legislative and regulatory regime

Persons wishing to undertake regulated Islamic banking services must be licensed by the CBB as an Islamic bank licensee. Regulated Islamic banking services consist of three determinant activities: (1) accepting *shariah* money placements or deposits; (2) managing *shariah* profit-sharing investment accounts; and (3) offering *shariah* financing contracts. If an institution has the requisite licence, it may be able to offer all three regulated activities

1 Salman Ahmed is a partner and Eleanor Clot is a trainee solicitor at Trowers & Hamblins.

2 <https://www.cbb.gov.bh/licensing-registration>.

alongside various supplementary activities. Islamic bank licensees must operate in compliance with *shariah* economic principles and only Islamic bank licensees may hold themselves out to be fully *shariah*-compliant institutions. Ultimately, it is the type of licence issued by the regulator that determines whether an institution is *shariah*-compliant.

Every individual Islamic bank in Bahrain has its own internal *shariah* board, which determines the *shariah* compliance of its products. In December 2018, there were 382 institutions and 98 retail banks registered in the banking sector, of which 21 were Islamic banks licensed by the CBB. The CBB does not interfere with this internal process but is usually very helpful and facilitates discussions about new ideas and concepts. The CBB must approve new products before they can be offered to customers. The banks also need to inform their customers of associated risks and any unusual product features if the capital is not protected. If the capital is protected then the banks must inform the customers that there is a chance that the actual return may be lower than the anticipated or projected return.

Islamic bank licensees are divided into two subcategories: Islamic retail banks and Islamic wholesale banks. Specific regulatory requirements may differ between these two subcategories where appropriate to address their risk profiles.

Islamic retail banks may undertake transactions in any currency, with both Bahraini residents and non-residents. To qualify as an Islamic retail bank, the activity of offering *shariah* financing contracts must account for a significant portion of the institution's business. This is defined, broadly, as accounting for over 20 per cent of an institution's assets.

Islamic wholesale banks may also undertake transactions without restriction when dealing with the government of Bahrain and its agencies, CBB bank licensees and non-residents. However, they may only undertake transactions denominated in Bahraini dinars or with a resident of the Kingdom of Bahrain if these transactions are to be wholesale in nature. Wholesale transactions are defined in terms of transaction size (broadly, 7 million dinars or more for the activities of accepting *shariah* money placements or deposits and offering *shariah* financing contracts, and US\$100,000 or more for any of the other activities falling within the definition of regulated Islamic banking services). Islamic wholesale banks are allowed to transact in dinars (or any other currency) for any amount with the government of Bahrain, Bahrain public sector entities (as defined in the guidelines for completion of the Prudential Information Returns for Islamic Banks Form) and CBB bank licensees. Islamic wholesale banks may also transact in dinars for any amount (where required) to fund their normal operating expenses when investing for their own account in securities listed on a licensed exchange.

Islamic bank licensees are subject to certain licensing conditions. These licensing conditions are consistent with international good practice, such as the relevant Basel Committee and Islamic Financial Services Board standards.

Islamic bank licensees must satisfy the CBB that their controllers are suitable and pose no undue risks to the licensee. There are also certain procedures, as set out in Articles 52 to 56 of the Central Bank of Bahrain and the Financial Institutions Law (the CBB Law)³ on controllers. Licensees and their controllers must also observe the CBB's capital markets requirements in respect of changes in holdings of shares of listed companies. There are differing requirements for locally incorporated licensees (Bahraini Islamic bank licensees) and branches of foreign banks (overseas Islamic bank licensees). Requirements for overseas Islamic bank licensees are less onerous than those for Bahraini Islamic bank licensees.

3 Decree No. 64/2006.

A licensee that carries on an activity such as dealing in *shariah*-compliant financial instruments as agent (i.e., buying, selling or subscribing for *shariah*-compliant financial instruments on behalf of a client) should not determine the terms of the transaction and should not use its own financial resources for the purpose of funding the transaction. This means that the licensee must act as an agent and must not have a say in the terms of the transaction. Such a licensee may, however, receive or hold assets in connection with the transaction in its capacity as agent of its client. The following are examples of activities that, when taken in isolation, are unlikely to be regarded as acting in the capacity of an agent:

- a* appointing professional advisers;
- b* preparing a prospectus or business plan other than in connection with the Regulatory and Supervisory Module on Issuing and Offering of Securities and Sharia Compliant Sukuk of 2013 (the OFS Module);
- c* identifying potential sources of funding;
- d* assisting investors, subscribers or borrowers to complete and submit application forms other than in connection with the OFS Module, the CBB Rulebook Volume 6 (Capital Markets) and the CBB Rulebook Volume 7 (Collective Investment Undertakings); or
- e* receiving application forms for processing or checking and onward transmission other than in connection with the OFS Module, the CBB Rulebook Volume 6 (Capital Markets) and the CBB Rulebook Volume 7 (Collective Investment Undertakings).

Islamic bank licensees must maintain a minimum daily cash reserve balance with the CBB, set as a ratio of their total non-bank dinar funds, whether placed by way of call or unrestricted investment accounts (or similar), as well as taken through the issuance of dinar-denominated Islamic investment certificates. The current required ratio is 5 per cent and may be varied by the CBB at its discretion.

Islamic bank licensees must arrange for their external auditor to confirm the accuracy of the data reported on the eligible accounts report for the deposits or unrestricted investment account protection funds.

ii Regulatory and supervisory authorities

Conventional banks and *shariah*-complaint banks (referred to collectively as licensees) are both regulated by the CBB; however, the rules for each differ. The accounting standards of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) are compulsory for all Islamic banks and for conventional banks if they are maintaining Islamic units.

The CBB's supervision of licensees is a mixture of on-site assessment (including the quality of systems and controls, and of books and records) and off-site supervision (which focuses on the analysis of regulatory returns, as well as of audited financial statements and other relevant public information). The CBB strengthened its supervisory role by establishing a centralised Shariah Supervisory Board in 2015 and launching the *shariah* governance framework, which became effective in June 2018.

On-site examinations are undertaken by the CBB's own examiners, as well as by experts appointed for the purpose by the CBB (such as accountants and actuaries). Off-site supervision also includes regular prudential meetings with licensees to review performance, strategy and compliance matters (such as capital adequacy, large exposures and liquidity).

For banks, a risk profiling system has been developed to underpin the above supervisory efforts, by providing a detailed framework for assessing the impact and risk profile of individual licensees and prioritising subsequent supervisory efforts. Work is under way to extend this profiling system to insurance companies.

Should a licensee fail to satisfy the CBB's regulatory requirements, then the measures outlined in the enforcement modules of the applicable volumes of the rule book may be applied. Enforcement measures include formal warnings, directions (e.g., to cease or desist from an activity), formal requests for information, adverse fit and proper findings, financial penalties or investigations. Extreme violations of the CBB's regulatory requirements may entail cancellation of a licence, putting into administration or criminal sanctions.

III COMMON STRUCTURES

Types of product offered ⁴	Description of product
<i>Mudarabah</i> savings account	A <i>mudarabah</i> savings account is based on the <i>shariah</i> principle of 'unrestricted <i>mudarabah</i> '. Under the <i>mudarabah</i> principle the customer will act as a capital provider and the bank will act as a <i>mudharib</i> (entrepreneur) using its expertise. The bank pools all customer funds with its own capital and invests it in <i>shariah</i> -compliant modes of investments. The resulting profit is shared between the bank and customers according to predetermined ratios. <i>Mudarabah</i> is a profit-and-loss sharing product and the better the bank performs, the higher the profits earned.
Term investment deposit (<i>mudarabah</i>)	Term investment deposit is based on the <i>shariah</i> principle of unrestricted <i>mudarabah</i> . Under the <i>mudarabah</i> principle the customer is an investor (<i>rab-al-mal</i>) for a fixed period and the bank will act as a <i>mudharib</i> (entrepreneur) using its expertise. The bank pools all customer funds with its own capital and invests it in <i>shariah</i> -compliant investments for a specified investment term and expected profit rate. The resulting profit is shared between the bank and customers according to predetermined mutually agreed ratios.
<i>Izdiibar</i> savings account	An <i>izdiibar</i> account is a savings account based on the Islamic principle of unrestricted <i>mudarabah</i> , which means customers can earn profit on their savings. Funds are placed in a common investment pool where they are invested in strict compliance with <i>shariah</i> principles to generate the best possible returns. Profits generated from the investments are shared between the bank and the customers according to a pre-agreed profit-sharing ratio.
Current account (<i>qard hasan</i>)	The current account is based on the Islamic contract of <i>qard hasan</i> (interest-free loan). You as a depositor will be the lender and the bank will be the borrower. The deposited funds are invested in <i>halal</i> activities only. Irrespective of the profit or loss generated by the bank from the investments, the funds are guaranteed payable on demand without any profit or penalty.
<i>Wakalah</i> investment	<i>Wakalah</i> investment is based on the Islamic concept of <i>wakalah</i> istithmar, under which you become the principal (<i>muwakkil</i>) and the bank becomes the investment agent (<i>wakeel</i>) of your funds. The bank invests these funds in <i>shariah</i> -compliant financing and investment activities. The targeted profit earned from the investments is distributed to the customers upon maturity of the account. The bank (as <i>wakeel</i>) deducts its agreed agency fee (<i>wakalah</i> fee) and, at maturity, pays both the targeted profit amount and the principal funds to the customers as per the terms of the <i>wakalah</i> agreement.

i Private equity investments

In Bahrain and from Bahrain private equity funds, whether they are to be established in a *shariah*-compliant manner or generally established as a conventional fund, no particular structure is used.

Common structures would be Cayman Islands exempt limited partnerships (if in the form of a partnership or a Cayman Islands exempt corporate fund). The investment may also

4 In relation to certain *mudarabah*-, *wakalah*- or *musharakah*-based savings accounts and products that are not capital guaranteed, it is possible that a customer may not be guaranteed a return and may even lose its principal. The CBB has strict criteria for offering these types of products, including suitable disclosures (i.e., product summary, risk factors, etc.). The customer must therefore assume complete performance risk, although, in practice, it is unusual for the banks not to provide the anticipated profit and return principal.

be set up in Bahrain as a private investment undertaking. This is a flexible type of fund that only needs to be registered with, rather than approved by, the CBB, and that has very limited restrictions on its ability to invest, although there are very high thresholds on the type of investor and the minimum investor amount in respect of investing in such a fund.

In general, any fund that is to be *shariah*-compliant would have to obtain a *fatwa* and make its investments in *shariah*-compliant products and in compliance with the various tenets of *shariah*.

ii Real estate investments

In respect of real estate funds, no particular structure is used and the same considerations in respect of a conventional fund would be taken in establishing a *shariah*-compliant real estate fund.

The common structures are offshore limited partnerships and companies, locally domiciled funds and real estate investment trusts. The Trust Law Bahrain⁵ was introduced in late 2016, enabling the establishment and listing of real estate investment trusts, known as Bahrain real estate investment trusts (BREITs).

BREITs can be established as either an expert collective investment undertaking (CIU) or an exempt CIU. Expert CIUs may be offered only to expert investors, who must deposit a minimum of US\$10,000. Exempt CIUs are lightly regulated but may only be offered to accredited investors who invest at least US\$100,000. BREITs are gaining more attention in Bahrain, though very few have been launched to date.

GCC nationals and wholly owned GCC entities may own land in Bahrain on a freehold basis. A non-Bahraini person or legal entity can own real estate or land in certain designated areas where foreign ownership is permissible.

iii Investment funds

Investment funds are generally established in Bahrain as companies, partnerships or trusts. No particular type of fund structure is used to enable it to be *shariah*-compliant.

A common structure used when the fund is to be marketed to retail investors would be a *shariah*-compliant expert fund. This type of fund requires a minimum investment of US\$10,000 and can only be offered to investors who already hold financial assets of at least US\$100,000. Expert funds can be leveraged by borrowing up to a limit of 20 per cent of the value of assets under management.

A further example of a type of investment fund used in Bahrain is a *shariah*-compliant exempt fund. This can only be marketed to accredited investors (who already hold assets worth US\$1 million) and the minimum investment amount is US\$100,000. This type of fund is lightly regulated.

Bahrain introduced the Investment Partnership Law⁶ in 2017 and in doing so is the first country in the GCC region to have introduced national legislation enabling the formation of limited partnerships in a manner comparable to structures utilised in reputable offshore fund domiciles. Key features of the new Law include the ability for a general partner of a Bahrain investment limited partnership to be established as a subsidiary or a special purpose vehicle of an investment business. This would allow sponsors not to be unduly exposed in terms of

5 Decree No. 23/2016.

6 Decree No. 18/2016.

liability and while using one of the preferred and widely recognised international models for private equity funds. The new Law also aims to make Bahrain a more attractive market for investors by setting a high liability standard in respect of general partners.

The Protected Cell Companies Law,⁷ enacted in Bahrain in 2016, allows for the formation of protected-cell companies (often called segregated portfolio companies or sub-funds). Both a limited partnership fund and a segregated portfolio fund can be established as a *shariah*-compliant fund. A protected-cell company is a corporate structure in which a single legal entity is comprised of a core legal entity under which there are several divided cells or portfolios. The protected-cell company allows for each cell to be managed by a single or separate investment manager. As a fund develops, expands and targets under or varying asset classes, new cells can be established, which enables long-term flexibility and provides opportunities for investors to be exposed to new asset classes or sectors at lower costs for the fund promoter or manager. Each cell's assets can be ring-fenced and are therefore only available, or exposed to, the creditors and shareholders of each particular cell. The development of this Law signifies a will to develop the funds industry in Bahrain.

As at the end of June 2019, the number of mutual funds stood at 2,136, of which 74 were Bahrain-domiciled, compared with 2,290 funds as at June 2018. The number of *shariah*-compliant funds stood at 80, as at June 2019.⁸

iv Trusts

The Trust Law Bahrain replaced the Bahrain Financial Trusts Law of 2006 and aims to provide detailed guidance on the creation and administration of financial trusts within the Kingdom. While such trusts are widely used in other jurisdictions, they are new to the Middle East and Bahrain is one of the first countries to put in place this type of legal framework. It is anticipated and hoped that these updates will allow for the development of onshore *shariah*-compliant structures to hold assets, particularly for families who have previously tended to use offshore jurisdictions to do so. These trusts are also used in the development of BREITs, which can be established pursuant to the CBB fund regulations.

IV TAXATION

Bahrain currently has no income tax, corporation tax (except for oil, gas and petroleum companies that are engaged in exploration, production or refining, regardless of their place of incorporation) or capital gains tax and no estate duty, inheritance tax or gift tax. However, Islamic finance transactions involving real estate may be subject to taxes. For example, if the legal ownership of the land is transferred or registered, this could result in registration fees. On all property purchases, a registration fee of 2 per cent is levied, which is reduced to 1.7 per cent if registration and payment are completed within 60 days of the relevant transaction. If an Islamic financial transaction involves payments under an *ijarah*, this will generally not be subject to taxation. In Bahrain, Islamic finance transactions typically involve no actual movement of legal ownership and only the economic or beneficial value or ownership is transferred, which is not subject to any taxes.

7 Decree No. 22/2016.

8 <https://www.cbb.gov.bh/collective-investment-undertakings>.

Under existing Bahraini laws, payments under the bonds, *sukuk* or notes will not be subject to taxation in Bahrain, no withholding will be required on such payments to any holder of notes, and gains derived from the sale of notes will not be subject to Bahraini income, corporation or capital gains tax. In the event of the imposition of any withholding, the issuer will have undertaken to gross up any payments subject to the withholding.

Following an extraordinary meeting of finance ministers in Jeddah in June 2016, the GCC countries approved the introduction of value added tax (VAT) in the GCC. Bahrain signed the GCC Unified VAT and Excise Treaties on 1 February 2017 and brought into effect on 1 January 2019 the Bahrain VAT Law.⁹ A new tax authority, the National Bureau for Revenue, has been set up to oversee the VAT regime and is responsible for the registration and assignment of those subject to VAT, and for enforcement of VAT-related obligations.

VAT has been introduced at the standard rate of 5 per cent although some supplies are zero rated, exempt from VAT or outside the scope of VAT. VAT has been introduced on a staggered basis depending on the size of a business's turnover. Businesses with annual turnover exceeding 5 million dinars became subject to VAT from 1 January 2019, businesses with turnover of between 500,000 and 500 million dinars became subject to VAT from 1 July 2019, and businesses with turnover of 37,500 to 500,000 dinars will become subject to VAT from 1 January 2020. Businesses below the 37,500-dinar threshold but with a turnover above 18,750 dinars are entitled to voluntary registration if desired.

There can be no doubt that from a commercial and legal perspective the introduction of VAT heralds a significant development in the region. The new VAT regime is consumer-friendly with zero ratings for basic necessities such as healthcare, education, basic food items and the construction of new buildings, both residential and commercial properties. The introduction of VAT by GCC governments will be regarded by many as a constructive measure to assist, diversify and strengthen those countries' respective fiscal revenue streams in an era of falling oil prices; and to promote economic stability in the long term. It is important to note in this regard that the International Monetary Fund has previously encouraged the GCC countries to introduce VAT.

Islamic financial transactions are generally exempt from VAT if the income earned by the supplier is by way of interest, a profit margin akin to interest, or by way of an implicit margin. However, fees, commissions or commercial discounts received by Islamic finance providers are not exempt and are subject to VAT at the standard rate of 5 per cent.

As with the introduction of VAT in Saudi Arabia and the United Arab Emirates from 1 January 2018, and on account of its staggered introduction, it is taking some time for businesses and the tax authorities to absorb the changes. It is currently too early to judge, but it is hoped that the Bahrain tax authorities will operate with a light touch during this introductory phase.

It is also notable that VAT has been introduced as part of a GCC-wide customs union. Therefore, it is vital that the design of local regimes takes this customs union into account, to avoid overload and unnecessary complexity for governments and businesses alike.

9 Decree No. 48/2018.

V INSOLVENCY

There is no separate insolvency regime for Islamic finance in Bahrain. The Bankruptcy Reorganisation and Bankruptcy Law (the Bankruptcy Law)¹⁰ and the Commercial Companies Law,¹¹ as amended, apply to bankruptcies, reorganisations and insolvency matters in Bahrain. There are separate insolvency rules for financial institutions licensed by the CBB under the CBB Law. Following the consultation period during which all CBB licensees, listed companies in Bahrain, law firms and audit firms provided their feedback, the Bankruptcy Law came into effect on 8 December 2018, replacing the Preventative Composition Law.¹² The Bankruptcy Law does not apply to those licensed by the CBB and therefore does not apply to Islamic finance services.

VI JUDICIAL FRAMEWORK

i Courts

Bahrain has a dual court system, consisting of civil and *shariah* courts. *Shariah* courts deal primarily with personal status matters (such as marriage, divorce and inheritance). *Shariah* courts of first instance are located in all communities. A single *shariah* Court of Appeal sits at Manama. Appeals beyond the jurisdiction of the *shariah* Court of Appeal are taken to the Supreme Court of Appeal, which is part of the civil system.

The *shariah* acts only as a 'guiding principle' and as such the terms and conditions of Islamic finance products are determined by national laws. In Bahrain, disputes revolving around Islamic finance contracts and products are heard before the civil courts.

VII OUTLOOK

Islamic finance is on the rise in Bahrain and internationally, although annual growth of up to 15 per cent per year as seen in recent years is unlikely in the near future. A recent report¹³ estimates that Islamic finance assets will reach US\$3.8 trillion by 2023, which equates to an average projected growth of 10 per cent per year. His Excellency Rasheed Mohammed Al Maraj (governor of the CBB) predicts 5 per cent annual growth over 2018 and 2019 for the Middle East Islamic banking sector.

Bahrain is growing in influence as a leading centre of innovation for Islamic finance. A number of amendments were made to the CBB's codes and rules between 2014 and 2019, with the aim of promoting best practice and on the basis of certain rulings of the primary global committee of banking supervision (the Basel Committee).

At present significant moves are being taken to strengthen banks' capital bases and to promote transparency and better governance. Banks in Bahrain are being encouraged to consider merging to strengthen themselves and compete more effectively. Several Islamic lenders have already merged (e.g., the three-way merger of Capinvest, Elaf Bank and Capital

10 Decree No. 22/2018.

11 Decree No. 21/2001.

12 Decree No. 11/1987.

13 'The State of the Global Islamic Economy Report 2017/18', published by Thomson Reuters and the Islamic Corporation for the Development of the Private Sector.

Management House in 2013) and more mergers are taking place, with the highest-profile of these being the proposed merger of Kuwait Finance House Bahrain with Bahrain's Ahli United Bank, which is expected to be completed by October 2021.

In early 2019, AAOIFI approved a draft regulation on *shariah* compliance for Islamic finance institutions requiring them to make publicly available information regarding solvency, financial stability and compliance.¹⁴ This information could then be used by ratings agencies and investors alike, providing greater transparency and certainty in Bahrain's Islamic finance market.

In early 2019, the Cabinet was debating a controversial draft law that would require all banks operating in Bahrain to become *shariah*-compliant and would ban non-Islamic finance practices.¹⁵ There has been strong opposition to this, given the potential exodus of non-Islamic banks that would result and the subsequent negative impact on Bahrain's financial market.

The Basel Committee recommendations made in light of the global financial crisis have led to a number of reforms and initiatives. Banks are now being asked to be more transparent, for example, by making more useful data available to stakeholders so that they can make informed choices.

These changes have resulted in major reforms. The governor of the CBB has said that 'the overall outcome is that Islamic finance is benefiting from these changes. The over-reliance on real estate and infrastructure projects is being systematically replaced with recognition that fixed income assets, which in turn provide identifiable, sustainable profits for the future, are the way forward.'

The CBB is working with bodies such as the non-profit International Islamic Finance Market (IIFM) to standardise Islamic banking practices further. One of its recommendations has been to ensure that Treasury product transactions are governed by the International Swaps and Derivatives Association (ISDA/IIFM Tahawwut Master Agreement). This agreement is designed to govern the relationship between the parties in a *shariah*-compliant hedging transaction. The use of these agreements is not mandatory in Bahrain.

The CBB has also urged Islamic banks to have their institutions rated by the Islamic International Rating Agency (IIRA), which has its headquarters in Bahrain. The IIRA ratings inform investors about corporate and *shariah* governance practices in addition to the financial risk profile of the entity.

The CBB has proposed further rules in an attempt by Bahrain to regain prominence in the Islamic finance industry. In August 2017, the CBB imposed a requirement that Islamic banks should be audited externally by *shariah* experts rather than be subject to self-regulation. Furthermore, banks would be required to disclose any non-permissible income and state how they intend to dispose of assets generated by non-*shariah*-compliant earnings or acquired through prohibited expenditure. It has been argued that the current approach allows more diversity and flexibility; however, there is growing support in Bahrain for reforms to increase transparency in this field.

Bahrain is a world leader in Islamic finance, accommodating the largest concentration of Islamic financial institutions in the Middle East. *Takaful* contributions to the Bahrain market have consistently averaged around 22 per cent, which compares favourably with the

14 <https://www.alayam.com/epaper/2019/05/10>.

15 <http://www.banksbahrain.org/2019/02/26/bab-warns-the-ban-on-conventional-banking-could-wreck-bahrains-financial-sector/>.

likes of the United Arab Emirates, which averages around 16 per cent.¹⁶ At present, there are six Islamic *takaful* insurance companies and two *retakaful* companies operating in Bahrain. Bahrain is a market leader for Islamic securities (*sukuk*).

Finally, Bahrain hosted both the 24th and the 25th World Islamic Banking Conference in December 2017 and November 2018 respectively, at which more than 10,000 global leaders gathered to address economic uncertainties and unlock opportunities for sustainable growth in the global Islamic finance industry. These events produced a road map for 2018 and beyond by showcasing new technology and cutting-edge research.

¹⁶ <https://www.islamicfinancenews.com/bahrain-leads-in-takafulpenetration-in-the-middle-east.html>.

CAYMAN ISLANDS

*Anthony Oakes*¹

I LEGISLATIVE AND REGULATORY FRAMEWORK

i Legislative and regulatory regime

The Cayman Islands are a British overseas territory of the United Kingdom. They were also a dependency of Jamaica for administrative purposes between 1863 and 1962. Cayman law is therefore a common law system largely based on English common law and statutes, with some influences from Jamaica.

The legal system has not diverged far from that of England and Wales. Many of the divergences are a result of the Cayman Islands being an international financial centre. Companies and partnerships established in IFCs are commonly used in structuring financial transactions, including Islamic finance transactions. Accordingly, many of the divergences between Cayman and English laws have arisen because of the Cayman Islands' legislature's desire to facilitate, and provide confidence around, financial transactions. For example, there is no restriction on a Cayman company giving financial assistance for the purposes of the acquisition of its own shares or shares of a holding company.

The financial services industry in the Cayman Islands is regulated by the Cayman Islands Monetary Authority (CIMA).

The relevant legislation is summarised below.

Banking

'Banking business' is a regulated activity. Section 2 of the Banks and Trust Companies Law (2013 Revision) (the Bank Law) defines banking business as 'the business of receiving (other than from a bank or trust company) and holding on current, savings, deposit or similar account money that is repayable by cheque or order and may be invested by way of advances to customers or otherwise'.

The Monetary Authority Law (2016 Revision) and the Bank Law give CIMA the responsibility for both licensing and regulating banking business. In relation to licensing, CIMA may issue the following categories of banking licences:

- a* Category A Banking Licence;
- b* Category B Banking Licence; and
- c* Restricted Category B Banking Licence.

The Category A Licence is the broadest and permits domestic business with residents of the Cayman Islands as well as offshore business. The Category B Licence permits only business

¹ Anthony Oakes is a partner at Ogier.

conducted outside the Cayman Islands. The Restricted Category B Licence is subject to the same limitations as the Category B Licence, but the licensee is further restricted to a pre-approved customer base.

CIMA further categorises each type of bank into two further categories – home-regulated banks and host-regulated banks. CIMA's policy has different requirements for each type of entity. Home-regulated banks are banks incorporated in the Cayman Islands and are financially regulated by CIMA. Host-regulated banks are usually branches of a foreign parent bank that are subject to regulation by the parent's home regulator. CIMA's approach to the licensing (and continuing regulation) of home-regulated banks is stricter, including in relation to:

- a* capital adequacy requirements;
- b* financial resources;
- c* information required to be provided to key shareholders;
- d* financial resources of key shareholders;
- e* audit requirements; and
- f* the bank's local presence in the Cayman Islands.

While Section 17(1)(a) of the Bank Law states that it is the duty of CIMA to maintain a general review of the banking practice, Cayman statute does not regulate the type of banking products that can be offered by licensee banks. Accordingly, there is no regulation in relation to Islamic banking products.

In addition to the regulation of banking business, 'money services business' is also regulated by CIMA. The Money Services Law (2010 Revision) defines money services business as including:

- a* money transmission;
- b* cheque cashing;
- c* currency exchange; and
- d* the issuance, or sale or redemption of, money orders or travellers cheques.

Capital markets

The Securities Investment Business Law (2015 Revision) (the Securities Law) provides for the regulation of persons carrying on 'securities investment business', including market makers, broker-dealers, securities arrangers, securities advisers and securities managers in or from the Cayman Islands.

Securities are broadly defined in Schedule 1 of the Securities Law as including:

- a* shares;
- b* debentures, bonds and certificates of deposit;
- c* warrants;
- d* options;
- e* futures; and
- f* certain types of swaps.

The regulated activities are set out in Schedule 2 of the Securities Law and include:

- a* dealing in securities;
- b* arranging deals in securities;
- c* managing securities; and
- d* advising on securities.

No distinction is made in the Securities Law between Islamic securities and other securities.

Under the Securities Law, a person who engages in securities investment business must hold a Securities Investment Business Licence unless exempted under:

- a* Schedule 3 – Excluded Activities; or
- b* Schedule 4 – Excluded Persons.

Excluded Activities include where a company is dealing in securities on its own account or providing finance to enable a person to deal in securities. Excluded Persons include persons who carry on a securities investment business exclusively for sophisticated or high-net-worth persons and persons regulated by a recognised regulatory authority in the jurisdiction where the securities investment business is being conducted.

Offering of securities

In relation to the specific issue of the offering of securities:

- a* if the issuer of securities is a Cayman exempted company, pursuant to Section 175 of the Companies Law (2018 Revision), it is prevented from offering its securities to members of the public in the Cayman Islands unless it is listed on the Cayman Islands Stock Exchange; and
- b* if the issuer of securities is not incorporated or established in the Cayman Islands, it can offer its securities to investors established or operating in the Cayman Islands, but subject to the provisions of the Securities Law.

Again, there is no distinction between Islamic securities and other types of securities.

Insurance

Engaging in ‘insurance business’ is also a regulated activity. Section 2 of the Insurance Law 2010 defines insurance business as: ‘the business of accepting risks by effecting or carrying out contracts of insurance, whether directly or indirectly, and includes running-off business including the settlement of claims’.

The Insurance Law gives CIMA the responsibility of regulating insurance business in the Cayman Islands. This includes licensing, ongoing supervision and enforcement. The day-to-day regulatory oversight of the sector falls to CIMA’s insurance supervision division.

Similarly to the Bank Law, the Insurance Law focuses on the licensing requirements for insurers and their continued monitoring (particularly in relation to capital requirements, solvency, reporting and risk management).

Also similarly to the Bank Law, the Insurance Law does not stipulate what insurance products (be they Islamic or otherwise) a licensee may provide. However, Section 23(1) of the Insurance Law does state that CIMA may direct a licensee, in relation to a policy, a line of business or the licensee’s entire business, to refrain from conduct that constitutes unsafe or unsound practice.

Funds

The Mutual Funds Law (2015 Revision) (the MF Law) is the principal legislation applicable to investment funds and determines whether an investment fund is required to be registered, administered or licensed with CIMA. In general terms, the MF Law applies to open-ended funds whose interests are redeemable at the option of the investor and that do not qualify or elect for exemption or other exclusion. One of the most commonly used exemptions is for

funds with no more than 15 investors (the majority of whom are capable of appointing or removing the operator of the fund). We shall refer to funds to which the MF Law applies as 'regulated funds'. As a general rule, regulated funds tend to be hedge funds and in the form of a Cayman exempted company.

Under the MF Law, a regulated fund must not carry on business in or from the Cayman Islands unless a current offering document is filed with CIMA. The offering document must contain such information as is necessary to enable a prospective investor in the fund to make an informed decision as to whether or not to subscribe for equity interests in the fund.

The MF Law also imposes on regulated funds a number of continuing obligations, including:

- a* to file with CIMA material amendments to the current offering document within 21 days;
- b* to have its accounts audited annually by an auditor approved by CIMA and to file those accounts with CIMA within six months of the end of its financial year;
- c* to pay an annual filing fee; and
- d* to have appointed to its board of directors at least two directors at any one time. Generally, these should be individuals.

If CIMA is satisfied that a regulated fund:

- a* is or is likely to be unable to meet its obligations as they fall due;
- b* is carrying on or attempting to carry on business or is winding up its business voluntarily in a manner that is prejudicial to its investors or creditors;
- c* has not been directed and managed in a fit and proper manner; or
- d* has a person holding a position as a director, manager or officer who is not a fit and proper person to hold that position,

then CIMA may:

- a* cancel the fund's registration;
- b* require the substitution of any promoter or operator of the fund;
- c* appoint a person to advise the fund on the proper conduct of its affairs; or
- d* appoint a person to assume control of the affairs of the fund.

The MF Law applies equally to Islamic and non-Islamic funds. However, the majority of Islamic funds tend to be closed-ended private equity or property funds, which are structured either as exempted limited partnerships or exempted companies (see Section II.ii).

ii Regulatory and supervisory authorities

As discussed in Section I.i, CIMA is the principal regulator in the Cayman Islands. As discussed above, each governing statute gives CIMA certain powers in relation to the particular regulated sector and lists the measures that CIMA may take, as regulator. CIMA's principal functions are set out in the Monetary Authority Law (2018 Revision). Its regulatory functions not only include regulating and supervising financial services business, but also monitoring compliance with money laundering regulations. In August 2017, CIMA published a revised regulatory handbook that sets out the policies and procedures to be followed by CIMA. In particular, the handbook describes the policies and procedures for:

- a* giving warning notices to persons affected adversely by proposed actions of CIMA;
- b* giving reasons for CIMA's decisions; and
- c* receiving and dealing with complaints against CIMA's actions and decisions.

The handbook further states that CIMA is to have due regard to international standards governing banking, insurance and securities supervision.

The handbook also describes CIMA's approach to:

- a* licensing approval and cancellation – including for the banking, insurance and funds sectors;
- b* reviewing licensees' financial statements and on-site inspections of licensees' premises;
- c* anti-money laundering procedures to be followed by licensees; and
- d* enforcement – including applying for court orders.

The handbook is binding on all CIMA's committees and officers.

Also worthy of mention is the Cayman Islands General Registry. The primary function of this government department is to develop and implement policies and procedures for all registers under its administration to ensure their continued effective contribution to the financial services industry and the public. The registers maintained by the General Registry include the register of Cayman companies and Cayman partnerships. As discussed below, Cayman companies and partnerships are widely used in Islamic finance transactions.

II COMMON STRUCTURES

i Islamic transactions

As described in Section I.i, above, the Cayman Islands is an international financial centre. The benefits of companies incorporated in IFCs have been well documented – including stable legal systems (typically based on English law), low cost and efficient company incorporation, little or no taxation, no exchange control, trusted court systems and sophisticated professional infrastructure (with an array of experienced professional service providers).

Accordingly, Cayman exempted companies are used as the issuer (often described as the trustee) in many Islamic financing transactions, including *sukuk*, *wakalah* and *ijarah*. Exempted companies are the most common type of company incorporated in the Cayman Islands and are formed to conduct business outside the Cayman Islands. Exempted companies are similar in structure to companies formed in other common law jurisdictions: shareholders' liability is limited (typically by shares) and the directors manage the business of the company.

Specifically, the Cayman company is set up as an 'orphan' special purpose vehicle (SPV). The company is referred to as an SPV because it is formed solely for the purpose of the relevant financing transaction. The SPV is referred to as an orphan because the beneficial interest in the shares of the SPV, rather than being held by a parent company, is held by a trustee (either pursuant to a charitable trust or Cayman STAR Trust)² for charitable or other specific purposes. As a result of the trust structure, the SPV is not part of the company group that is the ultimate borrower in the financing transaction. In that way, in the event of the insolvency of the borrower, a court is unlikely to find that the SPV should be included within the assets of the

² A STAR Trust is a form of statutory trust that can be established for persons or purposes (charitable and non-charitable) or both. The STAR Trust statutory provisions only apply where the trust instrument expressly states that they are to apply.

borrower's insolvent estate. The SPV is also made 'bankruptcy remote' under its constitutional documents or the transaction documents, or both, because it is prohibited from undertaking any activities other than the financing transaction. In that way, the SPV is unlikely to be liquidated, with a view to the transaction remaining intact and the lenders being repaid.

The *sukuk* structure essentially works as follows:

- a* The Cayman SPV issues certificates to investors.
- b* The proceeds are used by the Cayman SPV to purchase an asset from the borrower. The asset is then leased back to the borrower.
- c* The borrower pays rent to the Cayman SPV so that the SPV may pay principal and coupon payments on the certificates.
- d* If specific events of default occur, the borrower is obliged to repurchase the asset at a certain exercise price, so that the SPV may redeem the certificates.

ii Closed-ended funds

As discussed in 'Funds' in Section I.i, open-ended funds are typically regulated by CIMA. These funds are usually hedge funds established in the form of Cayman exempted companies.

On the other hand, closed-ended funds (i.e., funds whose interests are not redeemable at the option of investors) are not regulated by CIMA. These funds typically include private equity and property funds and are often established as Cayman exempted limited partnerships (ELPs) under the Exempted Limited Partnership Law 2014.

The structure of an exempted limited partnership is essentially as follows:

- a* The general partner (GP) is solely responsible for the management of the ELP. Limited partners (LPs) are excluded from the management.
- b* Any debt or obligation incurred by the GP in the conduct of the business of an ELP is a debt or obligation of the ELP.
- c* To meet such debts or obligations, the GP may call on the capital commitments of the LPs. That is, under the terms of the ELP agreement, each LP will agree to contribute amounts to the ELP up to a certain fixed amount (i.e., its total capital commitment).

The Cayman ELP is one of the most commonly used investment vehicles in the world, both for Islamic and non-Islamic funds. Islamic funds are established in compliance with applicable shariah principles. For example, an Islamic fund may only invest in industries or properties that comply with Islamic law, but will be established using an ELP, similarly to a conventional fund.

III TAXATION

As the area is an international financial centre, there is little taxation. The Cayman Islands have no form of income or capital gains tax nor do they have any estate duty, inheritance tax or gift tax. Where transaction documents are executed in, or taken into, the Cayman Islands, stamp duty will generally be payable. In most cases, the stamp duty will be nominal. However, *ad valorem* stamp duty will be payable where the transaction involves a transfer of, or security over, Cayman real property or shares in a Cayman company that holds Cayman real property. In relation to transfers, stamp duty is payable at the rate of 7.5 per cent on the purchase price or market value of the property, whichever is higher. In relation to security, stamp duty is payable on a sliding scale of 1 to 1.5 per cent depending on the amount secured by the mortgage. The Cayman Islands is not party to any double tax treaties. The tax position is the same for both Islamic and other types of finance transactions.

IV INSOLVENCY

i Rescue procedures

Adopted to address the needs of the Cayman Islands as an international financial centre, the Cayman insolvency regime focuses on the rights of creditors. The Cayman insolvency regime has rescue procedures aimed at resuscitating near insolvent companies, notably:

- a* provisional liquidation – the company itself or its creditors or shareholders may apply for a provisional liquidator to be appointed. The objective is usually to preserve or protect the company’s assets until the hearing of the winding-up petition. However, a provisional liquidator may give the company time to restructure its business or to obtain financing; and
- b* schemes of arrangement – the objective is to allow the company to enter into an agreement with its shareholders or creditors, or both, to either:
 - restructure its affairs while solvent so that it can continue to trade and avoid liquidation; or
 - reach a compromise or arrangement with shareholders or creditors, or both, after liquidation proceedings have commenced.

A scheme of arrangement requires the sanction of the Grand Court for it to be binding on the company and its creditors.

ii Liquidation

In relation to liquidation proceedings, a company may be wound up:

- a* compulsorily by the court;
- b* voluntarily; or
- c* under the supervision of the court – this is in the scenario where the company voluntarily appoints a liquidator but it becomes clear that:
 - the company is or is likely to become insolvent; or
 - court supervision will facilitate a more effective, less expensive or quicker liquidation.

iii Creditor protection

The insolvency regime is friendly to creditors in a number of ways:

- a* there is an express provision that secured creditors may enforce their security without the permission of the court or reference to the liquidator;
- b* there are provisions dealing with fraud in anticipation of the winding up, with criminal penalties applying; and
- c* the court may require liquidators to assist in the criminal investigation of liquidated companies.

The Cayman insolvency regime applies equally to Islamic and non-Islamic transactions.

V JUDICIAL FRAMEWORK

The Cayman Islands (Constitution) Order 2001 establishes the Grand Court, the Court of Appeal and an independent judiciary. The Grand Court has five divisions to manage cases: the Admiralty, Civil, Criminal, Family and Financial Services. The majority of commercial cases are held in the Financial Services Division.

The Court of Appeal sits as a three-judge bench. Final appeal lies to the Judicial Committee of the Privy Council, in London.

In the absence of specific Cayman decisions, relevant decisions of the superior courts of England and Wales and of the countries of the Commonwealth, while not strictly binding, are highly persuasive. There have been no significant cases in relation to Islamic finance products or structures.

VI OUTLOOK

There has been a recent development in Cayman law that may affect the type of Cayman entity used in Islamic finance transactions: the Limited Liabilities Companies Law 2016 has created a new class of Cayman entity – a limited liability company (LLC), which is similar to a Delaware limited liability company. Going forward, these LLCs may be used as hedge fund vehicles, orphan SPVs or as GPs of ELPs, rather than Cayman exempt companies, particularly where the transactions are structured in jurisdictions that are familiar with Delaware limited liability companies. The advantages of an LLC include flexible treatment of profits and losses free from capital maintenance rules and the ability to stipulate, in the LLC agreement, that a person appointed to the board by a particular member may act in the interests of that member, rather than the LLC.

EGYPT

*Mahmoud Bassiouny*¹

I LEGISLATIVE AND REGULATORY FRAMEWORK

i Legislative and regulatory regime

Egyptian law does not have a codified definition as to what constitutes Islamic finance or an Islamic financial instrument, as the Egyptian Civil Code is meant to be compliant with Islamic *shariah*. However, the following points are worth mentioning:

- a* Banks can offer corporate or retail products denominated as ‘Islamic’ upon obtaining a relevant licence from the Central Bank of Egypt (CBE) (e.g., an *ijarah* licence or a *sukuk* licence). Only licensed banks can request these licences from the CBE.
- b* *Takaful* insurance is also regulated by the Financial Regulatory Authority (FRA) and there are licensed *takaful* insurance companies operating in Egypt. It is expected that a new version of Law No. 10 of 1981 (the Insurance Law) will be issued to take *takaful* insurance into account. Non-banking financial activities are generally subject to FRA supervision with the FRA board regulating said activities by way of decrees and FRA board resolutions.
- c* *Sukuk* are the most specifically regulated Islamic financial instruments, by virtue of Law No. 95 of 1992, as amended by Law No. 17 of 2018 (the Capital Markets Law), which covers all envisaged *sukuk* types, the issuance regime and redemption rights, with FRA being the competent regulator. Note, however, that as a matter of practice there has been no major *sukuk* issuance to date. It is also worth noting that Law No. 148 of 2001 (the Real Estate Finance Law), as amended, recognises *ijarah* as a method of financing real estate and defines it as the leasing of real estate ending with ownership. The Capital Markets Law prescribes different structures, including, inter alia, *sukuk murabahah*, *sukuk istisnah* and *sukuk ijarah*. In addition, the Real Estate Finance Law allows for all types of *ijarah* in relation to real estate in Egypt.

ii Regulatory and supervisory authorities

The two main bodies competent to regulate and supervise Islamic finance activities are (1) the CBE, which is the entity competent to grant licences to Egyptian banks seeking to offer Islamic finance products; and (2) FRA, which grants licences for *takaful* insurance activities (in addition to its general competence to oversee financial non-banking activities, including those activities that are structured or branded as Islamic). Only banks registered

¹ Mahmoud Bassiouny is a partner at Matouk Bassiouny & Hennawy. The information in this chapter was accurate as at September 2018.

with the CBE can request the licence mentioned at (1) and such banks must have established a competent *shariah* board, as a matter of standard market practice based on best international market practice.

Regarding financial non-banking activities, FRA Board of Directors' Resolution No. 8 of 2014 provides that an investment fund or a *takaful* provider that offers products marketed as 'compliant with *shariah* provisions' must establish a board to ensure compliance with *shariah* principles (i.e., the *shariah* board, similar to the board established by banks offering 'Islamic products'). *Takaful* companies as such are subject to *shariah* audit by FRA. The board's members must be chosen from a list of scholars and professionals registered with FRA, in a special register made for that purpose. FRA also has its own *shariah* board, which, as a matter of practice, serves to provide supervision and follow-up to the FRA board on products deemed Islamic.

II COMMON STRUCTURES

Most major Egyptian banks offer a range of Islamic corporate and retail finance products, and have their own *shariah* boards. These banks may also offer conventional finance products in addition to Islamic products. For large-scale greenfield projects or asset acquisition financing, it is typical to have an international bank or development finance institution participate in the financing (with a *shariah*-compliant mandate forming a part of the finance scheme), with *ijarah* being the most commonly used tool. Because there is no specific regime under Egyptian law for ownership in Islamic finance transactions (since Egyptian law only recognises the transfer of title of real estate by way of official notarisation, which can be impractical in the case of Islamic financing owing to the timescales involved), Egyptian banks must proceed with an Islamic transaction as if it is a conventional one. For example, in an *ijarah*, whenever a bank is leasing an asset to a lessee, it is considered as the owner of said asset under the finance documentation, but the lessee will remain the registered owner and will provide a security on said asset to the bank. Egyptian companies must also adopt the Egyptian Accounting Standards for auditing purposes, even if the documentation provides for other accounting standards (e.g., those of the Accounting and Auditing Organization for Islamic Financial Institutions).

Egyptian banks with a licence from the CBE offer a range of *shariah*-compliant products, including *murabahah*, for consumer goods purchases (with purchase of cars being relatively successful) and banks have also started to offer service *ijarah* to finance service needs, in particular in the healthcare and education sectors.

III TAXATION

There is no specific treatment for Islamic financial products under Egyptian law. As long as the provider of the financing is a licensed bank, the transaction will be treated as a financing by the Egyptian tax authorities and, accordingly, the general tax provisions under Egyptian law would apply, including withholding tax, stamp duties, income taxes and VAT.

IV INSOLVENCY

There is no specific insolvency or bankruptcy regime for Islamic finance participants under Egyptian law. The Egyptian bankruptcy regime was previously set out in the Egyptian Commercial Code; however, a new Bankruptcy Law² was issued recently. The competent Egyptian commercial courts would adjudicate insolvency and bankruptcy-related disputes, regardless of whether the creditors or debtors have used *shariah*-compliant products in their dealings. As a matter of Egyptian law, the main criterion for the determination of an Egyptian court in relation to any bankruptcy proceeding would be the debtor's general inability to meet its debts when they fall due. The Bankruptcy Law introduces a new approach in dealing with persons and entities who are facing financial or administrative distress, such as: mediation, restructuring procedures and company rescue procedures, giving both debtors and creditors a higher degree of flexibility in dealing with debts.

V JUDICIAL FRAMEWORK

i Courts

There is no separate court system for Islamic finance products or participants. Civil courts or the economic courts would have jurisdiction to oversee disputes in this area (or arbitration, if agreed upon by the parties in their contractual arrangements). There is no separate legal regime for *shariah* under Egyptian law. However, it is worth noting that the Egyptian Constitution provides that *shariah* is one of the country's principle sources of legislation. To the extent that a *shariah* principle is claimed, Egyptian courts would have a discretionary authority to apply that principle in light of Egyptian legislation and public order.

ii Cases

There have been no recent cases in Egyptian courts relevant to the topic of Islamic finance.

VI OUTLOOK

Although one of the earliest modern finance initiatives intended to be *shariah*-compliant was in Egypt (Mit Ghamr Savings Bank, 1963), Islamic finance has not yet picked up in Egypt. The association made by the general public between Islamic finance and various pyramid schemes dubbed 'Islamic' in the 1980s and, more recently, certain political groups, is often said to be part of the reason for this. This is changing, however, as several 'Islamic banks' have started operating in Egypt, whether directly (such as Abu Dhabi Islamic Bank, which has an Egyptian presence) or through specific project financing, often with a development angle. The Islamic Development Bank's Islamic Corporation for the Development of the Private Sector is a notable example of this. There are also signs that the regulatory landscape is starting to integrate Islamic financial concepts. *Sukuk* have been regulated since 2013, and there have been announcements that a new Insurance Law will explicitly recognise and regulate *takaful*. Also, as clarified above, FRA is increasingly adapting its tools to oversee financial non-banking products marketed or intended as *shariah*-compliant.

2 Law No. 11 of 2018.

JAPAN

*Naoyuki Kabata and Satoshi Kato*¹

I LEGISLATIVE AND REGULATORY FRAMEWORK

Japanese law does not provide a special legal framework for supporting and regulating Islamic finance. Consequently, Islamic finance needs to be implemented under the legal framework for conventional finance in Japan. Under the laws and regulations governing conventional finance, an Islamic finance product that has legal characteristics that are equivalent to those of a conventional finance product or that is otherwise substantially equivalent or similar to a conventional finance product might be permitted as a type of conventional finance product. Further, certain types of Islamic finance products are plainly permitted pursuant to special clauses of the laws and regulations governing conventional finance. The scope of these permitted Islamic finance products has gradually been expanded over the past 10 years.

i Legislative and regulatory regime

Islamic banking

There is no special legal framework for banks that engage in Islamic finance. In general, Japanese law requires an entity engaging in the business of deposits, lending or money transfers (exchange transactions) to be licensed. A deposit or money transfer business (exchange transaction business) must have, in principle, a banking licence pursuant to the Banking Act of Japan (BA). A licensed bank may also engage in the lending business. However, when a person or entity only conducts a lending business (i.e., not concurrently with a deposit-taking business), that person or entity is required to be registered as a money lending business operator under the Money Lending Business Act of Japan (MLBA).

In addition, a sale transaction with instalment payments and a lease transaction with rent payments, which provide functions that are economically similar to lending, are regulated differently. Under the Instalment Sales Act of Japan (ISA), sales transactions with instalment payments can be conducted with or without registration depending on the specific type of transaction at issue. By contrast, lease transactions with rent payments can generally be conducted without any licence or registration.

Generally, transactions that target a customer in Japan from a foreign country are subject to the same licence requirements stated above. As a result, a foreign bank that engages in the banking business involving customers in Japan typically opens a Japanese subsidiary or branch and obtains a banking licence under the BA.

¹ Naoyuki Kabata is a partner and Satoshi Kato is a former associate at Anderson Mōri & Tomotsune.

The BA and its subordinate rules and guidelines that are applicable to licensed banks clarify the types of Islamic finance products that may be provided by a licensed bank and its subsidiaries (including those outside Japan). The following are identified as permissible Islamic finance products for licensed banks:

- a* a commodity sale and purchase transaction that is economically equivalent to lending, provided that (1) the commodities involved in the transaction are tradable in an exchange; and (2) the bank has removed all risks related to the commodities other than the purchaser's credit risk in paying the sale price, including the risk arising from the failure to sell or buy the commodities;
- b* an asset lease transaction that is economically equivalent to lending, provided that (1) the bank has removed all risks related to the asset involved in the transaction other than the lessee's credit risk in paying the rent; (2) the transaction must possess the characteristics of a financing lease transaction that the bank licensed under the BA is permitted to perform; and (3) the transaction does not involve any business or transaction that banks are prohibited from conducting, such as construction work;
- c* an acquisition of interest in a customer's business that is economically equivalent to lending, provided that (1) the cash flow generated by the interest is similar to that generated in a lending transaction; and (2) the bank has removed all risks related to the customer's business other than the customer's credit risk;
- d* a commodity sale and purchase transaction that is economically equivalent to a deposit, provided that the bank has removed all risks related to the commodities involved in the transaction; and
- e* a commodity sale and purchase transaction that is economically equivalent to an interest rate swap or currency swap, provided that the bank has removed all risks related to the commodities involved in the transaction.

Transactions referenced in items (a), (d) and (e) correspond to commodity *murabahah* transactions, while the transaction referenced in item (b) corresponds to *ijarah* and *istisna* transactions. The transaction described in item (c) corresponds to *musharakah* and *mudarabah* transactions. However, whether a particular Islamic finance product is permissible must be determined by analysing if the specific terms and conditions of that product meet the requirements of the BA and its subordinate rules and guidelines.

Further, the following are identified by the BA and its subordinate rules and guidelines as permissible Islamic finance products for a subsidiary of a licensed bank:

- a* those Islamic finance products that are deemed permissible for a licensed bank; and
- b* a transaction that does not involve cash lending, but that should be deemed to constitute the equivalent of cash lending, provided that (1) the customer of the transaction (i.e., the deemed borrower) is in a jurisdiction where the receipt of interest is prohibited owing to religious restrictions; and (2) the transaction is conducted pursuant to a judgment authorising the transaction from a board that is constituted by members who have special knowledge (which effectively refers to a *shariah* board) confirming that the transaction does not fall within the category of cash lending from the perspective of the applicable religious discipline.

In addition to those described above, other types of Islamic finance products might be permissible if the products are substantially the same as or similar to a conventional finance product. For example, a *mudarabah* transaction might be regarded as being similar to the

acquisition of interests under a silent partnership agreement or partnership agreement. As a result, although certain filing requirements would apply, a licensed bank might be permitted to conduct such a transaction depending on the specific characteristics of the products and the business conducted by the *mudharabah* business operator.

Capital markets

Japanese law also does not provide any special legal framework for Islamic finance in terms of capital markets products. Under the laws and regulations governing conventional finance, a securities brokerage business is subject to a registration requirement. More specifically, the Financial Instruments and Exchange Act of Japan (FIEA) requires a securities broker to register as either a Type I financial instruments business operator or a Type II financial instruments business operator depending on the types of securities that the broker handles. Thus, if an Islamic finance product is classified as a type of security under Japanese law, the broker of the product must register as either a Type I or Type II financial instruments business operator as described above. While a foreign securities broker is also subject to the registration requirements when it has customers in Japan, certain exemptions are provided by the FIEA for the benefit of a foreign securities firm (i.e., a foreign entity that is licensed to conduct a securities brokerage business under its home country's law). For example, without registering under the FIEA, a foreign securities firm may promote securities from outside Japan to certain limited categories of sophisticated investors such as banks, insurance companies, trust companies, broker-dealers and discretionary securities investment managers (all of which must be licensed in Japan).

With respect to the origination of *sukuk* in Japan, amendments to tax legislation enabled the issuance of *sukuk* using a specified purpose trust created under the Act on Securitisation of Assets of Japan (ASA). Based on a typical *sukuk* scheme that uses a sale and leaseback arrangement (*sukuk al-ijarah*), the originator entrusts its asset (such as real property) to a specified purpose trust and, in exchange, obtains special beneficial interests (a quasi-bond beneficial interest), which are to be distributed to investors as *sukuk*. The amendments to tax legislation, for example, have caused distributions payable under such special beneficiary interests to be treated the same as interest payable under corporate bonds. They have also resulted in exemptions to the imposition of real property registration tax and acquisition tax on the buy-back of real property by the originator upon the redemption of *sukuk*. The amendments to the tax legislation have provided a level playing field to *sukuk* issued through a specified purpose trust (see Section III for details).

With respect to the distribution in the Japanese market of *sukuk* originated outside Japan, the conventional regulatory framework applied to the sale of bonds will similarly apply. Consequently, assuming that the foreign *sukuk* is classified as a Type I security because of its high-liquidity, there are primarily two routes to distribute the *sukuk* that originated outside Japan. If those who have been solicited to purchase the foreign *sukuk* include one or more qualified institutional investors and 49 or less non-qualified institutional investors (i.e., private placement or private sale), then the foreign *sukuk* may be sold via a relatively simple procedure that does not require the filing of a securities registration statement. However, if the foreign *sukuk* is distributed via a public offering or public sale, securities registration statements typically must be filed, which is a fairly cumbersome and costly process.

Insurance

There is no special legal framework for Islamic insurance (*takaful*) under Japanese law. Further, because the legal structures of conventional insurance and *takaful* insurance are different, a Japanese insurance company, which is licensed under the Insurance Business Act of Japan (IBA), is unlikely to be permitted to handle *takaful* insurance. However, Japanese law does not fully discuss whether a Japanese insurance company is permitted to handle *takaful* insurance.

Funds

There is no special legal framework for Islamic funds under Japanese law. However, under the laws and regulations governing conventional finance, there are several legal frameworks for funds in Japan. Consequently, it may be possible to establish Islamic funds by restructuring one such legal framework to satisfy the Islamic finance requirements, such as by (1) restricting the investment portfolio to *shariah*-compliant business or products; and (2) managing the funds through a *shariah* board. Note that using existing investment management companies as fund managers or existing trust companies as trustee might cause *shariah* issues since most of these companies in Japan are affiliates of a licensed bank and engage in a large number of conventional finance transactions.

Under the FIEA, a discretionary securities investment manager is required to register as an investment management business operator, and a non-discretionary securities investment adviser is required to register as an investment advisory business operator. Accordingly, the fund managers of Islamic funds established in Japan are likely to be required to register either as investment management business operators or investment advisory business operators, depending on the specific roles of the fund managers under their respective fund schemes.

ii Regulatory and supervisory authorities

The Financial Services Agency of Japan implements the BA, the FIEA, the MLBA and the IBA. The Ministry of Economy, Trade and Industry implements the ISA, which governs sale transactions involving instalment payments.

Islamic finance business is treated like any other finance business in Japan. Accordingly, it is subject to the supervision and authority of the regulatory authorities. The regulatory authorities monitor the activities of a finance business through a combination of on-site and off-site inspections. If any issue or failure respecting compliance is found, the regulatory authorities conduct additional examinations. If the issue or non-compliance is material, the regulatory authorities may impose administrative sanctions, such as an order for business improvement, an order for suspension of business or an order for revocation of the relevant licence. Moreover, if there is any breach of criminal law, criminal penalties may also be imposed.

II COMMON STRUCTURES

To date, our understanding is that no Islamic finance product governed by Japanese law has been created. Nonetheless, Japanese financial institutions, such as Japanese banks and securities firms, engage in Islamic finance business in Malaysia and Middle Eastern countries through their subsidiaries or branches.

III TAXATION

Special tax treatment is applied to Japanese *sukuk*, which is structured using a specified purpose trust under the ASA. Although the Japanese *sukuk* is a trust beneficiary interest, as a result of a series of amendments to the tax legislation, the Japanese *sukuk* is now treated more like a bond than a trust beneficiary interest from the tax perspective. Under Japanese tax law, the dividends to be paid to the foreign holders of a trust beneficiary interest are subject to taxation. However, the foreign holders of a Japanese *sukuk* are exempted from such taxation when they register the Japanese *sukuk* with the Japanese depository system and receive the dividends of the Japanese *sukuk*.

In addition, special tax treatment that reduces the transactional costs of typical Japanese *sukuk* backed by real property has been introduced. When an originator buys real property back from the trustee upon redemption, the buy-back transaction is normally subject to registration and licence tax and real property acquisition tax. However, if the transaction is conducted as part of a Japanese *sukuk* transaction, it is not subject to this taxation under certain conditions.

Other than the special tax treatment described above, no special tax treatment is given to Islamic finance. Islamic finance transactions are subject to general taxation rules under Japanese law. For example, a sale and purchase in a *murabahah* transaction will be subject to consumption tax, registration and licence tax and real property acquisition tax depending on the types of assets at issue.

IV INSOLVENCY

No special legal framework is provided for the treatment of Islamic finance under Japanese bankruptcy procedures. Further, no court precedent is available. Consequently, Islamic finance products may be subject to the rules that are applicable to conventional financial products that are similar to the relevant Islamic finance products.

V JUDICIAL FRAMEWORK

i Courts

Because no *shariah* court has been established in Japan, a conventional Japanese court will have jurisdiction over a dispute in relation to Islamic finance. Even if the parties agree to designate *shariah* as the governing law, it is unlikely that a Japanese court will apply *shariah* as the law governing the judgment in that case.

ii Cases

There is no available case in which a Japanese court has handled a dispute in relation to Islamic finance.

VI OUTLOOK

The legal framework supporting and regulating Islamic finance is being gradually developed, primarily in the area of banking and *sukuk*. Because of the *de minimis* Muslim population in Japan, the Islamic finance retail business is unlikely to become prevalent in Japan. By contrast, the wholesale Islamic finance business, in particular for Muslim investors or

domestic companies engaging in business in Muslim countries, is likely to be the subject of increasing demand. Further development with respect to the legal, accounting and taxation framework in response to the demand from private sectors engaging in Islamic finance business is strongly expected to propel Islamic finance in Japan forward.

LUXEMBOURG

*Frank Mausen, Christopher Dortschy, Evelina Palgan and Zofia White*¹

I INTRODUCTION

The Grand Duchy of Luxembourg (Luxembourg) has long embraced Islamic finance as an important area of international finance and has taken an active role in fostering cooperation with firms and institutions engaged in *shariah*-compliant transactions. To create an environment conducive to the carrying out of such transactions in or via Luxembourg, Luxembourg has undertaken multiple initiatives designed to identify the particular needs of Islamic financial players and how they can be catered for. Often-cited examples of Luxembourg's credentials as an Islamic finance centre include the establishment in Luxembourg, in 1978, of the first Islamic finance institution in a non-Muslim country (the Islamic Banking System); authorising, in 1983, the first *shariah*-compliant insurance company in Europe; and the listing, in 2002, of *sukuk* on the Luxembourg Stock Exchange for the first time in Europe.² More recently, in 2009, the Luxembourg Central Bank (BCL), as the first European central bank, joined the Islamic Financial Services Board and the following year the BCL became one of the founding members of the International Islamic Liquidity Management Corporation.³

One of the conclusions reached on the basis of the research conducted by the various working groups, set up under the auspices of the Luxembourg government, was that Luxembourg's legal system provides investors and promoters interested in *shariah*-compliant products with a choice of suitable vehicles.⁴ The confirmation of the tax treatment of *shariah*-compliant vehicles and the development of best practice guidelines for Islamic financial services followed soon afterwards.⁵ The time and effort put in by Luxembourg's financial services sector into growing its Islamic finance competencies have paid off – Luxembourg has become a prime location for the listing of *sukuk* and, in terms of the number of Islamic funds set up in the market, Luxembourg is the largest Islamic fund hub outside the Muslim world and the third largest globally.⁶

1 Frank Mausen is a partner, Christopher Dortschy is a counsel, Evelina Palgan is a senior associate and Zofia White is an associate at Allen & Overy SCS (Luxembourg).

2 Luxembourg for Finance, *Islamic Finance*, January 2017.

3 Ernst & Young, *Luxembourg: the gateway for Islamic finance and the Middle East*, EY Luxembourg, May 2017.

4 See footnote 2.

5 *ibid.*

6 See footnote 3.

II LEGISLATIVE AND REGULATORY FRAMEWORK

In Luxembourg, there are no laws dedicated specifically to Islamic financial products or services. The existing legal framework has proved both flexible and innovative enough to accommodate the demands of Islamic financial practitioners, implementing various *shariah*-compliant structures through the use of Luxembourg vehicles and legislation. It is also relatively common and straightforward to combine, in a single transaction, elements of Luxembourg law with foreign law-governed agreements and structuring tools, such as, for instance, a trust governed by English law. Although it currently has no equivalent under Luxembourg law, an English law trust will generally be recognised, subject to certain conditions, by Luxembourg courts on the basis of the Convention on the law applicable to trusts and on their recognition concluded at The Hague on 1 July 1985. An English law trust declared in favour of *sukuk* holders over the underlying assets held by the issuer of *sukuk* will allow *sukuk* holders to retain a form of ownership over those underlying assets as prescribed by *shariah* law.

i Legislative and regulatory regime

Banking

The regulatory regime applicable to credit institutions in Luxembourg is mainly shaped by the European directives and regulations dealing with the banking and the investment sectors,⁷ as further completed by national law. All the provisions and requirements in force in Luxembourg relevant for credit institutions would apply to Islamic banks as no specific regime is provided, or indeed required, for this type of institution. This was confirmed by the findings of a cross-sector task force set up by the Luxembourg government in 2008. The relevant provisions of European law are implemented in large part in the Luxembourg act of 5 April 1993 on the financial sector, as amended (the Banking Act), and in the Luxembourg act of 18 December 2015 on the failure of credit institutions and certain investment firms, as amended.

According to the Banking Act, no person established under Luxembourg law may carry on the business of a credit institution without holding a written authorisation from the Minister responsible for the Commission de Surveillance du Secteur Financier (CSSF), which is the Luxembourg banking and financial supervisory authority. This licensing requirement to carry out banking and financial activities also applies to Islamic banks. Since 2014, Luxembourg has been a participating member of the Single Supervision Mechanism (SSM), which means, among other things, that entities willing to carry out banking activities in and from Luxembourg must obtain their licence from the European Central Bank (ECB), through the services of the CSSF (which remains the point of entry for licence applications).

Except for covered bond banks (the exclusive activity of which is to issue covered bonds), Luxembourg banks (including Islamic banks) qualify as ‘universal’ banks (which means that Luxembourg credit institutions are authorised to carry out any activity of the financial sector). According to the principle of the European passport, a Luxembourg bank may provide services, either through a branch or on a cross-border basis, in any other country of the European Economic Area (EEA) without any further licensing requirement in a host

⁷ The most recent and fundamental pieces of legislation being Directive 2013/36/EU and Regulation (EU) No. 575/2013 in the banking field and Directive 2004/39/EC, repealed by Directive 2014/65/EU on markets in financial instruments (MiFID) in the investment field.

country. A Luxembourg branch of a third-country institution (from outside the EEA) would, however, require a specific type of licence in Luxembourg, which would not allow it to benefit from the European passport.

Luxembourg banks are subject to two main sets of requirements:

- a* those relating to prudential supervision aimed at preventing systemic risks; and
- b* those relating to investors' and clients' protections that mainly stem from Directive 2014/65/EU⁸ and the EU consumer protection rules.

The prudential regulation imposes a number of requirements and ratios in terms of internal governance, own funds, liquidity and risk management, whereas the client and investor protection corpus requires certain conduct of business rules to be implemented and a high level of contractual formalism when dealing with clients.

As mentioned above, the CSSF is Luxembourg's national competent authority for banks with respect to both the prudential aspects and the client protection aspects. However, in the context of the SSM, the competence of the CSSF in relation to prudential matters is delegated to it by the ECB, which is now, as a matter of principle, the competent supervisory authority in the eurozone. Any credit institution that will qualify as a significant institution would be under the direct supervision of the ECB for those aspects. The CSSF remains the competent authority for less significant institutions.

Investment funds

Shariah investment funds may be set up under the general legal framework applicable to investment funds in Luxembourg as there is no specific legal requirement concerning these products.⁹ Therefore, these funds fall, depending on their structure, within the scope of the Companies Act,¹⁰ the Alternative Investment Fund Managers Act (AIFM Act)¹¹ or one of the Product Acts, or a combination of these.¹² The Association of the Luxembourg Fund Industry (ALFI) has also published a set of best practice guidelines for setting up and servicing Islamic investment funds,¹³ which have become an international standard in the financial sector.¹⁴ Thus, from a supervisory and regulatory perspective, there is no particular distinction between a *shariah* investment fund and any other type of fund.

The common regulatory principles applicable to managers of a regulated investment fund or its regulated external manager set up under Luxembourg law must also be fulfilled. For these investment funds and asset managers, *shariah* board members must therefore be of sufficiently good repute and be sufficiently experienced in relation to the investment policy of the concerned investment fund.¹⁵ The administrative practice is constantly changing.

8 MiFID.

9 CSSF, *Investment Funds and Islamic Finance*, 11 May 2011.

10 The Luxembourg act of 10 August 1915 on commercial companies, as amended.

11 The act of 12 July 2013 on alternative investment fund managers, as amended.

12 The term refers to the act of 15 June 2004 relating to the investment company in risk capital (the SICAR Act); the act of 13 February 2007 concerning specialised investment funds (SIF) (the SIF Act); the act of 17 December 2010 relating to undertakings for collective investment (UCI) (the UCI Act); and the act of 23 July 2016 on reserved alternative investment funds (the RAIF Act); each as amended or replaced from time to time.

13 ALFI, *Recommendations for setting up and servicing Islamic funds*, December 2012.

14 See footnote 2.

15 CSSF, *Investment Funds and Islamic Finance*, Luxembourg, 11 May 2011.

For instance, for certain regulated funds the CSSF may require that a board member be specifically designated as being in charge of anti-money laundering and counter terrorist financing (AML/CFT) matters, even where this function is delegated, and this therefore would require specific AML/CFT knowledge. Equally, the CSSF may also stipulate that the board members dedicate sufficient time to the regulated fund, and it may control the number of directorship mandates and time allocated per mandate by the board members. This rule has already been set in a circular for certain internally managed funds and asset managers, and limits managing members to a maximum of 20 mandates and 1,920 hours per year.

Capital markets

Traditional *shariah*-compliant structures can be replicated using Luxembourg vehicles, with the full benefits of the applicable Luxembourg tax and legal regime. A Luxembourg securitisation undertaking subject to the Securitisation Act¹⁶ (discussed in more detail below) is frequently the vehicle of choice for clients who seek to raise finance in compliance with *shariah* principles, in particular using *murabahah* and *ijarah* structures.¹⁷

As regards the offering of securities in Luxembourg – whether by way of private placement, an offer to the public or admission to trading on the regulated market or the Euro MTF market of the Luxembourg Stock Exchange, the same rules apply to *sukuk* as to conventional bonds. While private placements are not subject to any regulation and can be carried out without any form of offering document, an offer of securities to the public will (unless an exemption is available) have to be conducted in accordance with the Prospectus Regulation,¹⁸ which requires the publication of a prospectus drafted in accordance with the Prospectus Delegated Regulations.¹⁹ The Prospectus Regulation also requires a prospectus to be published in connection with the admission of securities to trading on the regulated market of the Luxembourg Stock Exchange. Once approved in Luxembourg by the CSSF (in circumstances where Luxembourg is the issuer's home Member State within the meaning of the Prospectus Regulation), a prospectus prepared in compliance with the Prospectus Regulation and the applicable annexes of the Prospectus Delegated Regulations can be used for public offers or admission to trading on regulated markets in other countries of the EEA without the need for a separate approval from the local competent authorities (subject to the CSSF notifying the competent authorities of its approval). Issuers of securities traded on the regulated market of the Luxembourg Stock Exchange will have to comply with the highly harmonised ongoing obligations relating to transparency and prohibition of market abuse. Alternatively, securities may be admitted to trading on the Euro MTF market of the Luxembourg Stock Exchange, which is not included in the list of regulated markets published by the European Commission, but which has built up a strong international reputation among issuers and investors. An offering circular to be prepared in connection with trading on the Euro MTF market will be approved by the Luxembourg Stock Exchange and it must comply with the disclosure requirements set out in the Rules and Regulations of the Luxembourg Stock Exchange – these requirements are lighter than those under the Prospectus Regulation, but they do not offer the possibility of 'passporting' the offering

16 The Luxembourg act of 22 March 2004 on securitisation, as amended.

17 See footnote 2.

18 Regulation (EU) 2017/1129 of the European Parliament and of the Council.

19 Commission Delegated Regulation (EU) 2019/979 and Commission Delegated Regulation (EU) 2019/980.

circular to other jurisdictions. The Rules and Regulations of the Luxembourg Stock Exchange also prescribe most of the ongoing disclosure requirements applicable to issuers of securities admitted to trading on the Euro MTF market.

Those interested in issuing or investing in *sukuk* should note that the Luxembourg Stock Exchange is a prime listing location for *sukuk* in Europe. At the end of 2016, the aggregate amount of *sukuk* traded on the markets of the Luxembourg Stock Exchange reached US\$95 billion.²⁰ Issuers of *sukuk* who have chosen the Luxembourg Stock Exchange come from Muslim countries as well as Europe, Hong Kong, South Africa and the United States.²¹

ii Regulatory and supervisory authorities

In Luxembourg, there is no office or authority charged with the supervision and monitoring of Islamic financial transactions or market participants using *shariah*-compliant structures. The CSSF is a secular institution, which will treat Islamic financial transactions in the same way as any other financial activity subject to its supervision. The extent of the CSSF's supervisory role is very broad and covers a wide range of actors in the financial sector, including regulated investment funds (also those that are *shariah*-compliant), regulated securitisation vehicles and credit institutions, to name just a few (but excluding insurance undertakings, which are supervised by the Insurance Commission). If a particular project falls within the scope of the CSSF's competence, the regulator will aim to ensure compliance with all relevant Luxembourg laws and regulations. Whether the project also meets the conditions set under *shariah* law would, from a Luxembourg law perspective, be a matter of contractual arrangements between the parties.

III COMMON STRUCTURES

i Investment funds

In Luxembourg, a large variety of *shariah*-compliant vehicles are available to asset managers and investors. The choice of investment structure depends on the investment policy, the investors targeted and the level of regulation desired. *Shariah*-compliant asset allocation can be achieved by setting out a strong investment strategy together with a *shariah*-oriented selection process. For instance, a *shariah*-compliant fund must follow the principles of equal treatment of shareholders and the prohibition of undue enrichment. In practice, this means that shares subscribed for by investors must be of equal value. Consequently, preference shares in an investment company (generally permitted under the Companies Act) are not allowed.²²

20 Luxembourg Stock Exchange, 'LuxSE Listing services for Sharia-compliant securities', available at www.bourse.lu/documents/brochure-LISTING-Sharia.pdf.

21 *ibid.*

22 Muhammad Ayub, *Understanding Islamic Finance*, 2009.

ii Available structuring options

From a legal standpoint, any Luxembourg investment vehicle can be used to set up a *shariah*-compliant fund. Generally, a Luxembourg investment fund can take either a corporate form²³ or a contractual form.²⁴

From a regulatory standpoint, *shariah*-compliant investment funds can either be structured as undertakings for collective investment in transferable securities (UCITS) governed by Part 1 of the UCI Act of 17 December 2010²⁵ or alternative investment funds (AIFs) within the meaning of Directive 2011/61/EU, as amended (the AIFMD). The main difference between the two kinds of funds is that only UCITS can be marketed on a pan-European cross-border basis to retail and professional clients under the UCITS passport, whereas AIFs can principally only be marketed to professional investors²⁶ under the AIFMD passport.²⁷ Certain specialised investment funds (SIFs) and investment companies in risk capital (SICARs) may not qualify as AIFs.

A SIF is a lightly regulated, operationally flexible and tax-efficient multipurpose investment fund for a pool of well-informed investors.²⁸ Even though a SIF does not have to comply with specific investment restrictions, it must follow the principles of risk diversification.²⁹ A SICAR is a regulated and tax-efficient structure, specifically designed for private equity and venture capital investments.³⁰ In contrast to a SIF, a SICAR may concentrate its assets in one single project as long as it invests in risk capital. Investments of a SICAR must be characterised by a high risk and an intention to develop the target entities. The purpose of the SICAR may consequently be in contradiction with the prohibition of *gharrar* (i.e., uncertainty and speculation) in Islamic finance. A reserved alternative investment fund (RAIF) is a vehicle reserved to well-informed investors encompassing the characteristics and structuring flexibilities of SIFs or, alternatively, SICARs, without being subject to any regulatory approval or supervision by the CSSF. The supervision is, however, operated indirectly as the manager must be regulated under the AIFMD.

Another option available to *shariah* promoters and investors is a Part II Fund, which is a flexible but regulated vehicle open to both retail investors and professional investors. Part II Funds must invest their assets according to the principles of risk diversification but are not limited as to the type of assets into which they can invest.

23 The most commonly used corporate forms are those of a public limited company (*société anonyme*), a private limited liability company (*société à responsabilité limitée*), a corporate partnership limited by shares (*société en commandite par actions*), a common limited partnership (*société en commandite simple*) or a special limited partnership (*société en commandite spéciale*).

24 This refers to the *fonds commun de placement* (FCP). Investment funds in the form of an FCP can only be set up under the UCI Act, the SIF Act and the RAIF Act.

25 UCITS are UCIs that are compliant with Directive 2009/65/EC, as amended.

26 UCIs under Part II of the UCI Act (Part II Funds) qualify as AIFs but can, from a Luxembourg perspective, be marketed to retail investors.

27 If the AIFs are managed by a fully authorised alternative investment fund manager under the AIFMD.

28 ALFI, 'sif-specialised investment funds', available at www.alfi.lu/setting-luxembourg/alternative-investment-funds/sif.

29 *ibid.*

30 ALFI, 'sicar – investment company in risk capital', available at www.alfi.lu/setting-luxembourg/alternative-investment-funds/sicar.

UCITS are open-ended funds investing in transferable securities such as units, bonds, money-market instruments and certain types of derivatives.³¹ These funds are harmonised on an EU level and widely sold to Islamic investors. The UCITS regime lays down common requirements for the organisation, management and oversight of such funds and imposes rules relating to diversification, liquidity and use of leverage.³² UCITS offer, therefore, high levels of investor protection and may incorporate *shariah* features, such as:

- a a ban on investment in any interest-bearing assets or debt instruments and cleansing of cash and dividends receipts;
- b a ban on futures or forward contracts, derivatives or short sales;³³
- c prohibition of investment related to *haram* activities such as gambling, alcohol and tobacco (including the advertising and marketing of these activities); and
- d creation of a *shariah* advisory board.³⁴

For further illustration purposes, government *mudarabah* certificates (i.e., a non-debt-creating mode of finance issued by the sovereign state) and commodity *murabahah* deposit (i.e., a short-term fixed income deposit) would generally qualify as eligible investments for UCITS.³⁵ However, specific consideration should be given to commodity *murabahah*, as the CSSF would only consider these as UCITS-eligible investments if the issuer is a credit institution that has its registered office in the EU or a non-EU state with equivalent rules.³⁶

iii Real estate and private equity investments

Real estate and private equity investments are characterised by their long-term and illiquid nature. The financing aspect of these investments is challenging because *shariah* law prohibits the use of conventional debt structures. In Luxembourg, this challenge can, however, be overcome by using alternative *shariah*-compliant instruments, such as *sukuk al-murabahah* (i.e., sales-based financing) or *sukuk al-ijarah* (i.e., lease-based financing) to finance the acquisition of assets.³⁷

With respect to leverage, under *shariah* law, debt financing and the payment of interest are proscribed (*riba*).³⁸ In practice, however, it is usually accepted that a *shariah*-compliant fund may engage in leverage through the use of *shariah*-compliant financing instruments.³⁹ Conventional loans or interest-bearing instruments are not permitted. It is also conceivable to open investment to additional equity-based investors using a *musharakah* contract whereby

31 European Commission, 'Background note: Draft Commission directive implementing Council Directive 85/611/EEC as regards the clarification of certain definitions', available at http://ec.europa.eu/internal_market/investment/docs/legal_texts/assets/070117_memo_en.pdf.

32 European Commission, White paper on enhancing the single market framework for investment funds, 2006.

33 See footnote 13.

34 Oliver R Hoor and Pierre Kreemer, Luxembourg, *Une localisation de choix pour structurer des investissements immobiliers conformes à la Sharia*, Les Cahiers du Droit Luxembourgeois.

35 See footnote 13.

36 *ibid.*

37 *ibid.*

38 Karim Ginema and Azhar Hamid, *Foundation of Shariah Governance of Islamic Banks*, 2015.

39 Luxembourg for Finance, *Islamic Finance*, available at www.luxembourgforfinance.com/sites/luxembourgforfinance/files/lff_brochure_islamic_finance.pdf.

each investor has management rights in proportion with its investment in the fund.⁴⁰ *Shariah*-compliant property investments can also be achieved by using a *mudarabah* or an *ijarah* contract.⁴¹ The *mudarabah* contract is similar to the relationship between a Luxembourg general partner (i.e., fund manager) and the limited partners (i.e., investors).⁴² By contrast, an *ijarah* contract is a lease contract for a specified asset or the usufruct of a specified asset.⁴³ The rules governing *ijarah* may be considered similar to those governing conventional leases,⁴⁴ subject to limitations provided for by the *shariah* law.

iv Capital markets

Benefits of the Luxembourg securitisation regime

Many issuances of *sukuk* in Luxembourg have been structured using a Luxembourg securitisation undertaking subject to the Securitisation Act. The securitisation undertaking may be set up in the form of a company or a securitisation fund managed by a Luxembourg management company. Securitisation funds do not have legal personality; they are constituted by one or more co-ownerships of assets or fiduciary estates, which provide a closer connection between the investors and the underlying assets – a considerable advantage from the point of view of *shariah* law.⁴⁵ While the vast majority of securitisation undertakings are unregulated, a securitisation undertaking that offers securities to the public more than three times per year has to apply for a licence from the CSSF to qualify as a regulated securitisation vehicle for the purposes of the Securitisation Act.

A securitisation undertaking's primary activity must be to engage in securitisations, defined by the Securitisation Act as transactions whereby a securitisation undertaking:

- a* acquires or assumes, directly or through another undertaking, risks; and
- b* to finance the acquisition or assumption of those risks, issues securities whose value or yield depends on those risks. Risks to be securitised may be related to all kinds of assets, including claims, receivable or equity interests, with no requirement of risk diversification.

Unlike funds, securitisation undertakings must not actively manage securitised assets. The Securitisation Act allows a securitisation undertaking to set up multiple compartments by a simple decision of its board of directors. Each compartment forms a distinct and independent part of the securitisation undertaking's assets and is segregated from its other compartments and general estate. One or more securitisations can be carried out independently out of each individual compartment, which significantly reduces transaction costs as one vehicle can be used for an unlimited number of distinct transactions. For instance, it would be possible for one securitisation undertaking to create several compartments, some of which would be dedicated to *shariah*-compliant transactions, while the other compartments could be used for

40 Monzer Kahf, *Islamic finance contracts*, 2013.

41 See footnote 40.

42 See footnote 13.

43 *ibid.*

44 Bayt al-Tamwil al-Kūwaytī, National Commercial Bank (Saudi Arabia), *Islamic Asset Management: Forming the Future for Shari'a-compliant Investment Strategies*, 2004.

45 *ibid.*

issuing conventional securities. Investors (irrespective of whether they hold equity or debt securities) will only have recourse to the assets comprised in the compartment to which the securities they hold have been allocated.

A securitisation vehicle is considered insolvency remote – a feature much valued by rating agencies. The main characteristics of Luxembourg’s sophisticated securitisation regime – the ring-fencing of compartment assets, priority of payments, limited recourse, prohibition of seizure of assets and non-petition for bankruptcy – are protected not only by contractual arrangements, but are also expressly recognised by the Securitisation Act. Legal proceedings initiated against a securitisation undertaking in breach of those provisions will, in principle, be declared inadmissible by a Luxembourg court.

It should also be mentioned that a securitisation undertaking issuing exclusively debt instruments (and *sukuk* is regarded as such from a Luxembourg law perspective) will be able to rely on an exemption from the scope of the AIFM Act. Other exemptions from the AIFM Act may also be available.

Raising finance in a shariah-compliant manner

One of the popular Islamic finance structures that have been put in place in Luxembourg using a securitisation vehicle is *murabahah*. A pioneering transaction, which combined a reducing revolving convertible *murabahah* with a note issuance, involved a Luxembourg securitisation company that acted both as the issuer of conventional bonds and as the lender under the *murabahah* facility. The issuer used the proceeds of the bonds to purchase certain commodities, which it subsequently sold, on deferred payment terms, to an Islamic investment bank for a sale price equal to the acquisition cost plus profit. The cash payments of the deferred sale price were used by the issuer to meet its obligations towards the bond investors. Additionally, the bondholders had the option to convert the cash distributions due to them under the bonds into shares of the lender under the *murabahah* contract (which constituted the securitised asset for the purpose of the bond issue).

Luxembourg issuers, some of them ordinary companies as opposed to securitisation undertakings, are regularly used to issue *sukuk*, the proceeds of which may be invested, directly or indirectly, in assets such as real estate or aircraft. A stream of rental income generated by those underlying assets is then distributed to investors via payments under the *sukuk*. Notably, Luxembourg has played host to a joint venture formed among prominent Islamic and conventional financial actors who invested, through a mixture of equity and *sukuk*, in a Luxembourg special purpose vehicle (LeaseCo) to acquire a string of retail properties leased to tenants. In return for the right to control the target properties and receive rents, LeaseCo paid the issue proceeds of the *sukuk* to a Luxembourg joint venture vehicle (PropCo), thereby enabling it to purchase the shares of the company whose subsidiary owned the relevant properties. Any rewards associated with the ownership of the properties were to be extracted by the joint venture members via payments made by LeaseCo in respect of the *sukuk*.

Another example of the successful application of Luxembourg law in the implementation of Islamic financial transactions is the issue of *sukuk* using a two-tier securitisation structure by an international Islamic organisation. This type of set-up is expressly permitted under the Securitisation Act and involves two securitisation undertakings: an issuing vehicle and an acquisition vehicle. In the case at hand, the issuing vehicle issues, on an ongoing basis, trust certificates and contributes the proceeds to the acquisition vehicle in exchange for the undivided beneficial ownership interest in *shariah*-compliant assets purchased by the acquisition vehicle using the contribution from the issuing vehicle. Those assets are held

by the acquisition vehicle for the benefit of the issuing vehicle under an English law trust. The issuing vehicle, for its part, holds the undivided ownership interest on trust for the holders of the trust certificates as well as acting as their agent (*wakeel*). Through its undivided beneficial ownership, the issuing vehicle is entitled to receive profits and redemption amounts generated by the underlying assets and uses the sums so received to honour its obligations under the trust certificates.

One of the prominent issuers of *sukuk* is the Luxembourg state itself, which, in 2014, became the first eurozone country to issue sovereign *sukuk*. For the purpose of the transaction, Luxembourg arranged for the setting up, and became the sole shareholder, of Luxembourg Treasury Securities SA, a special purpose vehicle that has acted as the formal issuer of the instruments. The Luxembourg *sukuk*, which is of the *al-ijarah* type, is backed by three administrative buildings that have been purchased by the issuer from the Luxembourg State using the issue proceeds of the *sukuk*. The buildings will be transferred back to the Luxembourg State for a pre-agreed purchase price when the *sukuk* matures. The Luxembourg *sukuk* have been admitted to trading on the Euro MTF market of the Luxembourg Stock Exchange.⁴⁶

IV TAXATION

Whereas there is no specific framework regulating Islamic finance transactions in Luxembourg from a legal perspective, there are two circulars issued by the directors of the direct tax administration and the indirect tax administration regarding the Luxembourg direct and indirect tax treatment of *murabahah* transactions and *sukuk*.

i Direct taxation

Murabahah transactions

For the purposes of the following paragraphs a *murabahah* transaction is to be understood as an agreement transaction consisting of two consecutive sales of a certain asset whereby, at the first stage, a party (the financier) purchases an asset from a third party upon the request of its counterparty (the purchaser) and then, at the second stage, resells the asset to the purchaser at a marked-up price, payable by the purchaser on a deferred basis.

From a Luxembourg general tax perspective, the 'capital gain' generated at the hands of the Luxembourg financier upon the mere execution of the second sale and purchase agreement between the financier, as seller, and the purchaser, would, in principle, be fully taxable at a current combined rate of 24.94 per cent (corporate income tax, increased by the solidarity surcharge, and municipal business tax for companies established in Luxembourg City) for 2019.

However, Circular LG-A No. 55 issued by the director of the Luxembourg direct tax administration on 12 January 2010 (the Direct Tax Circular) provides for deferred taxation of the capital gain on a straight-line basis over the full payment deferral period under the *murabahah* agreement (which usually corresponds with the duration of the *murabahah* agreement), notwithstanding any reimbursements made during this period.

⁴⁶ *Le Luxembourg place son premier Sukuk souverain*, Agefi Luxembourg, Mensuel de octobre 2014 – Fonds/Bourse.

From an economic perspective,⁴⁷ the Direct Tax Circular compares the capital gain generated in the hands of the Luxembourg financier to the remuneration for giving the purchaser the possibility of deferred payment (i.e., it is treated for Luxembourg tax purposes as ordinary interest income, which would have been earned by the Luxembourg financier under conventional financing). It should be noted that the deferred taxation is available only for remuneration earned by the financier for giving the possibility of deferred payment to the purchaser and not, for example, any intermediation fee that the financier may receive.

The treatment of the capital gain realised by the financier as interest income under the Direct Tax Circular is subject to the following conditions, which must be met by the *murabahah* transaction:

- a the *murabahah* agreement must clearly state that the financier is acquiring the asset for immediate resale to the purchaser (within a maximum of six months);
- b the *murabahah* agreement must clearly define the various elements constituting the financier's profit:
 - the remuneration for deferred payment;
 - the intermediation fee; and
 - the exact acquisition price of the asset to be paid by the financier and subsequently by the purchaser;
- c the *murabahah* agreement must provide for a clear and explicit acknowledgment and acceptance by all parties of the financier's profit;
- d the *murabahah* agreement must explicitly define the financier's profit as being the consideration for the service provided to the purchaser, being the possibility of deferred payment given to the purchaser; and
- e from an accounting and tax perspective, the financier's profit must be booked in the same way. In other words, the pure profit (i.e., the remuneration for the possibility of deferred payment) must be spread over the deferred payment period stipulated in the *murabahah* agreement, regardless of the actual dates of repayment.

If the purchaser is a Luxembourg tax resident, any payments remunerating the financier for giving the purchaser the possibility of deferred payment under the *murabahah* agreement should, in principle, be exempt from Luxembourg withholding tax and should also be deductible for tax purposes, subject to the interest deduction limitation rules that apply depending on the assets held and income received by the purchaser (not applicable to purchasers qualifying as financial undertakings such as, inter alia, UCITS, AIFs or 'securitisation special purpose entities' (SSPEs) within the meaning of Regulation (EU) 2017/2402),⁴⁸ and unless they relate to items of income that are exempt in Luxembourg (e.g., foreign real estate) and provided that the above conditions are met.

47 Based on the fundamental principle of 'economic analysis' in Luxembourg tax law (*wirtschaftliche Betrachtungsweise*).

48 Interest deduction limitation rules were introduced by the Luxembourg law dated 18 December 2018, which implements into Luxembourg law the anti-tax avoidance directive (Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market).

Sukuk

Pursuant to the Direct Tax Circular, *sukuk* may be considered a conventional debt instrument (i.e., as a bond (its return, or interest, being dependent on the performance of the underlying asset)). Any profit distributions made under the *sukuk* to its holders are, in principle, deductible in the hands of the issuer (subject to the interest deduction limitation rules that apply depending on the assets held and income received by the issuer (not applicable to issuers qualifying as financial undertakings such as, inter alia, UCITS, AIFs or SSPEs)) and such distributions are not subject to Luxembourg withholding tax.⁴⁹

ii Indirect taxation

Registration duties

Murabahah

Depending on the underlying asset of a *murabahah* agreement, Luxembourg registration duties could be due, in principle, on each sale and purchase of the said asset (e.g., Luxembourg *situs* real estate).

Pursuant to Circular No. 749 issued by the director of the Luxembourg indirect tax administration on 17 June 2010 (the Indirect Tax Circular), the registration duties payable in Luxembourg on a *murabahah* agreement concerning real estate located in Luxembourg City are limited to 2.8 per cent under the condition that:

- a* both notarial deeds (documenting the purchase and the resale) are registered with the indirect tax authorities at the same time; and
- b* the financier explicitly declares in the first notarial deed (documenting the purchase) that the real estate asset will be subsequently resold.

The amounts on which registration duties are calculated are limited solely to the acquisition price paid by the financier on the first sale. The profit of the financier, which is considered interest, is thus not subject to registration duties in Luxembourg under the following conditions:

- a* the purchaser must take possession of the real estate asset immediately after the second sale and purchase agreement;
- b* no more than 10 days must separate the first sale and purchase agreement from the second; and
- c* the first sale and purchase agreement must contain a clause stating that the transaction is being carried out as a *murabahah* agreement, a copy of which must be annexed to the notarial deed relating to the first sale and purchase agreement.

Sukuk

The issue of *sukuk* should, in principle, not give rise to any registration duties in Luxembourg, provided that the terms and conditions of the *sukuk* are not physically attached to a public deed or to any other document subject to mandatory registration in Luxembourg. If the proceeds derived from the issue of *sukuk* are used for instance to purchase Luxembourg *situs* real estate, registration duties would, in principle, be due with respect to the purchase agreement relating to the real estate properties.

⁴⁹ The 15 per cent withholding tax under Luxembourg tax law levied on payments made under certain participating debt instruments is explicitly excluded in the Direct Tax Circular.

Value added tax

The Indirect Tax Circular states that financiers created for the purpose of a *murabahah* transaction are treated under Luxembourg value added tax (VAT) law as taxable persons.

iii Taxation of shariah-compliant funds

Shariah-compliant funds structured as UCITS, Part II Funds, SIFs and certain types of RAIFs (SIF-type) are exempt from any Luxembourg income, withholding, capital gains or net wealth tax. They are, however, subject to an annual subscription tax ranging between 0.01 and 0.05 per cent, calculated and payable quarterly on their aggregate net assets as valued at the end of the relevant quarter. Certain exemptions and reductions can apply.

SICARs and certain types of RAIFs (RAIFs carrying out risk capital investments and opting for a special tax regime identical to the regime applicable to SICARs) may be incorporated in the form of a fiscally opaque vehicle or as a tax transparent vehicle. If set up as tax-opaque vehicles, these are considered fully taxable companies (i.e., subject to corporate income tax, municipal business tax and the solidarity surcharge), but benefit from an exemption on any income derived from transferable securities connected with investments in risk-bearing capital or for cash held for the purpose of a future investment. These types of funds may, however, be subject to the minimum net wealth tax regime.

Further, with respect to VAT, pursuant to Circular No. 723 of 29 December 2006, undertakings for collective investment are, in principle, considered VAT-taxable persons. Thus, Luxembourg VAT may be applicable under the reverse charge mechanism whereby a fund domiciled in Luxembourg receives taxable services from suppliers located in other EU Member States, unless a specific VAT exemption may be secured (such as fees on the negotiation of securities, for example). A fund would, in principle, have no right to deduct input VAT as it should normally carry out activities that are exempt from VAT only.

iv Taxation of securitisation undertakings

Securitisation undertakings subject to the Securitisation Act benefit from a favourable tax regime. If set up as a company, they are, in principle, fully taxable companies, subject to corporation tax at a current combined rate of 24.94 per cent (corporate income tax, increased by the solidarity surcharge, and municipal business tax for securitisation undertakings established in Luxembourg City) in 2019. However, the Securitisation Act states that the obligations assumed by securitisation undertakings towards their investors (including shareholders) and any creditors are to be considered tax deductible expenses. In other words, securitisation undertakings should be able to deduct any payments due or made to any investors, or creditors, from their taxable profits, subject to the interest deduction limitation rules that apply depending on the assets held and income received by the securitisation undertaking (not applicable to securitisation undertakings qualifying as SSPEs).

Securitisation undertakings are exempt from net wealth tax, except for the minimum net wealth tax.

Further, there is no Luxembourg withholding tax on payments of interest or on profit distributions made by the securitisation undertaking to its investors.⁵⁰

With respect to VAT, securitisation undertakings are considered VAT-taxable persons if they are deemed to be carrying out an economic activity. If a securitisation undertaking

50 Except for certain interest payments to Luxembourg resident individuals.

qualifies as a VAT-taxable person, Luxembourg VAT may be applicable under the reverse charge mechanism if a securitisation undertaking domiciled in Luxembourg receives taxable services from suppliers located in other EU Member States. A securitisation undertaking would, in principle, have no right to deduct input VAT as it solely carries out activities that are exempt from VAT.

V INSOLVENCY

In Luxembourg, there is no special insolvency regime with respect to *shariah*-compliant products.

In insolvency or restructuring scenarios, holders of *sukuk* should, in principle, be treated in the same way as holders of conventional bonds. This is in line with the position of the Luxembourg direct tax administration, expressed in the Direct Tax Circular, according to which there should be no difference in the tax treatment of *sukuk* and conventional bonds.⁵¹

In this respect, it is important to highlight the advantages of using Luxembourg securitisation undertakings subject to the Securitisation Act, which frequently act as issuers of *sukuk*. As discussed above, such securitisation undertakings are bankruptcy-remote and their investors benefit from a high level of protection and legal certainty embedded in the law. Thanks to provisions such as the compartmentalisation of rights and claims relating to different transactions and the limitation of investors' recourse to the assets available in the compartment in which they have invested, the risk of the entire vehicle becoming insolvent is very small.

VI JUDICIAL FRAMEWORK

Luxembourg does not have a specific court or tribunal for Islamic finance disputes. Luxembourg conventional courts will hear claims relating to transactions governed by Luxembourg law over which they have jurisdiction, including those involving aspects of *shariah* law. In the case of a conflict between Luxembourg laws and the principles of *shariah* law, Luxembourg laws will prevail.⁵²

Any conflicting matter in relation to regulated funds or their Luxembourg-regulated manager may potentially be dealt with by the CSSF following the out-of-court resolution of the complaints procedure. The CSSF's out-of-court resolution of disputes procedure is provided on a voluntary basis. It aims to simplify the resolution of disputes without the need for legal proceedings. Opening an out-of-court complaint resolution procedure with the CSSF is subject to the condition that the complaint has been dealt with by the management of the relevant professional beforehand. In this respect, the complaint must have been first submitted in writing to the individual responsible for complaint handling.⁵³ If the CSSF does not manage to resolve the issue, the parties are free to bring their claim before the relevant tribunal.

51 Florence Stainier and Bishr Shiblaq, 'Luxembourg', *Getting the Deal Through – Islamic Finance and Markets 2014*, Law Business Research Ltd.

52 *ibid.*

53 CSSF, 'Customer complaints: Out-of-court complaint resolution', available at www.cssf.lu/en/consumer/complaints/.

To the best of our knowledge, there has been no Luxembourg court case that would have impacted the treatment of Islamic finance products or structures implemented under Luxembourg law or using a Luxembourg vehicle.

VII OUTLOOK

The CSSF has signed memoranda of understanding (MoU) with the supervisory authorities of a number of major markets in the area of Islamic finance, such as Bahrain, Malaysia, Oman, Qatar and United Arab Emirates (including Dubai and Abu Dhabi).⁵⁴ Following the European Securities and Markets Authority's approval of cooperation agreements between EU securities regulators and their international counterparts, the CSSF has also signed MoU with supervisory authorities of third countries, such as Dubai, Egypt and Malaysia,⁵⁵ meeting the requirements of the AIFMD in view of developing cooperation agreements. Luxembourg has also signed double taxation treaties with major actors in Islamic finance, such as Malaysia, Qatar and Saudi Arabia,⁵⁶ and other treaties are currently under negotiation with Kuwait, Lebanon and Oman.⁵⁷ These developments highlight the growing interest in Islamic finance and are in line with the proactive approach adopted by the Luxembourg government aimed at making Luxembourg an attractive place for Islamic financial players.⁵⁸ Although *shariah*-compliant products and structures have become a regular feature on the list of services offered by Luxembourg's diverse and dynamic financial sector, there is still potential for growth and numerous opportunities are waiting to be explored.

54 CSSF, 'List of Memoranda of Understanding signed by the CSSF', available at www.cssf.lu/en/eu-international/memoranda-of-understanding/.

55 See footnote 3.

56 Luxembourg Inland Revenue, 'Conventions en vigueur', available at www.impotsdirects.public.lu/fr/conventions/conv_vig.html.

57 Luxembourg Inland Revenue, 'Conventions en négociation', available at www.impotsdirects.public.lu/fr/conventions/conv_neg.html.

58 Journal des Tribunaux Luxembourg, *Fonds Islamiques – Le guide des bonnes pratiques de l'Association Luxembourgeoise des Fonds d'Investissement*, Larcier, No. 26, 5 April 2013.

MALAYSIA

Rodney Gerard D'Cruz and Murni Zuyati Zulkifli Aziz¹

I LEGISLATIVE AND REGULATORY FRAMEWORK

Malaysia presently finds itself just over a year into the tenure of a new government, at the helm after former opposition Pakatan Harapan's historic victory in the 14th general election in May 2018, and the country's first change of government following 61 years of rule by the previous Barisan Nasional government. Pakatan Harapan had campaigned on the basis of its plan for fiscal reforms entitled, the 'First 100 Days Fiscal Reforms', which outlined its full commitment to undertake responsible and progressive fiscal reforms to both enhance fiscal equity, transparency and accountability and to accelerate productive investment and economic growth in Malaysia. In the Annual Budget 2019 (announced in November 2018), the new government identified key priorities to support the transition of the Malaysian economy towards 'more balanced, sustainable and inclusive growth' and expressed its ambition to promote Malaysia as a global leader in the bond and *sukuk* markets by establishing a special committee on Islamic finance together with the extension of tax incentives for *sukuk*, *ijarah* and *wakalah*.²

Malaysia has developed a sophisticated Islamic finance sector over the past 30 years, which in turn has generated a vibrant business environment for financial institutions, intermediaries, investors, issuers and service providers alike. In the course of this development, Malaysia successfully established a mature and robust Islamic finance regulatory framework and pioneered the dual banking system, wherein both Islamic and conventional financial systems operate and co-exist within a single regulatory framework.

The financial services industry of Malaysia has always been championed as a key driver of Malaysia's economic development. It is one of the 12 national key economic areas (NKEAs) under Malaysia's Economic Transformation Programme (ETP), the national strategic initiative formulated by the previous government to elevate the country to developed-nation status by 2020,³ and is the foundation of the Financial Sector Blueprint (FSB), the 10-year master plan implemented by the country's central bank (Bank Negara Malaysia (BNM)), for the management of Malaysia's transition towards becoming a high-value-added, high-income

1 Rodney Gerard D'Cruz and Murni Zuyati Zulkifli Aziz are partners at Adnan Sundra & Low. The authors would like to express their gratitude to Ms Wong Zhi Xin for her contribution in relation to the contents of this chapter.

2 See: <http://www.treasury.gov.my/pdf/budget/speech/bs19.pdf>; <https://www.nst.com.my/business/2018/11/427757/sc-operationalising-measures-announced-2019-budget>.

3 See <http://www.teraju.gov.my/nkea-info/?lang=en>.

economy.⁴ A key recommendation under the FSB is for Malaysia to consolidate its success and position itself as a leading international centre and global hub for Islamic finance. Further, the Malaysian government has also committed under its financial services NKEA for Islamic finance in Malaysia to constitute 40 per cent of total financing in Malaysia by 2020.

In January 2017, the Securities Commission Malaysia (SC) announced the launch of a five-year Islamic Fund and Wealth Management Blueprint (the Blueprint)⁵ to drive further development and growth of Malaysia's Islamic capital market. The Blueprint envisages leveraging Malaysia's Islamic capital market ecosystem to establish the country as a leading international centre for Islamic fund and wealth management⁶ (see also Section VI.iii). The SC has achieved early success in implementing the Blueprint, as 2017 witnessed the maiden public offering of *waqf* shares by Larkin Sentral, green *sukuk* issuances, as well as new players in the fund administration and fund management business in Malaysia.⁷

In July 2017, BNM, in collaboration with certain Islamic banking and finance institutions, embarked on the development of several strategies aimed at strengthening the roles and impact of Islamic banking institutions. These strategies, called value-based intermediation, were to focus on delivering the intended outcomes of *shariah* through the adoption of practices, conduct and offerings that generate a positive and sustainable impact on the economy, community and environment.⁸ The new government lost no time in effecting leadership change at BNM and, in July 2018, the Ministry of Finance announced the appointment of Datuk Nor Shamsiah Mohd Yunus as the central bank's new Governor.⁹

Nevertheless, BNM continued to build on the 2017 Strategy Paper on Value-based Intermediation (VBI) and issued three guidance documents in October 2018, namely the Implementation Guide for VBI, the VBI Financing and Investment Impact Assessment Framework and the VBI Scorecard to facilitate the practical adoption of VBI, as VBI aims to re-orient Islamic finance business models towards realising the objectives of *shariah*.¹⁰ VBI is also consistent with global finance initiatives in support of achieving the Sustainable Development Goals (SDGs) set by the United Nations (UN). Islamic banks continued to make progress in driving the VBI agenda through enhanced offerings and strong institutional commitments¹¹ and in September 2018, HSBC Amanah Malaysia Bhd launched the world's first UN SDG *sukuk*.¹²

4 See <http://ntp.epu.gov.my/nkea> and the BNM website at www.bnm.gov.my/index.php?ch=en_press&pg=en_press&ac=130&lang=en.

5 See: <https://www.sc.com.my/api/documentms/download.ashx?id=ae2432a7-a0c7-4221-b262-b170827ac703>.

6 Securities Commission Malaysia Annual Report 2016. See: <https://www.sc.com.my/api/documentms/download.ashx?id=ef843977-2536-4258-b2b0-8cb7138752bf>.

7 Securities Commission Malaysia Annual Report 2017. See: <https://www.sc.com.my/api/documentms/download.ashx?id=097e62ec-8464-46a2-a3e0-9cb4ee164ca7>.

8 The BNM's 'Value-based Intermediation: Strengthening the Roles and Impact of Islamic Finance', See: <http://www.bnm.gov.my/index.php?ch=57&pg=137&ac=612&bb=file> www.bnm.gov.my/index.php?ch=57&pg=137&ac=612&bb=file; and www.thestar.com.my/business/business-news/2017/07/20/bank-negara-releases-strategy-paper-on-vbi/.

9 http://www.bnm.gov.my/index.php?ch=en_press&pg=en_press&ac=4700&lang=en.

10 See: http://www.bnm.gov.my/index.php?ch=en_announcement&pg=en_announcement&ac=670&lang=en and <https://www.thestar.com.my/business/business-news/2018/10/03/guidance-on-value-banking/>.

11 See: BNM Financial Stability and Payment Systems Report 2018 (page 48).

12 See: <https://www.nst.com.my/business/2018/10/418193/hsbc-amanah-launches-worlds-first-un-sdg-sukuk-priced-rm500m>.

While it may still be too soon to comment on measures introduced by the new government, it was reported that in the first quarter of 2019 (Q1 2019), Malaysia's Islamic bond market remained the biggest in emerging East Asia, where *sukuk* comprised 61 per cent of total local currency bonds outstanding. Malaysia was also among emerging East Asian economies that saw the local currency bond market continue to expand over Q1 2019, despite trade conflicts and moderating global growth.¹³

i Legislative and regulatory regime

Islamic banking

In line with the FSB, the regulatory and supervisory framework in Malaysia in respect of the Islamic banking and finance sector was recently consolidated and updated under the Islamic Financial Services Act 2013 (IFSA),¹⁴ the governing law of Malaysia's Islamic finance sector.

As the primary source of legislation governing the licensing and operation of Islamic and international Islamic banking businesses conducted by financial institutions, the IFSA, together with guidelines and circulars issued by BNM,¹⁵ contains extensive provisions on end-to-end *shariah* compliance, governance and enforcement, which include the following basic premises:

- a* establishing BNM as the *shariah* regulator over the financial sector;
- b* providing the legal basis for the rulings of BNM's Shariah Advisory Council (the BNM SAC);
- c* prohibiting financial institutions that conduct Islamic and international Islamic banking businesses from carrying out non-*shariah*-compliant activities; and
- d* empowering BNM to direct and penalise financial institutions for breaches of the IFSA and offences committed thereunder.¹⁶

Under the IFSA, BNM was conferred regulatory and supervisory powers and was also empowered to issue guidelines and circulars on *shariah* requirements to promote financial stability and ensure *shariah* compliance. Following therefrom, the IFSA provides that the operations, structure and the terms and conditions of Islamic financial products and services provided by financial institutions must be *shariah*-compliant. Any entity that conducts Islamic

13 <https://www.thestar.com.my/business/business-news/2019/06/19/malaysia-bond-market-sees-continuous-expansion-in-1q19#b7XbvsriPJgiphqK.99>.

14 The IFSA repealed and consolidated the Islamic Banking Act 1983 and the Takaful Act 1984.

15 BNM is empowered under Section 59 of the Central Bank of Malaysia Act 2009 to issue circulars, guidelines or notices on any *shariah* matter relating to the Islamic financial business carried on by any Islamic financial institutions in accordance with the advice or ruling of the BNM's Shariah Advisory Council (the BNM SAC).

16 Section 28(3) of the IFSA provides that any financial institution becoming aware that its activities are not in compliance with *shariah* or the advice of its *shariah* committee or the advice or ruling of the BNM SAC shall notify BNM and cease the non-*shariah*-compliant activity whereas Section 37(1) of the IFSA empowers BNM to compel any financial institution to appoint any person as BNM may approve, to carry out an audit on *shariah* compliance on the said financial institution.

banking business¹⁷ or international Islamic banking business¹⁸ must possess the licences granted by the Minister of Finance (the Minister) on the recommendation of BNM. There are various measures taken by the authorities to strengthen consumer protection, including (1) the issuance of the revised BNM's Rules on Prohibited Business Conduct in 2016¹⁹ to supplement the prohibitions on financial institutions from engaging in conduct deemed to be inherently unfair to consumers under Schedule 7 of the IFSA; (2) the establishment of the Financial Ombudsman Scheme under the Islamic Financial Services (Financial Ombudsman Scheme) Regulations 2015; and (3) the setting up of the Malaysia Deposit Insurance Corporation (MDIC) pursuant to the Malaysia Deposit Insurance Corporation Act 2011 (MDICA), under which the MDIC insures consumers against the loss of their deposits (including Islamic deposits) in financial institutions in Malaysia²⁰ for up to 250,000 ringgit per depositor per financial institution in the event of loss caused by failure of a financial institution holding such deposits.

Islamic capital markets

The Capital Markets and Services Act 2007 (CMSA)²¹ constitutes a single framework regulating the licensing of both conventional and Islamic capital market services, market conduct and offering and issuances of securities, including unlisted Islamic securities or *sukuk*, with the exception of specific laws, regulations and guidelines that apply exclusively to the operation of the Islamic capital market. This marked a major milestone in the SC's continuous efforts to strengthen the capital market regulatory framework.

In this regard, the CMSA provides, inter alia, as follows:

- a that Islamic securities are securities for the purposes of securities laws;²²
- b that any proposal, scheme, transaction, arrangement, activity, product or matter relating to Islamic securities shall comply with the relevant requirements under securities laws and guidelines issued by the SC;²³ and

17 Section 2 of the IFSA defines 'Islamic banking business' as the business of (1) accepting Islamic deposits on current accounts, deposit accounts, savings accounts or other similar accounts, with or without the business of paying or collecting cheques drawn by or paid in by customers; or (2) accepting money under an investment account; and (3) provision of finance; and (4) such other business as the Minister may prescribe, on the recommendation of BNM. For the avoidance of doubt, the provision of finance by itself would not fall under the definition of Islamic banking business unless the provision of finance were specifically prescribed by the Minister under Section 3 of the IFSA.

18 Section 2 of the IFSA defines 'international Islamic banking business' as Islamic banking business in currencies other than ringgit or such other business as the Minister may prescribe, on the recommendation of BNM. For international Islamic banking business, see BNM Guidelines on International Islamic Banks.

19 This was issued pursuant to Section 135(3) as well as Section 136(2) of the IFSA and supersedes the previous BNM's Rules on Prohibited Business Conduct, which were issued in 2014.

20 Pursuant to Section 42 of the MDICA.

21 The CMSA repealed and consolidated the Securities Industry Act 1983, the Futures Industry Act 1993 and parts of the Securities Commission Malaysia Act 1993 (SCMA).

22 See Section 316B(1) of the CMSA.

23 See Section 316B(2) of the CMSA.

- c that the Minister may, for the purposes of securities laws and, on the recommendation of the SC, inter alia, prescribe any instrument or product or class of instruments or products to be:
- Islamic securities;
 - Islamic derivatives; or
 - Islamic capital market products.²⁴

The following features of the CMSA accord greater protection to investors of securities (including Islamic securities) in Malaysia: (1) the SC's power to take civil and administrative actions; (2) the SC is allowed to recover three times the amount of losses through civil action for a wider range of market misconduct; (3) the standards of trustees for debenture holders are enhanced; and (4) investor protection is extended to clients of financial institutions.

With the CMSA, there are various guidelines and practice notes issued by the SC to regulate the Malaysian capital markets, including Islamic capital markets. In 2015, the SC introduced the Guidelines on Unlisted Capital Market Products Under the Lodge and Launch Framework as part of its initiative to promote process efficiency, shorten time-to-market and provide certainty of product offering.

Takaful (Islamic insurance)

Under the IFSA, any companies that are in the *takaful* business or international *takaful* business must hold a valid licence granted by the Minister on the recommendation of BNM. *Takaful* operators must also comply with the relevant BNM guidelines on *takaful*²⁵ and have in place an effective *retakaful* management strategy that is appropriate to the overall risk profile of the *takaful* business, and ensure that risks are ceded to *takaful* or *retakaful* operators.²⁶ In addition, *takaful* operators shall not accept inwards reinsurance from insurance or reinsurance companies except where the risk is *shariah*-compliant and the arrangement is based on *shariah*-compliant *retakaful* contracts.²⁷ In June 2019, BNM issued the guidelines on Takaful Operational Framework, which will come into force on 1 July 2020, thereafter superseding the current guidelines, which were issued on 26 June 2013. The document provides additional guidance related to the specificities of *takaful* business and also seeks to strengthen *takaful* fund management practices to ensure their sustainability, and prudent management. Collectively, these guidelines seek to spur greater innovation in the *takaful* industry while further safeguarding the position of *takaful* participants.²⁸

24 See Section 5 of the CMSA.

25 See Section 10 of the IFSA.

26 See Paragraph 10.09, Guidelines on Takaful Operational Framework issued by BNM on 26 June 2013.

27 *ibid.*, Paragraph 10.11.

28 See guidelines on Takaful Operational Framework 2019: <http://www.bnm.gov.my/index.php?ch=57&pg=140&ac=807&bb=file>.

Collective investment schemes (funds)

The BNM Guidelines on Investment in Shares, Interest-in-Shares and Collective Investment Schemes for Islamic Banks (the BNM Guidelines) constitute the main guidelines governing for collective investment schemes (CISs) offered by Islamic banks. The BNM Guidelines adopt a more principle-based regulatory approach to enable financial institutions to define the scope of their equity-related investments according to capacity and capability. Other than guidelines issued by BNM, the SC has also issued various guidelines governing CISs.²⁹

Generally, under the BNM Guidelines, there are two categories of investments that may be made by financial institutions: (1) investment in shares or interest-in-shares of any corporation;³⁰ or (2) investment in CISs, which includes unit trusts.³¹ In addition, the SC has issued various guidelines on the establishment of a variety of CISs that can be invested in by financial institutions.³²

Midshore financial centre

Labuan International Business and Financial Centre (Labuan IBFC) is the midshore financial centre in Malaysia and provides a platform for local as well as international financial institutions to offer Islamic financial products or services and Islamic capital market instruments in foreign currencies.

The Labuan Islamic Financial Services and Securities Act 2010 (LIFSSA) is the governing law of the Islamic financial industry in Labuan IBFC. The LIFSSA provides for the registration of business vehicles used by financial institutions and the licensing of financial institutions to conduct regulated business activities. The LIFSSA must be read together with any guidelines or circulars issued by the Labuan Financial Services Authority (Labuan FSA).

The LIFSSA provides for the establishment of the Shariah Supervisory Council (SSC),³³ and for the SSC to (1) ascertain Islamic law for the purposes of any business regulated or supervised by the Labuan FSA and issue rulings; and (2) advise on any *shariah* issue relating to any business regulated or supervised by the Labuan FSA.³⁴ The SSC, however, may only make rulings upon reference being made to it by licensed or regulated entities under the LIFSSA

29 CISs are broadly defined under the BNM Guidelines as follows: any arrangement made for the purpose, or having the effect, of providing facilities for persons to participate in or receive profits or income arising from the acquisition, holding, management or disposal of securities, futures contracts or any other property, or sums paid out of such profits or income. In such schemes, participants do not have day-to-day control over the management of the schemes' assets.

30 See Paragraph 5.1, BNM Guidelines on Investment in Shares, Interest-in-Shares and Collective Investment Schemes for Islamic Banks (http://www.bnm.gov.my/guidelines/01_banking/04_prudential_stds/14_Investment_in_Shares_IIS_and_CIS_2806.pdf).

31 *ibid.* Unit trusts include institutional funds, real estate investment trusts, property trust funds and exchange-traded funds.

32 These include (1) Guidelines on Islamic Fund Management 2007; (2) Guidelines for Real Estate Investment Trusts 2018; (3) Guidelines on Unit Trust Funds 2017; (4) Exchange-Traded Funds Guidelines 2018; (5) Guidelines for Public Offerings of Securities of Closed-end Funds; (6) Guidelines for the Offering, Marketing and Distribution of Foreign Funds; (7) Handbook for CIS Operators of ASEAN CISs; and (8) Prospectus Guidelines for Collective Investment Schemes 2019. Note that this also falls under the purview of BNM vide Guidelines on Investment In Shares, Interest-in-Shares and Collective Investment Schemes for Islamic Banks.

33 See Section 7 of the Labuan Islamic Financial Services and Securities Act 2010 (LIFSSA).

34 See Section 8 of the LIFSSA.

or as determined by the Labuan FSA.³⁵ While the rulings of the SSC shall, upon issuance, be binding upon the Labuan FSA and the entity making the referral, the rulings shall not be binding on any other licensed entity, entity regulated under LIFSSA or *shariah*-compliant entity unless specified as such by the Labuan FSA.³⁶

ii Regulatory and supervisory authorities

BNM

BNM was established under the Central Bank of Malaysia Act 1958 and continues to operate under the Central Bank of Malaysia Act 2009 (CBA). BNM reports to the Minister and keeps the Minister informed of policies governing the monetary and financial sector.

BNM is empowered to act as the regulator of financial institutions under the IFSA, the Financial Services Act 2013 and the CBA. The CBA confers the necessary powers and instruments on BNM to achieve its mandates effectively and legitimises the duality of both the conventional and Islamic financial systems in Malaysia and in doing so, establishes the legal foundation for development of an Islamic financial system within the overall Malaysian financial system. BNM is also the financial adviser to the Malaysian government and its primary objectives include the prudent conduct of monetary policy, financial system stability and the development of a sound and progressive financial sector.³⁷ Other functions of BNM include the monitoring and supervision of payment systems, money markets and foreign exchange markets by adopting a risk-based supervisory approach that monitors and reviews the manner in which all financial institutions identify, control and deal with their respective business risks.

Notwithstanding the above, it is the Minister who is the authority for the issuance and revocation or imposition of conditions of licences to carry on the businesses provided for under the IFSA on the recommendations of BNM.³⁸

SC

The SC is a regulatory body established under the Securities Commission Malaysia Act 1993 (SCMA), which is mandated to regulate the Malaysian capital market (including the Islamic capital market) and which is directly responsible for the regulation, supervision and monitoring of all persons licensed under the CMSA with the main objective of protecting investors. It is also primarily responsible under the CMSA for encouraging and promoting the development of the securities and derivatives markets in Malaysia and for the monitoring and supervision of public listed companies to ensure compliance with securities laws.

Bursa Malaysia Berhad

Bursa Malaysia Berhad (Bursa) operates a fully integrated exchange under Section 15 of the CMSA. It not only provides a complete range of exchange-related services such as trading, clearing, settlement and depository services but also offers various Islamic market products,

35 See Section 9(1) of the LIFSSA. In addition, consumer complaints may be made to the Labuan FSA by completing the web forms available on the Labuan IBFC website at www.labuanibfc.com/contact-us.

36 See Section 9(3) and 9(4) of the LIFSSA.

37 This is an excerpt from page 333, chapter 22 on Malaysia by Rodney Gerard D'Cruz, *The Banking Regulation Review*, 10th Edition, Law Business Research Ltd, 2019.

38 See Section 10 of the IFSA.

namely equities, derivatives, commodities and debt securities across all sectors and industries. To perform the tasks and duties assigned under the CMSA, Bursa has set up subsidiaries to handle some of its principal activities. As at 31 May 2019, 77 per cent of securities listed on Bursa are *shariah*-compliant.³⁹ Aside from conducting commercial activities, Bursa is also empowered to regulate and administer:

- a* the FTSE Bursa Malaysia Hijrah Shariah Index;
- b* the FTSE Bursa Malaysia EMAS Shariah Index;
- c* the FTSE Bursa Malaysia Small Cap Shariah Index;
- d* the Sukuk Index;
- e* Bursa Suq Al Sila' (an electronic Islamic commodity trading platform); and
- f* listed *shariah*-compliant instruments, such as Islamic exchange-traded funds, Islamic real estate trusts and Islamic unit trusts.

However, SC, and not Bursa, is responsible for the screening of companies to determine whether they are *shariah*-compliant for the purpose of being listed on the stock exchange.

Labuan FSA

The Labuan FSA was established under the Labuan Financial Services Authority Act 1996 and is solely responsible for the regulation, supervision and development of the Labuan IBFC under the LIFSSA. Aside from issuing licences for financial institutions operating within Labuan IBFC,⁴⁰ it is also empowered to make recommendations, investigate, collect and divulge information and conduct entry search and seizure, as well as to establish or participate in any body corporate for the purpose of promoting research and training.

Shariah advisory councils and shariah committees

Other than the establishment of *shariah* advisory councils (SACs) within BNM and the SC, individual financial institutions are also required to establish their own internal *shariah* committees to ensure the *shariah* compliance of their respective business operations.

BNM SAC

As mentioned earlier, the BNM SAC was established under the CBA as the authority for the ascertainment of Islamic law for the purposes of Islamic financial business.⁴¹ In any Islamic financial business proceedings, the court or arbitrator must refer to the published rulings of the BNM SAC or refer any question concerning *shariah* matters to the BNM SAC for its ruling, which shall be binding on the court or arbitrator.⁴²

39 See www.sc.com.my/news/media-releases-and-announcements/sc-releases-updated-list-of-shariah-compliant-securities-by-shariah-advisory-council.

40 See Section 67 of the LIFSSA.

41 See Section 51 (1) of the CBA, and footnote 6.

42 See Sections 56 and 57 of the CBA.

SC SAC

The SC Shariah Advisory Council (SC SAC) was established in 1996 to advise the SC on *shariah* matters relating to Islamic capital market and is the authority for the ascertainment of the application of *shariah* principles in respect of Islamic capital markets businesses or transactions.⁴³

The SC SAC has the following functions:

- a* to ascertain the application of *shariah* principles on any matter relating to Islamic capital market business or transactions;
- b* to issue rulings on any matters relating to Islamic capital market business or transactions;
- c* to advise the SC on any *shariah* issue relating to Islamic capital market business or transactions;
- d* to provide advice to any person on any *shariah* issue relating to Islamic capital market business or transactions; and
- e* such functions as may be prescribed by the Minister.⁴⁴

In carrying out the above functions, the SC SAC adopts two significant approaches. First, by conducting research or studying the validity of conventional instruments from the *shariah* point of view, where focus is on the mechanism and use of the instruments to ensure their compliance with *shariah* principles. Second, by formulating and developing new financial instruments based on *shariah* principles. These approaches have formed the basis in developing several key *shariah* rulings on *sukuk* issuance.

Shariah committees of financial institutions

Every licensed holder under the IFSA must establish an internal *shariah* committee to ensure that its business, affairs and activities are *shariah*-compliant.⁴⁵ It is an independent body that reports directly to the board of directors. The appointment of the *shariah* committee members must be done with BNM's prior written approval.⁴⁶

All Islamic financial products or services offered by a licensed holder must be evaluated and approved by its *shariah* committee. The *shariah* committee may consult the BNM SAC for their ruling on any *shariah* matter and the latter's ruling prevails over the former's.⁴⁷

Malaysia International Islamic Financial Centre Initiative

In 2006, the Malaysia International Islamic Financial Centre Initiative (the MIFC Initiative) was launched to position Malaysia as an international Islamic financial hub to, inter alia, facilitate Islamic finance business within the Asian region. Pursuant thereto, the MIFC was established as a network of the country's financial sector regulators, including BNM, the SC, the Labuan FSA, Bursa and government ministries and agencies, together with industry participation from the banking, *takaful*, capital markets, research and talent development

43 See Section 31ZI(1) of the SCMA.

44 See Section 31ZJ of the SCMA.

45 See Section 30(1) of the IFSA.

46 See Section 31 of the IFSA.

47 See Section 58 of the CBA.

institutions and service providers within Islamic finance. The MIFC network has greatly contributed to the development of Islamic finance in Malaysia by building strong ties among key stakeholders locally and abroad.

II COMMON STRUCTURES

The following discussion on common structures used by the financial institutions in offering Islamic financial products or financing facilities is based on the BNM SAC's rulings, which were published in the second edition of Shariah Resolutions in Islamic Finance in October 2010. The rulings must be followed by all local or foreign financial institutions offering such products or services in Malaysia.⁴⁸

i Consumer finance

Deposits typically involve contracts or arrangements under the *shariah* principle of *wadiah*, where property is deposited with a financial institution for safekeeping or protection, or *mudarabah*, which envisages the depositor as investor and the financial institution as entrepreneur, whereby the depositor contributes capital and the entrepreneur contributes expertise and operations. Profit earned is distributed according to agreement, but any losses suffered are borne by the investor.

As such it is permitted for (1) Islamic savings accounts to be established under the *shariah* principle of *mudarabah*;⁴⁹ and (2) Islamic current accounts to be established under the *shariah* principles of *mudarabah*, *wadiah* and *wadiah yad dhamanah*.⁵⁰

Under the IFSA, there are two major classifications of products for the acceptance of money from customers, namely (a) Islamic deposits using *shariah* contracts with principal guaranteed features, applying the *shariah* principles of *wadiah yad dhamanah*, *qard* or *murabahah*; and (b) Islamic investment accounts using *shariah* contracts with non-principal guaranteed features, applying the *shariah* principles of *mudarabah*, *musharakah* or *wakalah*.

Given the above, investment accounts would not constitute debt obligations owed by the financial institution to its depositors, whereas in the case of Islamic deposits, whether the same constitute debt obligations owed by the financial institution to its depositors would depend on whether the financial institution's obligation to fully repay is based on a debt obligation, such as in the case of accounts opened under the *shariah* principles described at (a) above. This duality also enables customers with higher risk appetites to place their funds in investment accounts that will in turn receive higher returns depending on the performance of the underlying portfolio. This is also a new source of funding that may be utilised by financial institutions to fund more entrepreneurial business opportunities.

Islamic credit cards are offered using two *shariah* concepts, namely *bai al inah* and *wadiah*.⁵¹ Two separate contracts must be entered into under the concept of *bai al inah* for sale and buy-back transactions of an asset. Financial institutions will sell an asset at a nominal value plus profit to the customer with an agreed deferred payment term and the customer will

48 See Section 59 of the CBA.

49 See BNM, *Shariah Resolutions in Islamic Finance* (2nd edition, Kuala Lumpur: 2010), at p. 24 (ruling No. 15).

50 *ibid.*, at pp. 26 and 155 (rulings Nos. 17 and 94).

51 *ibid.*, at p. 148 (ruling No. 89).

subsequently sell the same asset to the financial institution at a nominal value and payable on cash basis. The sale proceeds will be credited into the *wadi'ah* account to facilitate the purchases of goods or services by the customer.

The concept of *ijarah thumma al-bai* is applied in vehicle financing and involves two independent contracts: the *ijarah* contract and the *al-bai* contract.⁵² Under the *ijarah* contract, the financial institution will appoint the customer as an agent to purchase the vehicle identified by the customer and the former will then lease the vehicle to the latter for a specified period. The customer has the option to purchase the vehicle from the financial institution upon the expiry of the lease period. An *al-bai* contract will be entered into should the customer opt to purchase the vehicle.

ii Home finance

The principle of *bai bithaman ajil* (BBA) is commonly used in Islamic home financing facilities. BBA contracts are contracts of sale and deferred payment where a home is sold on a deferred payment basis at an agreed selling price that consists of the actual cost of the home and the profit margin agreed between the financial institution lender and the customer borrower.⁵³

Under BBA home financing, the agreed payment instalments remain fixed throughout the financing period as the selling price is fixed at the outset and the financing is not tagged to base lending rates. The latest Islamic home financing products allow customers to receive *ibra* (a rebate) on the monthly instalment amount if the home financing is linked to a *mudarabah* deposit account as long as the cost associated with the *ibra* is borne solely by the financial institution.⁵⁴

In addition, the concepts of *ijarah mawsufah al-zimmah* and *musharakah mutanaqisah* are used to finance homes that are still under construction.⁵⁵ Based on the contract of *musharakah mutanaqisah*, both customer and financial institution share the rights over the home under construction. The financial institution will then lease its portion to the customer under the contract of *ijarah mawsufah al-zimmah*. The customer is required to pay advanced rent during the construction period of the home and will continue to pay full rent upon completion of the home.

iii Takaful

In Malaysia, *takaful* involves contribution of money based on the *tabarru* concept (voluntary contribution) by all *takaful* participants who agree to relinquish all or part of their contribution as donation to aid other *takaful* participants who suffer losses or difficulties. This is originated from the concept of *ta'awun* (mutual assistance). A *takaful* company will then be appointed as their agent to manage the *takaful* fund and will in return receive commission of fixed service fee under the *wakalah* contract. A *retakaful* business model based on *tabarru* and *wakalah* or based on the *wakalah* model with the element of *wakaf* is permissible.⁵⁶

52 *ibid.*, at p. 3 (ruling No. 1).

53 In this case, legal title to the home is with the customer or borrower.

54 See footnote 44, at p. 128 (ruling No. 80).

55 *ibid.*, at p. 16 (ruling No. 12).

56 *ibid.*, at p. 62 (ruling No. 41).

iv Islamic private equity investments

The common structures used for *shariah*-compliant private equity or venture capital are *musharakah*, *mudharabah* and *wakalah*. The first Islamic venture capital fund established in Malaysia was based on the concept of *musharakah*, a risk-sharing partnership.⁵⁷ In this partnership, the ratio of distribution of profits need not coincide with the ratio of participation in the financing of the business activity but all parties bear the loss in proportion to their share in financing in the event of loss.

The requirements for the registration of corporations undertaking Islamic venture capital and Islamic private equity activities are provided for in the Guidelines on the Registration of Venture Capital and Private Equity Corporations and Management Corporations dated 9 March 2015.⁵⁸ Under these Guidelines, an applicant who wishes to undertake Islamic venture capital or private equity activities must appoint a *shariah* adviser to provide *shariah* expertise and guidance on all matters pertaining to the Islamic venture capital or private equities activities and ensure that all aspects of the activities are in accordance with *shariah* requirements, including resolutions issued by the SC SAC.⁵⁹ In the case of investment in securities of any venture corporation by the registered corporations undertaking Islamic venture capital or private equity activities, the activities of the venture corporations must be *shariah*-compliant.⁶⁰

v Islamic real estate investment trusts

Malaysian Islamic real estate investment trusts (REITs) are governed by the SC but will also fall under the purview of Bursa if they are listed on the stock exchange. The SC revised the Guidelines on Real Estate Investment Trusts on 15 March 2018 (the Guidelines on REITs),⁶¹ and issued the Guidelines on Listed Real Estate Investment Trusts on 15 March 2018 (the Guidelines on Listed REITs) in relation to listed REITs.⁶²

Currently the number of listed Malaysian Islamic REITs remains at four as at 30 May 2019.⁶³ These Islamic REITs specialise in different classes of assets and are as follows:

- a Al-'Aqar' Healthcare REIT (healthcare);
- b Al-Salam Real Estate Investment Trust (*shariah*-compliant properties that include retail, office, food and beverage, which consists of restaurant and non-restaurant outlets);
- c AXIS-REIT (office buildings and industrial properties); and

57 See *Islamic Finance: An Ideal Model for Private Equity and Venture Capital* dated 30 September 2015, published by BNM.

58 For more details about the registration requirements, see Part B of the Guidelines.

59 See Chapter 5 of Part B of the Guidelines on the Registration of Venture Capital and Private Equity Corporations and Management Corporations.

60 See Part D of the Guidelines on the Registration of Venture Capital and Private Equity Corporations and Management Corporations.

61 See: Guidelines on Real Estate Investment Trusts (<https://www.sc.com.my/api/documentms/download.ashx?id=efad9ab2-37fc-489c-9a8a-0e56964f8d66>).

62 See: Guidelines on Listed Real Estate Investment Trusts (<https://www.sc.com.my/api/documentms/download.ashx?id=afacc30c-060e-4cc0-b40f-d4546db74724>)

63 See <https://www.sc.com.my/api/documentms/download.ashx?id=bcbac70-81c3-4d09-9699-11f411dda781>.

- d Kuala Lumpur City Centre (KLCC) REIT (first *shariah*-compliant stapled REIT where the existing shares of KLCC Property Holdings Berhad are stapled together with the units of KLCC's three prime properties, namely Petronas Twin Towers, Petronas Tower 3 and ExxonMobil Tower).

In addition, the current Guidelines on REITs allow for the establishment of unlisted REITs. Malaysia also has its first *shariah*-compliant unlisted REIT, the ALPHA REIT of 2017, dealing with purely education-related properties.⁶⁴

For Islamic REITs, tangible assets will be acquired and rented out or leased to generate profits for the investors based on an *ijarah* contract. The owners of real estate sell assets to the Islamic REITs and a back-to-back asset lease arrangement will be entered into simultaneously. This helps to mitigate risks as an income stream is secured and the issue of securing a long-term tenant or buyer is solved.

Under these Guidelines, a *shariah* advisory committee must be established to oversee the *shariah* compliance of the REIT's operations. The rental of real estate by I-REITs is permissible provided that the property is not used for non-permissible activities.⁶⁵ *Takaful* schemes must be purchased to insure real estate and conventional insurance schemes can only be allowed if the former is unable to provide insurance coverage.

vi Investment funds

The *shariah* principle of *musharakah*, a joint venture profit and loss sharing arrangement, is commonly applied in investment and financing activities in Malaysia to provide working capital financing, trade financing and asset financing. There are two commonly used forms of *musharakah*-based financing:⁶⁶ (1) a joint venture partnership where the facility sums will be credited (in a lump sum or in stages) into a joint account that is registered under the customer's name but is managed by the financial institution in accordance with the *musharakah* principle; and (2) equity participation through establishment of a private limited joint venture company where the company's management will be appointed by both parties to represent their interests and will be responsible towards the development of a project. For the second form of *musharakah*-based financing, the financial institution will disburse the facility sums in one lump sum through additional paid up capital of the private limited company. These financing approaches are allowed provided that there is no element of capital or profit guarantee by any of the partners on the other partners.

Further to the above, the *shariah* principle of *istisna* (a type of sale contract where a subject matter is transacted before it comes into existence) is commonly used to finance construction and manufacturing activities in Malaysia. According to *istisna*, the financial institution enters into an agreement to purchase the project or asset to be developed from

64 See <http://www.focusmalaysia.my/Assets/paving-the-way-for-education-reits>.

65 Non-permissible activities include financial services based on *riba* (interest), gambling, conventional insurance, entertainment activities that are not permissible according to *shariah* principles, manufacturing or sale of tobacco-based products or related products, stockbroking or share trading in non-*shariah*-compliant securities, hotels and resorts and other activities to which the *shariah* committee may apply *ijtihad* (the process of making a legal decision by independent interpretation of the sources of the law, the Quran and the Sunnah) for other non-permissible activities to be included as a criteria in assessing whether the rental income for the I-REITs is *shariah*-compliant or not.

66 See footnote 44, at p. 40 (ruling No. 29).

the customer (*istisna* – purchase by order) and will immediately sell it back to the customer at a marked-up price under the principle of *al-istisna* (sale by order). The purchase price will only be released by the financial institution upon presentation of the requisite documents (such as a valid architect's certificate) whereas the customer is required to settle the selling price by way of instalments within the agreed period or by redemption exercise. The BNM SAC has previously ruled that a conventional bond can be used as a security for financing of this type as it is not made for the purpose of ownership, but merely as a security.⁶⁷

vii Other areas – Islamic financial derivative instruments

Forward foreign currency exchange transactions

The concept of *wā'd* is widely used by the financial institutions to conduct forward foreign exchange transactions, whereby one of the parties to the contract promises to buy from or sell to the other counterparty a specific currency at an agreed exchange rate and settlement date. Aside from *wā'd*, BBA is also allowed to be used as the underlying concept for forward foreign currency exchange transactions as all the deferred payment sale transactions are conducted independently and not related to each other. The unilateral *wā'd mulzim* (binding promise) is permissible to be applied in a forward foreign exchange transaction as it is treated as a promise.⁶⁸

Islamic profit rate swap based on bai al inah

The *shariah* contract of *bai al inah* is used for Islamic profit rate swap (IPRS),⁶⁹ and depending on the duration of the swap contract, there are several stages involved in this contract.

First, the financial institutions representing the swap counterparties jointly invest⁷⁰ in a *mudarabah* interbank investment (MII) whereupon this investment will be used as the underlying asset in the swap transaction. The financial institutions will enter into an IPRS agreement with a third party to conduct a series of trade transactions on agreed dates⁷¹ (e.g., semi-annually during the swap contract period, which in this instance shall be assumed to be two years).

Second, the financial institutions will sell the MII to the third party at a deferred sale price payable every six months (i.e., semi-annually) and the third party will thereafter sell it back to the financial institutions at a sale price based on the fixed profit rate agreed in the swap contract. The settlement of the purchase price due from the third party will be offset against the payable amount due from the financial institutions, which results in the financial institutions being obliged to pay the fixed profit rate to the third party every six months during the two-year period. Third, the financial institutions will sell the MII to the

67 *ibid.*, at p. 21 (ruling No. 15).

68 *ibid.*, at p. 137 (ruling No. 84).

69 *ibid.*, at p. 139 (ruling No. 85).

70 As *mudarib* or managers for the swap counterparties (1) the FIs invest in the MII, but do not acquire it, to avoid the costs and implications of legal title; and (2) the amount invested by FIs is a notional swap amount contributed by the swap counterparties as prescribed in the swap contract.

71 The dates (described as 'reset dates' in the ruling) constitute determination points of the applicable floating profit rates to be swapped. These dates are set by swap counterparties and may fall quarterly, semi-annually, annually or otherwise.

third party at the price agreed in the swap contract, which is based on the prevailing floating profit rate and the third party will thereafter sell it back to the financial institutions at this agreed price.

The settlement of the purchase price due from the third party will again be offset against the payable amount due from the financial institutions and thus the financial institutions will only be required to pay the floating profit rate for every six months for the two-year contract period.

The difference between payment obligations of both contracting parties resulting from the final step at the second stage and the final step at the third stage will be paid to the receiving party. Finally, the third stage will be repeated at the agreed reset date, which will be determined every six months until the swap contract matures. This arrangement is allowed and the issue of sale of debt with debt (which is prohibited by *shariah*) does not arise as the transfer of beneficial ownership takes place automatically given that the underlying asset used in the transaction is the MII. The transfer will be reflected in the contract documentation and is *shariah*-compliant.

III TAXATION

Both conventional and Islamic financial products are governed under the same taxation regime. However, tax incentives are offered from time to time by the Malaysian government to encourage growth in the Islamic finance sector and facilitate Malaysia's aim towards becoming the regional Islamic finance hub. Some of the most significant and recent tax incentives are as follows:

i Malaysian Budget

The existing tax incentives announced under the Malaysian Budgets in 2016, 2017, 2018 and 2019 respectively comprise the following:

- a companies enjoy single deduction on additional expenses⁷² incurred for the issuance of *sukuk* under the principles of *ijarah* and *wakalah*⁷³ and enjoy double deduction on additional expenses incurred for the issuance of *sukuk* under the principles of *mudarabah*, *musharakah*, *istisna*, *murabahah* and BBA based on *tawarruq* until 2020;⁷⁴
- b companies that issue sustainable and responsible *sukuk* will benefit from a tax deduction on their issuance costs until 2020;⁷⁵

72 These are: (1) professional fees relating to due diligence, drafting and preparation of prospectus; (2) printing cost of prospectus; (3) advertisement cost of prospectus; (4) SC prospectus registration fee; (5) Bursa processing fee and initial listing fee; (6) Bursa new issue crediting fee; and (7) primary distribution fee. See Appendix 9 of the 2016 Malaysian Budget: www.bnm.gov.my/files/Budget_Speech_2016.pdf.

73 The Income Tax (Deduction for Expenditure on Issuance of Sukuk) Rules 2015 provide that a company shall be given a revenue deduction on an amount equal to the expenditure incurred on the issuance of *sukuk* under the *shariah* principles of *ijarah* or *wakalah* approved or authorised by, or lodged with, the SC or approved by the Labuan FSA. This is applicable until 2020. See Appendix 10 of the 2019 Malaysian Budget.

74 See Appendix 11 of the 2019 Malaysian Budget.

75 See Paragraph 72 and Appendix 8 of the 2016 Malaysian Budget.

- c companies that provide *shariah*-compliant fund management services and are certified by the SC will also enjoy a tax exemption on statutory income from the provision of such services until 2020;⁷⁶
- d recipients of green sustainable and responsible investment (SRI) *sukuk* grants enjoy income tax exemption for the purpose of financing the external review expenditure until 2020;⁷⁷
- e investors enjoy stamp duty exemptions on contract notes for trading of exchange-traded funds and structured warrants until 2020;⁷⁸
- f the fund manager managing an SRI fund approved by the SC will be given tax exemptions on management fee income from managing conventional and *shariah*-compliant SRI funds until 2020 to further promote fund management activities globally;⁷⁹ and
- g the following tax incentives that were provided pursuant to the MIFC Initiative from 2007 to 2016 have been further extended until 2020:⁸⁰
 - full tax exemption on income earned from Islamic banking business or *takaful* business conducted through the International Currency Business Unit in foreign currencies by licensed financial institutions or licensed *takaful* companies and *takaful* units; and
 - full stamp duty exemption on instruments executed pertaining to the above-mentioned activities.

Tax allowances and exemptions made under previous years' budgets are discussed in Section VI.

ii Malaysian Income Tax Act 1967⁸¹

While Section 2(7) of the Malaysian Income Tax Act 1967 (ITA) provides that any reference in the ITA to interest shall apply to gains or profits received and expenses incurred, in lieu of interest, in transactions conducted in accordance with *shariah* principles, Section 2(8) of the ITA provides that any reference in the ITA to the disposal of an asset or a lease shall exclude enabling transactions under a scheme of financing approved by BNM, the SC, the Labuan FSA or the Malaysia Co-operative Societies Commission.

iii Malaysian Stamp Act 1949

Sukuk issuances currently enjoy stamp duty exemptions in Malaysia by way of orders issued under the Malaysian Stamp Act 1949, which include the following: (1) Stamp Duty (Exemption) (No. 23) Order 2000, which provides that all instruments relating to the issue of, offer for subscription or purchase of, or invitation to subscribe for or purchase, debentures approved by the SC under Section 32 of the Securities Commission Act 1993 and the transfer

76 *ibid.*, Appendix 10.

77 See Appendix 4 of the 2018 Malaysian Budget.

78 See Appendix 8 of the 2018 Malaysian Budget.

79 See Appendix 5 of the 2018 Malaysian Budget.

80 See: http://www.mifc.com/index.php?ch=ch_contents_media_centre&pg=pg_media_centre&ac=20996.

81 For more tax incentives that are or were previously offered under the Income Tax Act for various Islamic capital market products or services, see www.sc.com.my/home/special-incentives-2/islamic-capital-market/.

of such debentures are exempted from stamp duty; and (2) Stamp Duty (Exemption) (No. 4) Order 2013, which provides that an instrument relating to the sale and purchase of retail *sukuk* as approved by the SC under the CMSA are exempted from stamp duty.

IV INSOLVENCY

In Malaysia, corporate insolvency is currently governed by the Companies Act 2016 (CA), which repealed and replaced the Companies Act 1965.⁸² The modes of winding-up proceedings provided thereunder still include compulsory and voluntary winding up and the appointment of receivers and managers over a corporation. However, the CA introduced two new corporate rescue mechanisms, namely corporate voluntary arrangement and judicial management in Division 8 of Part III of the CA, which came into force on 1 March 2018.⁸³ A voluntary winding up under the CA can either be a member's voluntary winding up or a creditor's winding up. A company may be wound up voluntarily if so provided under its constitution and the company has passed a resolution in a general meeting requiring itself to be wound up voluntarily or a special resolution for its winding up is passed.⁸⁴ In addition, the CA provides 12 situations⁸⁵ whereby a court may wind up a company, which include a company being unable to pay its debts, the most commonly occurring scenario.

Over and above the CA, however, a specialised framework addressing the failure of financial institutions licensed to undertake Islamic or international Islamic banking business under the IFSA to pay their debts as they fall due can be found in the IFSA and the MDICA.

i MDICA

The MDICA empowers the MDIC to assume control of a non-viable financial institution and to acquire and take control of non-performing loans that are outstanding between the financial institutions, borrowers and security providers through the appointment of a conservator. The MDICA further provides that upon the appointment of the conservator, a moratorium shall take effect during which, inter alia, (1) no action, suit or proceeding may be commenced or continued against the MDIC, the conservator or the financial institution; (2) any petition for the winding up of the financial institution shall be dismissed; (3) no receiver, receiver manager or liquidator may be appointed over the financial institution; and (4) no steps may be taken to enforce any security over the assets of the financial institution.⁸⁶

Under the MDICA, BNM may provide written notice to the MDIC where BNM is of the opinion that a financial institution has ceased to be viable or is likely to cease to be viable, whereupon the MDIC can exercise, inter alia, the following powers:

- a the financial institution to take any step or action or refrain from any act or thing, in relation to itself, its businesses or its officers, to cease soliciting, taking or repaying deposits or carry on its business or such part of its business as the MDIC may direct or to restructure the whole or part of its business as may be specified by the MDIC;
- b acquire or subscribe to the shares of the financial institution;

82 See Part IV of the CA, which provides for voluntary and compulsory winding up of a company.

83 https://themalaysianlawyer.com/wp-content/uploads/2018/02/pub_20180228_p-u-b-106-2018-27-2-2018-crm.pdf.

84 Section 439 of the CA.

85 Section 465 of the CA.

86 Sections 161 and 179 of the MDICA.

- c* assume control over the financial institution, carry on the whole or part of its businesses and manage the whole or part of its assets, liabilities and affairs, including disposal of its assets or businesses or any part thereof, or appoint any person to do so on behalf of the MDIC;
- d* apply for the appointment of a receiver or manager, or both, to manage the whole or part of the assets, liabilities, businesses and affairs of the financial institution;
- e* subject to the approval of the Minister, present a petition for the winding up of the financial institution;
- f* with the approval of the Minister, designate one of its subsidiaries as a 'bridge institution'; or
- g* transfer such assets and liabilities of the non-viable financial institution to the bridge institution on terms as determined by the MDIC.⁸⁷

ii IFSA

The provisions of the IFSA include measures for addressing the insolvency of Islamic financial institutions. Under the IFSA, BNM acts as a resolution authority that is, with the prior approval of the Minister, empowered to assume control of the whole or part of the business, affairs or property of an Islamic financial institution, manage it or appoint any person to do so on behalf of BNM in the event that BNM is of the opinion that certain circumstances exist in relation to the Islamic financial institution concerned, including the following:

- a* the assets of the institution are not sufficient to give adequate protection to its depositors, policy owners, participants, users or creditors, as the case may be;
- b* the capital of the institution has reached a level or is eroding in a manner that may detrimentally affect its depositors, policy owners, participants, users, creditors or the public generally; and
- c* the financial institution has become or is likely to become insolvent or is likely to become unable to meet all or any of its obligations.⁸⁸

Additionally, the IFSA provides BNM with further powers if it is found that an Islamic financial institution is insolvent or is on the verge of insolvency, whereupon BNM may:

- a* make an application to appoint a receiver or manager, or both, over the whole or part of the business, affairs or property of the financial institution;⁸⁹
- b* with the prior approval of the Minister, vest in a bridge institution or any other person, the whole or part of the business, assets or liabilities of the financial institution;⁹⁰
- c* with the prior approval of the Minister, provide financial assistance to another institution or any other person to purchase any shares, or the whole or any part of the business, assets or liabilities, of the financial institution;⁹¹ or
- d* recommend to the Minister and the Minister may, on that recommendation, authorise BNM to file an application for the winding up of the financial institution.⁹²

87 Sections 98 and 99 of the MDICA.

88 Sections 177 and 179 of the IFSA.

89 Section 184 of the IFSA.

90 Section 188 of the IFSA.

91 Section 200(b) of the IFSA.

92 Section 205 of the IFSA.

Lastly, the IFSA further provides that:

- a* the provisions of the CA shall apply to the winding up of an institution, unless specifically provided otherwise. However, no application for the winding up of a financial institution may be presented by any person without the prior written approval of BNM;⁹³ and
- b* in the winding up of the licensed Islamic bank or the licensed *takaful* operator, the assets of that financial institution shall be available to meet all its liabilities to depositors or *takaful* participants in priority over all other unsecured liabilities, other than preferential debts set out in the CA and debts due and claims owing to the government under the Government Proceedings Act 1956.⁹⁴

V JUDICIAL FRAMEWORK

i Courts

Although Malaysia has a dual judicial system consisting of secular laws (criminal and civil) and religious laws (*shariah*), each with its own court system, cases involving Islamic finance business disputes fall within the jurisdiction of the civil courts and not the *shariah* courts.

Article 121 of the Federal Constitution of Malaysia 1957 (FC) sets out the jurisdictions of the Malaysian civil courts whereas Article 74(1) of the FC prescribes that Parliament may make laws with regard to the matters contained in the Federal List, inclusive of List I under the Ninth Schedule of the FC (List I), which, inter alia, includes civil and criminal procedure, the administration of justice and contracts⁹⁵ but specifically excludes the constitution and organisation of the *shariah* courts. As such, Articles 121 and 74(1) read together indicate that the jurisdiction of the civil court is specifically set out in List I.

Article 121(1 A) of the FC states that the civil court has no jurisdiction over matters within the jurisdiction of the *shariah* court, whereas Article 74(2) of the FC provides that a state legislature may make laws contained in the State List, inclusive of List II of the Ninth Schedule of the FC (List II), which, inter alia, includes Islamic law and personal and family law of persons professing the religion of Islam and the constitution and organisation of the *shariah* courts.⁹⁶

Based on the above provisions, jurisdiction over Islamic banking and finance laws lies with the civil court for the following reasons:

- a* while the term 'Islamic law' in List II is wide,⁹⁷ its application is only limited to persons professing the religion of Islam and would not be applicable to banks and financial institutions, which cannot be said to profess the religion of Islam;
- b* laws relating to Islamic banking and finance fall within the category of contract and mercantile law under List I, which is under the purview of the Malaysian federal legislative body. As such, these are subject to the jurisdiction of the civil courts as civil court judges are bound by laws and regulations that are exclusively federal;⁹⁸ and

⁹³ Sections 204, 206 and 207 of the IFSA.

⁹⁴ Sections 217 and 218 of the IFSA.

⁹⁵ See Paragraphs 4(a) and 4(b) of List I of the Ninth Schedule of the FC.

⁹⁶ *ibid.*, Paragraph 1 of List II.

⁹⁷ *ibid.*

⁹⁸ This refers to the Malaysian Civil Law Act 1956, the Malaysian Courts of Judicature Act 1964 and the Rules of the High Court 1980.

c the judgment of the Malaysian Supreme Court in the case of *Mohamed Habibullah bin Mahmood v. Faridah Dato' Talib*⁹⁹ held that the *shariah* court may only decide matters falling under its jurisdiction and as such Article 121(1 A) does detract from the jurisdiction of the High Court in respect of the matters in List I.

ii Cases

As stated above, disputes relating to Islamic finance in Malaysia are decided by the civil courts rather than the *shariah* courts, notwithstanding the application of *shariah* principles. Bearing this in mind, together with the popular usage of the BNM SAC approved BBA principle in Malaysian home financing transactions, the following cases are noteworthy in illustrating how the Malaysian courts have progressively dealt with disputes involving Islamic finance transactions.

Initially, the civil courts dealt with disputes through the application of common law principles applicable to conventional banking without discussing or reference to applicable underlying *shariah* principles.¹⁰⁰ In *Bank Islam Malaysia Bhd v. Adnan Omar*,¹⁰¹ the court applied common law doctrine that parties were bound by the four corners of their agreement. The defendant was therefore obliged to pay the entire selling price as he had knowingly entered into the contract and was fully aware of its terms. The decision did not examine whether the BBA facility involved non-*shariah*-compliant elements, expressly referred to the facility as a loan and held that defendants had no right to a rebate, which was at the discretion of the lender. Understandably, this operated to the disadvantage of the defendants, who in defending claims against them, were deprived of an analysis of *shariah* principles by the court.

Subsequently, the courts took a more interventionist approach in *Affin Bank v. Zulkifli Abdullah*,¹⁰² which concerned a BBA facility wherein the customer had defaulted in instalment payments for the asset sale price and the lender had claimed the outstanding balance of the asset sale price (i.e., minus the payments previously made). In coming to a decision, the courts decided that a critical examination of the underlying *shariah* principles in the financing was required to ensure justice and equality between the parties.

This approach was subsequently followed in *Malayan Banking Berhad v. Marilyn Ho Siok Lin*,¹⁰³ in which the court specifically analysed whether the transaction was contrary to Islam and ruled that the Islamic banks could not claim unearned profits on BBA contracts because the contract was similar to a conventional loan and unearned profits were equal to interest calculation. The resulting judgment disallowed the lenders claims for unearned profits notwithstanding that the predecessor to the CBA, the Central Bank of Malaysia Act 1958 was amended in 2003¹⁰⁴ to allow for a referral by the court to the BNM SAC for

99 [1993] 1 CLJ 264. See also the Malaysian High Court judgment in *Bank Islam Malaysia Berhad v. Adnan Omar* [1994] 3 CLJ 735, in which the High Court held that, inter alia, *shariah* courts can only decide cases that fall under the State List of the Malaysian Federal Constitution, which excludes commercial law matters such as Islamic banking and finance.

100 See *Bank Kerjasama Rakyat Malaysia Bhd v. Emcee Corporation* [2003] 1 CLJ 625, CA, which held that the law applicable to Islamic banking disputes was the same as that applicable to conventional banking disputes. This was followed in *Tahan Steel Corporation v. Bank Islam Malaysia Bhd* [2004] 6 CLJ 25.

101 [1994] 3 CLJ 735.

102 [2006] 3 MLJ 67.

103 [2006] 3 CLJ 796.

104 See Section 16B of the CBA 1958.

shariah-related issues. However, the court was not bound to make such a referral and the judge in *Affin Bank* declined to do so and decided the matter based on a review of the transaction documents.

The *Affin Bank* judgment was not well received in the Islamic finance industry as lenders became uncertain as to what they could claim in default situations. In addition, *shariah* scholars were dissatisfied with the decision and viewed it to be defective from a *shariah* law perspective. Some three years later, the presiding judge in *Affin Bank* further developed this approach in *Arab-Malaysian Finance Bhd v. Taman Ihsan Jaya Sdn Bhd & 11 Ors*,¹⁰⁵ where *Affin Bank* was affirmed and the court ruled that a bona fide sale was required in BBA financing for the profit or selling price to be *shariah*-compliant. In the absence of a bona fide sale, deferred payment of the sale price would be nothing more than a credit or loan extended and any profit therefrom would be prohibited as *riba*. The judge rejected the approach in *Adnan Omar* and held that the parties' agreement alone did not prevent the court from examining and determining the exact nature of a transaction.

The other judges presiding over disputed BBA financing transactions began to adopt differing views by seeking the advice of *shariah* scholars and the BNM SAC, in contrast to *Affin Bank*. In *Malayan Banking Bhd v. Ya'kup Oje & Anor*¹⁰⁶ the court opined that there would be great uncertainty if customers entering into financing contracts approved by both the Islamic financial institution lenders *shariah* committee and by the BNM SAC were allowed to challenge the *shariah* compliance of the contract in court and that this was morally unacceptable from a *shariah* perspective.

The Malaysian Court of Appeal considered *Taman Ihsan Jaya* on appeal in *Bank Islam Malaysia Berhad v. Lim Kok Hoe & Anor* and other appeals¹⁰⁷ and held that the High Court judgment in *Taman Ihsan Jaya* was manifestly wrong and must be set aside for the following reasons:

- a* the judge in *Taman Ihsan Jaya* was plainly wrong to equate profit earned as being similar to *riba* or interest. The two cannot be similar as a BBA contract is in fact a trade transaction between the customer and the bank and the element of profit is therefore completely distinct from interest in conventional loans;
- b* judges in civil court should not take it upon themselves to declare whether banking business is in accordance with the religion of Islam; this requires consideration by eminent jurists properly qualified in the field of Islamic jurisprudence; and
- c* the judge in *Taman Ihsan Jaya* failed to follow the judicial precedent of superior courts, which clearly favoured the common law approach in *Adnan Omar*.

In the appellate case of *Maybank Islamic Berhad v. M-IO Builders Sdn Bhd & Anor*,¹⁰⁸ the appellate court opined that the validity of the disputed Murabahah Overdraft Facility agreements should be governed by the law that generally governs the contract between parties in Malaysia, namely the Contracts Act 1950. Therefore, the said agreements were held to be valid notwithstanding their failure to comply with *shariah* principles. It is interesting to note that most of the claims were filed as an attempt by customers to escape liability as a whole or to reduce the quantum of their liability. If courts were to declare these facilities, which are

105 [2008] 5 MLJ 631.

106 [2007] 5 CLJ 311.

107 [2009] 6 MLJ 839.

108 [2016] MLJU 1415.

monitored and approved by BNM, as invalid, the development of the local Islamic banking industry would be adversely affected as Islamic financial institutions would face uncertainty and increased risk in their ability to recover the principal and profit in relation to the granting of these facilities.

Subsequently, BNM and Parliament conclusively laid much uncertainty to rest with the coming into force of the CBA, which provides, inter alia, that:

- a the BNM SAC would be the authority for determining Islamic law for the purposes of Islamic finance business;¹⁰⁹
- b the BNM SAC would be a consultative body to the Malaysian judiciary and that consequently judges and arbitrators were required to take into consideration published rulings of the BNM SAC or refer to the BNM SAC for its ruling on any *shariah* issues arising from disputes being adjudicated;¹¹⁰ and
- c once a ruling is issued by the BNM SAC in response to a reference, that ruling was binding on the referring financial institution, court or arbitrator.¹¹¹

In addition to this, the issuance of BNM's Guidelines on Ibra' (Rebate) for Sale-Based Financing obliged Islamic banks to grant *ibra* to customers of sale-based financing facilities, thus resolving earlier questions of unfairness or injustice. With these developments, the above-mentioned cases remain purely of academic interest.

Section 56 and Section 57 of the CBA were enacted to mandate the courts to refer to the BNM SAC to answer questions on *shariah* issues in cases involving Islamic financial institutions. In the case of *JRI Resources Sdn Bhd v. Kuwait Finance House (M) Bhd (President of Association of Islamic Banking Institutions Malaysia & Anor, and Central Bank of Malaysia as interveners)*,¹¹² the Federal Court affirmed that the SAC's ruling is limited to ascertaining the position of Islamic law on financial matters or business applicable to the dispute but does not conclude or settle the dispute between the parties. The final decision on the dispute remains with the court. Moreover, in the case of *Tan Sri Abdul Khalid Ibrahim v. Bank Islam Berhad*,¹¹³ there was an argument that these provisions are unconstitutional and ultra vires as the courts have to refer to the BNM SAC for answers on *shariah* questions in Islamic finance, thereby compelling the court to adopt the decision of the council as its judgement. In response, the Court of Appeal interpreted the judicial role of the BNM SAC provided in Sections 56 and 57 as a new procedural requirement, and one that does not give judicial power to the BNM SAC.

VI OUTLOOK

The following recent developments illustrate Malaysia's continuing commitment to its financial services objectives under the ETP, the FSB and the Blueprint. Collectively, they underscore a promising outlook for Malaysia's dynamic and innovative Islamic finance sector and its continuing efforts to lead in the growth and development of Islamic finance globally.

109 See Section 51 of the CBA.

110 See Section 52(1) (a) of the CBA.

111 See Sections 56 and 57 of the CBA.

112 [2019] 3 MLJ 561.

113 [2013] 3 MLJ 269.

i Islamic indices

To ensure that *shariah*-based investments continue to grow, the SC and Bursa acknowledged that Islamic indices serve an essential role in Islamic finance as they identify securities available for investment within Islamic financial markets and facilitate the valuation of *shariah*-compliant products. These indices also broaden the base of investors and increase *shariah*-compliant product diversity.

In line with the above, Bursa launched Bursa Malaysia-i, the world's first end-to-end integrated Islamic securities exchange platform in September 2016.¹¹⁴ The platform's basic function is to enable investors to invest in and trade *shariah*-compliant products via a *shariah*-compliant trading platform incorporating the full range of *shariah*-compliant exchange-related services, including listing, trading, clearing, settlement and depository facilities. Bursa Malaysia-i forms an important part of Bursa Malaysia's plan to position Malaysia as the pre-eminent marketplace for Islamic-based financial offerings and *shariah* investing.

In July 2019, the Bond Pricing Agency Malaysia (BPAM) launched the country's first environmental, social and governance (ESG) bond index series, which will monitor bonds with a market capitalisation of 4.05 billion ringgit and covers long-term Islamic bonds. The index series highlights bond issuers issuing under ESG principles and tracks their performance. It covers bonds that were issued under or aligned with the SC's SRI *sukuk* framework, the ASEAN Green Bond Standards, ASEAN Social Bond Standards, ASEAN Sustainability Bond Standards and the United Nations Sustainable Development Goals.¹¹⁵

ii Islamic pension fund

In August 2016, Malaysia's state pension fund, the Employees Provident Fund (EPF) made available to its members the option of converting their current conventional savings into an Islamic pension scheme option, simply called 'EPF Simpanan Shariah', which took effect on 1 January 2017, whereby dividend rates would not be guaranteed, but based on the performance of *shariah*-compliant investments. EPF Simpanan Shariah is open to all members regardless of race, religion and nationality. However, members who have chosen Simpanan Shariah would not be allowed to revert to the conventional scheme after the effective date. According to EPF sources, a total of 59.03 billion ringgit of the initial 100 billion ringgit fund allocated for Simpanan Shariah 2017 have been taken up and 635,037 members had switched to Simpanan Shariah as at 23 December 2016. As at 31 December 2017, EPF had about 700,000 contributors with a total of 67.76 billion ringgit for Simpanan Shariah, from 100 billion ringgit allocated for the savings as at 31 December 2017.¹¹⁶ EPF allocated 50 billion ringgit as further injection for Simpanan Shariah 2018.¹¹⁷

The EPF also announced that it had allocated an initial fund size of 100 billion ringgit, equivalent to about 15 per cent of the EPF's total investment assets of 681.71 billion ringgit (as at end March 2016) and that its investment in *shariah* assets was expected to grow by at least 25 billion ringgit per annum on average, or in tandem with its total asset growth, to

114 See www.thesundaily.my/news/1961269.

115 See <https://www.thestar.com.my/business/business-news/2019/07/25/bpam-launches-malysias-first-esg-bond-index-series#bdfxv1ka6xh7gupt.99>.

116 See www.theedgemarkets.com/article/syariah-account-will-offer-similar-returns-long-term%C2%A0.

117 See <https://www.thestar.com.my/business/business-news/2017/01/18/epf-more-than-half-of-simpanan-shariah-fund-taken-up/>.

maintain a minimum of 45 per cent *shariah* assets.¹¹⁸ As at 31 December 2017, the *shariah* assets stood at 47.5 per cent of the fund's total asset exposure and contributed 42.9 per cent of total income in 2017.

iii Islamic fund and wealth management

The SC unveiled the Blueprint on 12 January 2017 with the aim of, among other things, establishing Malaysia as a leading international centre for Islamic fund and wealth management.

According to the Blueprint, one of the strategic thrusts to achieve the aim is to develop Malaysia as an international provider of Islamic wealth management services. In this regard, focus will be concentrated on efforts to deepen and broaden the suite of *shariah*-compliant wealth management solutions while enhancing the supporting market infrastructure and creating a more conducive and enabling environment. Efforts will also be directed towards promoting and differentiating aspects of Islamic wealth management across the value chain of wealth generation, accumulation, preservation and distribution by aligning products and services to the tenets of the *maqasid al-shariah* and by utilising *waqf* assets and structures. This will enable the Islamic fund and wealth management service provider to tap into a target market of affluent investors, especially Muslim investors.

iv Sustainable and responsible investments

With a clear shift in global trends towards business strategies that incorporate sustainable practices, stronger governance and ethics, together with environmental and social concerns, this enabled Islamic finance, based on the principles of fairness, social and environmental responsibility, to feature prominently in the rise of sustainable development projects. With this in mind, the SC introduced the SRI *sukuk* framework in 2014 to facilitate the creation of an ecosystem conducive for SRI investors and issuers.

The framework further enhances Malaysia's position and reputation as a hub for Islamic finance and sustainable investments. In June 2015, Malaysia's sovereign wealth fund, Khazanah Nasional Bhd issued the first tranche of the 1 billion ringgit SRI *ihisan sukuk*, the proceeds of which were to be utilised for the Yayasan Amir trust schools programme, a not-for-profit foundation that is party to a public private partnership with the Malaysian Ministry of Education.¹¹⁹

According to the Global Sustainable Investment Review 2016, Malaysia is the largest SRI market in the region, with a 3 per cent share in Asia (excluding Japan), as Malaysia recognises *shariah*-compliant funds as part of the SRI universe.¹²⁰ The SC has developed a framework for SRI funds by issuing the Guidelines on Sustainable and Responsible Investment (SRI) Funds in December 2017 to facilitate and encourage growth of SRI funds in Malaysia. This will build on Malaysia's position as a regional *shariah*-compliant SRI centre; a strategic thrust that was identified under the Blueprint. These Guidelines are applicable for both conventional and *shariah*-compliant funds.¹²¹ Malaysia achieved further success

118 See www.thestar.com.my/business/business-news/2016/06/20/epf-shariah-savings-scheme-open-for-registration-on-aug-8/ and www.freemalaysiatoday.com/category/nation/2018/02/10/epf-declares-6-9-dividend-6-4-for-simpanan-shariah/.

119 Part 1 of the SC Annual Report 2015 and www.yayasanamir.org.my.

120 See www.theedgemarkets.com/article/trends-global-sustainable-investments-25.

121 See: <https://www.sc.com.my/news/media-releases-and-announcements/the-sc-continues-to-drive-sustainable-and-responsible-investment-sri-issues-new-guidelines-on-sri-funds>.

in the SRI space in July 2017 with the establishment of the world's first green SRI *sukuk* by Tadau Energy (a joint venture between Kagayaki Energy, a Malaysian renewable energy and sustainable technology investment firm, and Edra Solar, owned by the China General Nuclear Power Corporation). This was a significant development in the green financing and global *sukuk* arena and the result of a collaboration between the SC, BNM and the World Bank Group, aimed at developing an ecosystem to facilitate the growth of green *sukuk* and to introduce innovative financial instruments to accommodate global infrastructure needs and green financing.¹²²

In November 2017, the Association of Southeast Asian Nations (ASEAN) Green Bond Standards (GBS) were launched at the inaugural ASEAN Capital Market Conference. The ASEAN GBS aim to provide more specific guidance on how the Green Bond Principles are to be applied across the ASEAN, to promote transparency and consistency in the ASEAN green bond market framework. Quantum Solar Park (Semenanjung) Sdn Bhd issued the largest green *sukuk* in the world of 1 billion ringgit, which coincides with the ASEAN GBS. The proceeds are to fund the construction of three large solar power plants with total capacity of 150 megawatts (MW), which are the largest solar power projects in South East Asia. This transaction would assist Malaysia in achieving its renewable energy generation target of 7,200MW by 2020 and propel the nation's objective to be a key driver in the green Islamic financial space. The green SRI *sukuk* paves the way for more sustainable and responsible financing in Malaysia and ASEAN and coincides with ASEAN GBS, which further supports and assists the establishment of climate-friendly investments.

In December 2017, Permodalan Nasional Bhd issued the first tranche of 690 million ringgit under its 2 billion ringgit and 15-year Merdeka ASEAN green SRI *sukuk* programme. This was the first green *sukuk* recognised under both the SC's SRI *sukuk* framework and the ASEAN GBS.¹²³ In addition, tax incentives were announced in July 2017 to attract green issuers, which included tax deduction until year of assessment of 2020 on issuance costs of SRI *sukuk* approved, authorised by or lodged with SC,¹²⁴ over and above the measures previously introduced in the 2014 Budget.¹²⁵ In the 2018 Malaysian Budget, the former Prime Minister unveiled a series of tax incentives, including an income tax exemption on green SRI *sukuk* grants, aimed at encouraging the issuance of green SRI *sukuk* in Malaysia. The SC, through the Capital Market Development Fund, will provide a green SRI *sukuk* grant of 6 million ringgit to finance the external review expenditure incurred by a green SRI *sukuk* issuer.¹²⁶ Malaysia has issued five green SRI *sukuk*, with an amount of 2.4 billion ringgit raised in 2017 and 2018,¹²⁷ including the issuance of ASEAN Green SRI Sukuk by Pasukhas Green Assets Sdn Bhd to fund the hydropower plant in Sungai Rek, Kelantan, and to explore other renewable energy assets in Malaysia.¹²⁸

In line with the growing importance of sustainable finance in ASEAN, the ASEAN Capital Markets Forum introduced the ASEAN Social Bond Standards and ASEAN

122 See <https://www.nst.com.my/opinion/columnists/2017/09/283670/malysias-green-sukuk-going-places>; and www.mifc.com/index.php?ch=28&pg=72&ac=184&bb=uploadpdf.

123 See footnote 6.

124 See https://www.sc.com.my/post_archive/malysias-first-green-sukuk-under-scs-sustainable-responsible-investment-sukuk-framework/.

125 See www.mida.gov.my/home/tax-incentives-for-green-industry/posts/.

126 See Appendix 4 of the 2018 Malaysian Budget, page 63.

127 See: Securities Commission Annual Report 2018.

128 <https://www.theedgemarkets.com/article/danajamin-guarantees-pasukhas-islamic-notes-programme>.

Sustainability Bond Standards at the ASEAN Capital Market Conference in October 2018, to support ASEAN's sustainable development needs in financing projects that are socially beneficial and to finance a combination of both green and social projects that offer environmental and social benefits.

v Financial technology

The role of fintech in Islamic finance as a key enabler for future business and facilitator for an automated end-to-end Islamic banking system for *shariah*-compliant banking operations. To this end, six Islamic banking institutions in Malaysia collaborated in February 2016 to launch the Investment Account Platform,¹²⁹ the first bank-intermediated fintech platform combining Islamic banking services and technology to channel funds from investors to *shariah*-compliant economic ventures.¹³⁰ In this regard, BNM and the SC have taken initiatives to boost the development of fintech in Malaysia as elaborated below.

BNM has approved seven firms to operate within its 'regulatory sandbox' in accordance with the Guidelines on Financial Technology Regulatory Sandbox Framework dated 18 October 2016.¹³¹ This will enable innovation of fintech to be deployed and tested in a live environment within specified parameters and time frames. The Islamic financial institutions are encouraged to embrace the movement by coming up with their own fintech innovations or by working with fintech start-ups, especially those in the digital payments space. In 2018, BNM introduced the Specialised Sandbox, which uses more focused and standardised testing parameters to allow for a more targeted and efficient testing approach for high-impact innovations.¹³²

In addition, the SC and the Australian Securities and Investments Commission entered into an innovation cooperation agreement on 27 June 2017 to further promote innovation in financial services in their respective markets. This enables both regulators to explore potential joint innovation projects relating to the application of new technologies and to facilitate referrals of innovative businesses seeking to operate in each other's jurisdictions. This marks an important milestone for Malaysia's digital finance sector.¹³³ In September 2017, the SC signed a series of innovation cooperation agreements with several other regulators in major financial centres: the Hong Kong Securities and Futures Commission, the Dubai Financial Services Authority and the Monetary Authority of Singapore.¹³⁴ In February 2018, the Global University of Islamic Finance inked a memorandum of understanding with MIMOS Bhd, Malaysia's national information and communications technology research and development centre, to collaborate in the development of a blueprint for an Islamic finance-based investment technology platform.¹³⁵ In September 2018, to promote an inclusive financial system that further supports Malaysia's middle and low-income groups, the United Nations Capital Development Fund, BNM and Malaysia Digital Economy Corporation launched

129 See www.iaplatform.com.

130 See www.bnm.gov.my/index.php?ch=en_announcement&pg=en_announcement&ac=356&lang=en.

131 See www.myftg.com/?page_id=1131.

132 See: BNM Financial Stability and Payment Systems Report 2018.

133 See: <https://www.sc.com.my/news/media-releases-and-announcements/sc-and-asic-sign-innovation-cooperation-agreement-to-establish-fintech-bridge> .

134 See www.sc.com.my/post_archive/sc-establishes-fintech-cooperation-agreements-with-major-financial-centres/.

135 www.inceif.org/2018/03/02/inceif-collaborates-with-mimos-to-embark-on-islamic-fintech/.

the Digital Finance Innovation Hub and Inclusive Fintech Accelerator Program to support greater use of technology by service providers, such as financial institutions and fintech start-ups, in offering inclusive financial solutions.¹³⁶

The government, through the Malaysia Digital Economy Corporation, has introduced the Islamic Digital Economy Guide (Mi'yar), a reference guide for start-ups, venture capital firms and the supporting ecosystem of participants in these areas who wish to explore and understand the various components of the Islamic digital economy, such as Islamic venture capital, business operations, and products and services that are *shariah*-compliant or conform to a halal perspective.¹³⁷

vi Securities Industry Dispute Resolution Centre

Securities Industry Dispute Resolution Centre (SIDREC) is an independent body established by the SC in 2011 for the settlement of disputes between investors and capital market intermediaries. SIDREC offers a free service and aims to ensure that investors have access to an independent and impartial and expert dispute resolution avenue. Commercial and Islamic banks offering capital market services and products have become members of SIDREC in September 2017 following the SC's amendment to the Capital Markets and Services (Dispute Resolution) Regulations 2010. With these developments, investors can initiate dispute resolution claims for amounts of up to 250,000 ringgit. SIDREC may also provide mediation for claims exceeding 250,000 ringgit with the consent of both parties.¹³⁸ In 2018, SIDREC expanded its purview, allowing it to offer its services to investors and capital markets services providers with disputes relating to claims exceeding 250,000 ringgit. The new service, being a voluntary scheme, requires both parties to a dispute to agree to use SIDREC's alternative dispute resolution services.¹³⁹

vii Conclusion

Malaysia is recognised by the Islamic Finance Services Board and International Monetary Fund as a systemically important jurisdiction in which 15 per cent or more of its financial sector assets are Islamic,¹⁴⁰ and it has maintained its leading position as the most developed Islamic finance market globally, as recognised by the Thomson Reuters's Islamic Finance Development Indicator 2018.¹⁴¹ It is recognised that Malaysia's achievements are attributable to the development of effective market structure, diverse players, a deep Islamic finance talent pool and robust legal, regulatory and *shariah* frameworks conducive to the sector's growth and development.¹⁴² The BNM SAC has also played an important role in developing Islamic finance in Malaysia through its *shariah* rulings, which have not only instilled customer and market confidence, but also catalysed a number of industry innovations (e.g., the BNM SAC's

136 See: http://www.bnm.gov.my/index.php?ch=en_press&pg=en_press&ac=4747 and BNM Financial Stability and Payment Systems Report 2018.

137 <https://www.digitalnewsasia.com/digital-economy/malaysia-track-become-leader-islamic-digital-economy>.

138 See www.bnm.gov.my/index.php?ch=en_press&pg=en_press&ac=4246&clang=en.

139 See <https://sidrec.com.my/sidrec-expands-purview-can-handle-claims-above-rm250000/>.

140 www.reuters.com/article/us-islamic-finance-imf/imf-to-add-islamic-finance-to-market-surveillance-in-2019-idUSKCN1IQ081.

141 www.zawya.com/islamic-finance-development-indicator.

142 See BNM Financial Stability and Payment Systems Report 2017 (www.bnm.gov.my/files/publication/fsps/en/2017/fs2017_book.pdf).

approval to use hybrid contracts, such as *musharakah mutanaqisah* (diminishing partnership), which enabled the introduction of innovative products).¹⁴³ Moody's has recognised Malaysia as the largest Islamic issuer in terms of volume, both in the long and short-term market, at 34 per cent of total global issuances. Following the decline of global sovereign *sukuk* issuance in 2018, Moody's expects issuance in Malaysia to recover in the context of moderate oil prices and higher *sukuk* refinancing needs.¹⁴⁴ As at 31 March 2019, Malaysia remained the top *sukuk* issuer with 35.1 per cent, or US\$13.9 billion, of the global *sukuk* issuance of US\$39.5 billion.¹⁴⁵ With the new government's determination to focus on the country's finances and economic management,¹⁴⁶ there is optimism that Malaysia will consolidate and continue its leadership and innovation in Islamic finance, to do its part in forging a more sustainable, equitable, socially responsible and environmentally beneficial world.

143 *ibid.*

144 See: <https://www.theedgemarkets.com/article/global-sovereign-sukuk-issuance-recover-2019-%E2%80%94-moodys>.

145 See: <https://www.theedgemarkets.com/article/malaysia-retains-top-spot-global-sukuk-issuance-1q>.

146 See: <http://www.thesundaily.my/news/2018/05/11/govt-will-focus-finances-economic-management-mahathir>.

NETHERLANDS

*Omar Salah*¹

I INTRODUCTION

Dutch banks were among the first banks to become active in the field of Islamic finance: at the beginning of the twentieth century, the Netherlands Trading Society was established in Jeddah, Saudi Arabia, to provide interest-free money exchange services to pilgrims from Indonesia.² Since the emergence of modern-day Islamic finance in the 1990s, however, there has been limited Islamic finance activity in the Netherlands. In 2004, the first European *sukuk* was issued by the German state of Saxony-Anhalt using a Dutch vehicle (a *stichting*) as the issuing entity, but the entire structure was initiated by the German state so this was in essence a German Islamic finance transaction. ABN AMRO and the Liechtensteinische Landesbank launched a structured investment product called LLB Top 20 Middle East Total Return Index Certificate in 2007 and Barclays launched three Amsterdam-listed Islamic investment products in 2008. Further, Rabobank studied the potential demand for Islamic banking among households in the Netherlands. In 2007, Minister Wouter Bos (former Minister of Finance) also announced that the possibilities for Islamic finance in the Netherlands should be studied. Despite several studies that showed there is a potential demand for Islamic finance in the Netherlands,³ the Islamic finance market did not pick up. Hence, there have not been many Islamic finance transactions in the Netherlands and, in general, Islamic finance remains a novel and exotic form of financing for most Dutch financiers and borrowers.

II LEGISLATIVE AND REGULATORY FRAMEWORK

i Legislative and regulatory regime

In 2008, the Dutch central bank (DCB) and the Dutch financial services regulatory authority (AFM) conducted a study on Islamic finance in the Netherlands. One of their conclusions was that the existing regulatory framework in the Netherlands can be applied to Islamic finance, but with respect to certain financial supervision-related matters (e.g., market entry, conduct-of-business, capital adequacy and provision of information) the Dutch regulatory framework may require amendments to specifically address Islamic finance products.⁴

1 Omar Salah is a senior associate at De Brauw Blackstone Westbroek.

2 O Salah, *Sukuk Structures: Legal Engineering Under Dutch Law*, Eleven International Publishing 2014, pp. 5–6.

3 See, among others, B Verhoef, S Azahaf and W Bijkerk, 'Islamic finance and supervision: An exploratory analysis', DNB Occasional Studies 2008-6/3, pp. 21–24.

4 B Verhoef, S Azahaf and W Bijkerk, 'Islamic finance and supervision: An exploratory analysis', DNB Occasional Studies 2008-6/3, pp. 35–36.

However, no such legal amendments were introduced. Consequently, there is no legislative and regulatory regime that focuses exclusively on Islamic finance, but instead the existing legislative and regulatory regime for conventional finance also applies to Islamic finance.

The regulatory regime for banks and other financial undertakings (including Islamic banks and other Islamic financial undertakings) is based on both European regulations and Dutch national (financial supervision) laws. These laws are primarily codified in the Dutch Financial Markets Supervision Act (FMSA), which came into force on 1 January 2007. Banks (both conventional and Islamic) established in the Netherlands are required to obtain a banking licence from the European Central Bank (ECB), while the DCB processes licence applications. Further, if (Islamic) banks intend to provide investment services or perform investment activities in the Netherlands, they have to apply for a wider banking and investment firm licence. In general, Dutch branches of foreign (Islamic) banks with activities in the Netherlands are subject to the same licence requirements as banks with registered offices in the Netherlands. However, if the foreign (Islamic) banks have their registered offices in another eurozone country, they may conduct banking activities through their Dutch branches or on a cross-border basis in the Netherlands using their 'European passport': they may conduct banking activities under their ECB banking licence, provided that the ECB has been notified of this. A comparable regulatory regime applies to insurance companies (whether conventional or the Islamic *takaful*), which also have to obtain a licence in the Netherlands.

The FMSA establishes the rules for the offering of securities in the Netherlands, prospectus approval, public bids and the operation of regulated markets. These rules apply to both the issuance of conventional bonds and shares and the issuance of *sukuk*. The FMSA also contains extensive rules on the relationship between (Islamic) banks and their customers; (Islamic) banks must comply with certain conduct-of-business rules if they offer loans to customers. In addition, the Dutch Civil Code (DCC) and the Act on Consumer Credit govern the civil law relationship between (Islamic) banks and their customers: according to these laws, (Islamic) banks have to provide detailed information to their customers, there are specific requirements for the contents of loan contracts and customers have additional consumer protection rights to rescind loan contracts under certain circumstances. The relatively new Chapter 2b of Book 7 DCC provides rules on creditworthiness assessments, obligations to provide information to consumers and customers having certain consumer protection rights in cases of early repayments, arrears and foreclosures. Following further recent amendments, Chapters 2a, 2b and 2c of Book 7 DCC provide rules on consumer credit, asset financing and loans, for leasing contracts such as the *ijarah* and the *ijarah wa iqtina*, and for a purchase and sale of property in instalments such as the *murabahah* (as discussed further below); these provisions are now only mandatory if the borrower or lessee is a consumer, but they are not mandatory for professional parties.

While the conclusion of the DCB/AFM study in 2008 was that legal amendments to the FMSA would have been preferred to further facilitate the supervision of Islamic finance products in the Netherlands, no such amendments are required for the structuring of Islamic finance products under Dutch commercial (civil, contract and property) and corporate laws. Dutch commercial and corporate laws are compatible with the structuring of Islamic finance transactions. Partnership contracts such as the *musharakah* and *mudarabah* can be structured through a limited partnership contract or a general partnership contract, but also

by incorporating stock companies, such as a public limited liability company⁵ or a private company with limited liability (BV).⁶ The contract of *murabahah* qualifies as a purchase and sale of property in instalments pursuant to Article 7:84(3) DCC. Also, leasing contracts such as the *ijarah* can be structured under Dutch law. The *ijarah* qualifies as a rental agreement under Article 7:201 DCC. Depending on how the *ijarah wa iqtina* is structured in practice, it may qualify as a rental agreement or as a hire purchase agreement under Articles 7:101 and 7:84(3) DCC. As mentioned above, no mandatory rules under Book 7 DCC that may conflict with Islamic law apply to the *murabahah*, *ijarah* and *ijarah wa iqtina* if these contracts are concluded between professional parties, as will be the case in most Islamic finance transactions (e.g., corporate lending, real estate transactions and debt capital market transactions such as *sukuk* issuances). If, however, an Islamic bank contemplates offering these Islamic finance products to consumers, certain mandatory rules in Book 7 DCC (e.g., rules on rebate in cases of early repayment) have to be assessed carefully to ensure *shariah* compliance while structuring these products under Dutch law.

One of the main challenges for *sukuk* under Dutch law is the lack of trust laws in the Netherlands. In practice, often English law trusts are used in *sukuk* structures to accommodate the Islamic law requirement that *sukuk* holders must hold some form of ownership in the underlying asset of the *sukuk* structure. For example, in the case of a *sukuk al-ijarah*, whereby a tangible asset is sold and leased back by the originator to a special purpose vehicle (SPV) that issues *sukuk*, the SPV holds the underlying asset (which is leased back to the originator) in trust for the *sukuk* holders. As a result, the SPV holds the legal ownership of the underlying asset, while the *sukuk* holders hold its beneficial ownership. This is market practice in most *sukuk* structures and the main rationale for the use of English law trusts is, as stated, to meet the Islamic law requirement that *sukuk* holders must hold some form of ownership. However, the concept of a trust is not accepted under Dutch law. As a matter of fact, Article 3:84(3) DCC contains a ‘fiducia prohibition’, which prohibits the use of fiduciary security and holding fiduciary title to an asset.

In practice, this may be solved by creating an English law trust that will be recognised in the Netherlands on the basis of the Hague Trust Convention on the Law Applicable to Trusts and their Recognition (the Hague Trust Convention). The Netherlands is a party to the Hague Trust Convention. Consequently, it is obliged to recognise certain elements of a trust created under English law. However, if the significant elements of the trust are more closely connected to the Netherlands, then, under Article 13 of the Hague Trust Convention, the Netherlands is not bound to recognise an English law trust. In cases of this kind, there are alternative ways under Dutch law to deal with the Islamic requirement that *sukuk* holders must hold some form of ownership of the underlying asset. This may require further explanation to a *shariah* supervisory board who may be dealing with a *sukuk* issuance in the Netherlands for the first time (which will be the case, given that so far there have been no *sukuk* issuances in the Netherlands). If one looks very closely at the Islamic requirements for *sukuk*, one will notice that the Islamic *shariah* requires *sukuk* holders to hold some form of ownership in the underlying asset so that the *sukuk* holders trade in that asset instead of trading in debt claims while trading their *sukuk* in secondary markets (which would, otherwise, lead to

5 *Naamloze vennootschap* or NV.

6 *Besloten vennootschap met beperkte aansprakelijkheid* or BV; for a discussion of the *musharakah* as a BV, see O Salah, *Sukuk Structures: Legal Engineering Under Dutch Law*, Eleven International Publishing 2014, pp. 73–82.

a violation of the Islamic *shariah* prohibition on the *bay al-dayn*). However, under Islamic *shariah*, the use of trusts or the division of the right of ownership (*milkiyyah*) into legal and beneficial ownership is not prescribed as a prerequisite for *sukuk* structures.⁷ As stated, the use of English law trusts emerged – and has been accepted – in Islamic finance practice.

In the Netherlands, the Islamic *shariah* requirement of ownership of *sukuk* holders can be met – in the case of unsecured *sukuk* (which are predominantly issued globally) – by transferring the economic ownership of the underlying asset to the *sukuk* holders. As a result, the *sukuk* holders do not acquire any *in rem* rights in the underlying asset, but will contractually be entitled to the economic benefits of the underlying asset.⁸ In the case of secured *sukuk*, the aforesaid may be accompanied by the creation of a collective security arrangement that provides the *sukuk* holders with security over the underlying asset.⁹

ii Regulatory and supervisory authorities

There is no regulatory or supervisory authority that deals exclusively with Islamic finance in the Netherlands. The regulatory and supervisory authorities dealing with conventional products also cover Islamic finance products. The supervision model in the Netherlands focuses on (1) system and prudential supervision, and (2) conduct-of-business supervision.¹⁰ The ECB and DCB are responsible for system and prudential supervision, while the AFM is responsible for conduct-of-business supervision.

System supervision mainly boils down to ensuring the stability of the financial system as a whole. As regards prudential supervision, this covers the granting of licences and being responsible for prudential and integrity supervision of banks, insurers, investment firms, clearing institutions, payment services providers and trust companies. Under the Single Supervisory Mechanism, the ECB is the central prudential supervisor of financial institutions in the eurozone. The ECB is responsible for the prudential supervision of the most significant banks in the Netherlands, while the DCB is responsible for less significant banks.

The AFM is responsible for conduct-of-business supervision. It supervises the operation of the financial markets and strives for efficiency therein. It covers the entire financial market sector (both retail and wholesale). Further, it is responsible for prospectus supervision, listing matters and the trading infrastructure. For example, the AFM would have to approve a prospectus for the issuance of *sukuk* in the Netherlands.

III COMMON STRUCTURES

As mentioned above, Islamic finance has not picked up in the Netherlands (yet). Consequently, there are no commonly used structures. There have been only a handful of real estate *shariah*-compliant transactions. The funding for these transactions was often provided by (the Islamic windows of) foreign financial institutions. The structures that were used were based either on *murabahah* or *ijarah* contracts.

7 O Salah, *Sukuk Structures: Legal Engineering Under Dutch Law*, Eleven International Publishing 2014, pp. 24–25 and 56–60.

8 *ibid.*, pp. 122–128.

9 *ibid.*, pp. 128–142.

10 M Van Loopik and M Ter Haar, chap. 25 on Netherlands, in: J Putnis (ed), *The Banking Regulation Review*, Law Business Research 2019, pp. 376–393.

One of the structures used is based on *murabahah*. The *murabahah* contract used in Islamic finance transactions in the Netherlands is the commodity *murabahah* (also known as *tawarruq*). *Shariah*-compliant investors interested in real estate located in the Netherlands will incorporate a BV to acquire the real estate (the PropCo). The PropCo will purchase and acquire the real estate from a potential seller. The purchase price will be funded partially through an equity investment from the *shariah*-compliant investors and partially through external funding (often, this is the largest part of the funding). The PropCo will approach a financier and enter into a *murabahah* facility with it. Under the *murabahah* facility, the financier purchases commodities for X price from a commodities broker and the financier sells those commodities to the PropCo for X + profit margin. The sale from the financier to the PropCo is an instalment sale: the purchase price of X + profit margin is deferred and will be paid in instalments. If the financier is providing secured funding, the PropCo will also create a right of mortgage on the real estate. Next, the PropCo sells (under the documentation it is, in fact, the financier acting as agent for the PropCo to sell) the commodities for X price to another commodities broker (which can then onsell it to the initial commodities broker). As a result, the PropCo obtains immediate funding equal to X and has an obligation to pay X + profit margin to the financier in instalments.

The financier can be a bank, but it can also be an SPV (incorporated as a separate BV). In the latter case, the SPV will enter into a back-to-back facility agreement with a bank to obtain funding equal to X and the interest paid under the facility agreement will be equal to the profit margin under the *murabahah* facility between the SPV and the PropCo. If the funding is secured, the SPV will create a right of pledge over its secured rights under the *murabahah* facility (including a right of mortgage) in favour of the bank.

The other structure used for *shariah*-compliant real estate transactions in the Netherlands is based on the contract of *ijarah*. In this structure, there will be one BV that will acquire the real estate (PropCo) and another BV through which *shariah*-compliant investors will invest (InvestCo). The PropCo will purchase and acquire the real estate from a third-party seller. The PropCo will be the legal owner of the real estate. The acquisition of the real estate will be partially funded by the *shariah*-compliant investors and partially through external funding. The PropCo will enter into a (conventional) facility agreement with a bank to attract external funding and, if it is a secured funding, create a right of mortgage in favour of the bank. Further, the PropCo will enter into an *ijarah* contract with the InvestCo pursuant to which the real estate will be leased to the InvestCo. This can be structured either in the form of a rental agreement under Dutch law, or by creating a right of long lease in favour of the InvestCo. The *ijarah* is a back-to-back lease to the conventional facility agreement, so that the lease payments are equal to the interest paid by the PropCo to the bank under the facility agreement. The InvestCo then, in turn, subleases the real estate to lessees and makes a return on it. The difference between what is received by the InvestCo from subleases and its obligations under the *ijarah* lease is distributed to the *shariah*-compliant investors.

IV TAXATION

There is no separate taxation regime for Islamic finance products in the Netherlands and such products are not afforded special treatment under Dutch tax law. Dutch tax law has an economic approach towards financial transactions (whereby the economic substance of a transaction prevails over its formal legal structure). Since most Islamic finance products mirror the economic effects of conventional finance products, Dutch tax law does not

seem to raise major issues while structuring Islamic finance transactions.¹¹ This especially holds true for wholesale and investment banking. In the case of retail banking, however, tax law has been flagged as an obstacle for the introduction of Islamic retail banking products in the Netherlands. Despite much debate on the matter, the Dutch tax authorities are of the opinion that the profit paid in Islamic mortgage transactions (e.g., the profit margin in the *murabahah*) does not qualify as interest. Therefore, it is not eligible for mortgage interest relief. This puts Islamic retail banking products at a disadvantage compared to their conventional counterparts, resulting in the lack of a level playing field for Islamic finance from a tax perspective. Despite this, the Dutch legislature has not introduced any legislative amendments in relation to Dutch tax law, in contrast to other European countries, such as the United Kingdom, Ireland, France and Luxembourg.

V INSOLVENCY

There is no separate insolvency regime for Islamic finance products in the Netherlands and such products are not afforded special treatment under Dutch insolvency law. In general, the treatment of an Islamic finance product under Dutch insolvency law will depend on the type of Islamic finance contract and its qualification under Dutch law.

It is, however, important to bear in mind that where the concept of economic ownership is used under Dutch law (e.g., for *sukuk* structures) as a Dutch alternative to the English law trust, the economic owners do not hold any *in rem* rights under Dutch law. For example, if the issuer of an unsecured *sukuk* provides the economic ownership of an underlying asset to the *sukuk* holders under Dutch law, the *sukuk* holders only have a bundle of contractual rights that entitle them to the economic benefits of the underlying asset. If the issuer of the *sukuk* is declared bankrupt by a Dutch court, the relevant asset will fall into its bankruptcy estate (contrary to trust assets, which are separated from the insolvency estate of a trustee under English law). The *sukuk* holders as the economic owners of the underlying asset only have a contractual claim to the benefits of the underlying asset, which they can file with the bankruptcy trustee.

VI JUDICIAL FRAMEWORK

i Courts

Dutch courts have jurisdiction to decide on disputes involving *shariah*-compliant products, assuming there is no clause on submission to jurisdiction of another court and no arbitration clause in the relevant Islamic finance contract. In the Netherlands, there are no separate *shariah* courts with jurisdiction over Islamic finance products.

ii Cases

There have been no (significant) cases that have been decided by the Dutch courts on or in respect of Islamic finance products and structures.

¹¹ See A Rozendal and A Westhoff, 'Een alternatief voor de financiering van Nederlands beleggingsvastgoed?', in O Salah (ed), *Islamitisch bankieren: Van religieuze principes naar financiële transactiestructuren*, Wolf Legal Publishers 2011, pp. 89–98.

VII OUTLOOK

Within the Netherlands, the major Dutch banks, such as Rabobank, ABN AMRO, ING and de Volksbank, have not yet taken initiatives to enter, or develop, the Islamic finance market, but have been looking at it with some interest. Moreover, the major Dutch banks are, or have been, active in the Islamic finance market outside the Netherlands; for example, in South East Asia and the Middle East.

Certain banks, in particular foreign Islamic banks, have been looking with interest to the Dutch Islamic finance market for retail banking. The entrance of these banks will be a game changer for the development of Islamic finance in the Netherlands. In addition, various small organisations are currently assessing the possibility of offering the first *shariah*-compliant mortgage loans in the Netherlands, possibly with the cooperation of larger institutions. At the same time, discussions on abolishing mortgage interest relief have been ongoing for a while now. If mortgage interest relief is completely abolished, this will undoubtedly be regarded as a positive development for Islamic retail banking from a tax law perspective, as it will place Islamic retail banking products on a level playing field with their conventional counterparts. It will give the smaller Dutch organisations an incentive to continue their efforts to provide the first *shariah*-compliant mortgage loans in the Netherlands.

Another interesting development is that various Dutch multinational companies are expanding globally and encountering Islamic finance as a form of financing for their activities in South East Asia and the Middle East. Given the continuing growth of these multinational companies, one would expect their exposure to Islamic finance to increase. By contrast, inbound investments from Islamic countries into the Netherlands may be preferred on a *shariah*-compliant basis (i.e., *shariah*-compliant investors looking to invest and finance themselves on a *shariah*-compliant basis). Given that the Dutch legislative framework perfectly assists Islamic wholesale banking, there are no impediments to facilitating transactions of this kind.

In conclusion, the outlook for the development of an Islamic finance market in the Netherlands remains challenging. Although the legislative framework is there and there are certain developments that may contribute to the Islamic finance market in the Netherlands, in general there are no major incentives to structure financial products in a *shariah*-compliant manner (instead of on a conventional basis). The entrance of more parties with a clear preference for *shariah*-compliant funding may change these prospects. If and when that happens, it is good to know that the Dutch legislative and regulatory framework will not impose any impediments on those parties wishing to conduct business and attract funding on a *shariah*-compliant basis.

OMAN

*Mansoor J Malik, Asad Qayyum and Hussein Azmy*¹

I LEGISLATIVE AND REGULATORY FRAMEWORK

i Legislative and regulatory regime

Oman's Islamic finance industry, albeit recently developed, has rapidly become one of the most heavily regulated sectors in the country. This degree of regulation correlates with the rapid growth of the Islamic finance industry in Oman, which grew by an impressive 14 per cent in 2018 according to Moody's.²

Islamic banking was formally introduced in Oman by Royal Decree (RD) No. 69/2012, which amended RD No. 114/2000 (the Banking Law) by adding a new chapter dedicated to Islamic banking. Subsequently, the Central Bank of Oman (CBO) issued circular IB 1/2012, promulgating the Islamic banking regulatory framework (IBRF), which is a sophisticated regulatory guideline setting out the requirements and conditions for the undertaking of *shariah*-compliant commercial and investment banking activities and the offering of *shariah*-compliant products in Oman.

The IBRF regulates the following areas: licensing requirements, general obligations and governance, accounting standards and auditor reports, supervision and control, capital adequacy, credit risks, market risks, operational risks, liquidity risks and miscellaneous matters. The IBRF provides for the right to set up fully fledged Islamic banks and Islamic windows of conventional banks and it sets out the process and requirements to be followed when applying to the CBO for an Islamic banking licence. In this respect, it is to be noted that domestic banks, foreign banks and Islamic windows are required to have paid-in capital of no less than 100 million Omani rial, 20 million rial and 10 million rial, respectively, which may be subject to higher capital requirements imposed by the CBO.

Additionally, the IBRF specifies the criteria, requirements, specifications and risks of each type of Islamic finance product (e.g., *ijarah*, *murabahah* and *mudarabah*). In this regard, the IBRF expressly prohibits *tawarruq* (i.e., commodity *murabahah*), which, although frowned upon by the majority of Islamic scholars, is allowed in several GCC countries, including Saudi Arabia. Therefore, Oman's position regarding *tawarruq* is much more stringent than that of other GCC countries.

Further, the IBRF is very comprehensive and focuses on the transactional and operational *shariah* compliance of all licensed Islamic financial institutions in more detail than most GCC countries. In this respect, the IBRF leaves the task of verification of *shariah*

1 Mansoor J Malik is a senior partner, Asad Qayyum is a partner and Hussein Azmy is an associate at Al Busaidy, Mansoor Jamal and Co.

2 See <https://muscatdaily.com/Archive/Business/Oman-s-Islamic-banking-sector-records-14-growth-5dh8>.

compliance of Islamic banking transactions to qualified *shariah* boards and *shariah* auditors within each licensed Islamic bank or Islamic window, and does not provide for a centralised authority for the auditing of Islamic banking transactions. The professional requirements, and prerequisites, for the members of *shariah* boards are provided by the IBRF, and are not left to individual banks to regulate. It should be noted that a central *shariah* authority was established in 2013 by CBO Regulation No. BM/54/12/2013, inter alia, to advise the CBO in relation to *shariah*-compliant transactions and settle *shariah*-related disputes that may arise among the *shariah* auditing boards of financial institutions in Oman.

The *shariah*-compliant capital market sector has been formally expanded with the amendment of RD No. 80/1998 (the Capital Market Law) by RD No. 59/2014, which expressly recognised the ability of companies listed on the Muscat Securities Market (MSM) to issue *sukuk*. Subsequently, and on the basis of the amendment to the Capital Market Law, Decision No. 3/2016 Issuing Sukuk Regulation (the Sukuk Regulation) of the Capital Market Authority (CMA) specified the procedures and requirements relating to *sukuk* issuances in Oman. *Sukuk*, as provided by the Sukuk Regulation, can be issued either directly by the beneficiary or originator, or through a trustee or an agent. Notably, the Sukuk Regulation's treatment of the function of 'trustee' is unprecedented since no concrete definition of this function (even outside the context of finance) has been provided by Omani law in the past.

As regards Oman's *takaful* industry, RD No. 11/2016 (the Takaful Insurance Law) provides a robust and comprehensive framework covering all aspects of the *takaful* insurance sector and regulates all aspects of a *takaful* operator's activities (e.g., oversight and reporting requirements, product standards and liquidity levels) subject to the oversight of the CMA, which has been tasked with regulating and supervising *takaful* operators in the Sultanate. The Takaful Insurance Law requires *takaful* insurers to be publicly listed on the MSM and to have capital of no less than 10 million rial. Further, the Takaful Insurance Law requires *takaful* operators to form an internal specialised *shariah* committee for the purpose of auditing the *takaful* operator's *shariah* compliance. Other provisions of the Law govern the maintenance of solvency margins, fund setup and management, and the transfer of *takaful* business from one company to another. A draft *takaful* regulation is currently being prepared by the CMA.

There is no express legal or regulatory framework governing *shariah*-compliant investment funds. However, with regard to real estate investment funds or trusts (REITs), which are a sub-class of investment funds, CMA Decision No. KH/2/2018 (the REIT Regulation) makes several references to *shariah*-compliant REITs by providing, inter alia, for the necessity of establishing a *shariah* committee or using the services of a *shariah* board or third-party committee to ensure that the activities of the REIT are compatible with the principles of Islamic law. The REIT Regulation sets out the duties, characteristics, requirements and restrictions relating to the members of the *shariah* board to ensure their impartiality and objectivity when auditing the fund's *shariah* compliance. As with a conventional REIT, the licensing of a *shariah*-compliant REIT requires substantial minimum capital.

With the introduction of RD No. 18/2019, the new Commercial Companies Law (CCL), replacing RD No. 4/1974, the former CCL, new regulations and requirements have been introduced with regard to the issuance of both bonds and *sukuk* in a separate chapter. In addition, the CCL imposes a general requirement on commercial companies undertaking *shariah*-compliant activities to have their transactions comply with the principles of Islamic law, and it has tasked the CMA and the Ministry of Commerce and Industry (MOCI) to issue specific regulations on the *shariah*-auditing mechanisms to be implemented within such companies.

ii Regulatory and supervisory authorities

Regulators of the Islamic finance sector in Oman enjoy broad authority in terms of licensing and investigation and penalising of breaches of law. The primary regulators of the Islamic finance industry in Oman are the CBO and the CMA.

The CBO is the main regulator of Islamic banks and Islamic windows operating in Oman, and in this respect the scope of its supervisory and regulatory authority is set out in the Banking Law and the IBRF. The IBRF acknowledges that the Islamic banking business increases an Islamic bank's liabilities as it 'bestows greater burden of responsibility on Licensees so far as Shari'a compliance is concerned',³ and the CBO has affirmed that it will take serious note of and sanction appropriately any breaches of *shariah* principles by a licensed Islamic financial institution.

Pursuant to the Banking Law, the CBO has the authority (1) to license Islamic banks and windows, (2) to establish licensing regulations, procedures and conditions, (3) to inspect and audit the audited financial statements of Islamic banks and windows in Oman and to request clarifications in respect of these, (4) to investigate and audit the activities of Islamic banks and windows in Oman and, in this respect, to ask for and obtain any documents, information or clarification required by it, and (5) to issue guidance, mandatory instructions and warnings to licensed banks in relation to their activities. The CBO regularly issues publicly available circulars containing its instructions, recommendations and guidance to Islamic banks in Oman.

Among the more significant regulatory powers vested in the CBO, the latter is empowered to suspend the activities of a licensed bank either partially or wholly, to confiscate its assets and place them under its control, and upon the occurrence of certain events to impose fines or deny the licensee access to the credit facilities offered by the CBO, including if the licensed bank has breached, or there is proof that it intends to breach, the provisions of the Banking Law, the IBRF or the circulars issued by the CBO, or if the licensed bank becomes incapable of following the instructions and guidance of the CBO, or if the licensed Islamic bank has breached *shariah* rules and principles. The CBO also has the right to place a bank under its curatorship, which may result in the licensed bank's liquidation. Before imposing any penalty, the CBO may notify the defaulting licensee and grant it an opportunity to cure its breach.

The CMA is the regulator for *takaful* companies, *shariah*-compliant REITs and, more generally, public joint-stock companies carrying out *shariah*-related activities. With respect to *takaful* companies, the Takaful Insurance Law sets out the scope of the regulatory authority of the CMA. The CMA has the authority to receive, accept and reject licensing applications and to determine the process and requirements for the licensing of *takaful* insurance and related professions (e.g., *takaful* brokerage and agency).

The CMA also has the authority to inspect and investigate the activities of licensed companies to ensure compliance with the provisions of the *takaful* law and the CMA's instructions; in this respect, it has the power to (1) task an actuary at the expense of the licensed company to evaluate the company's assets, liabilities and overall financial situation and prepare a report for the CMA; (2) appoint a member on the board of directors of the licensee who will have the right to attend and observe the board meetings and express an opinion on resolutions, without being entitled to vote; (3) dissolve the licensee's board of

³ See Section 4.1.3 of the Islamic banking regulatory framework.

directors and appoint a temporary administration committee for the purpose of managing the licensee; (4) suspend or cancel (either wholly or partially) the licence of the licensee; (5) issue warnings and impose penalties on the licensee; and (6) dismiss members of the board or the executive committee. The Takaful Insurance Law expressly provides that the CMA's officers and employees shall have judicial enforcement powers in the context of ensuring compliance by licensees with the provisions of the law.

With regard to the regulation of REITs (both Islamic and conventional) and public joint-stock companies (whether or not their activities are *shariah*-compliant), the CMA's supervisory responsibilities are largely the same, as both are based on the provisions of the Capital Market Law and Executive Regulation of the Capital Market Law No. 1/2009, issued by the CMA. The CMA is responsible for licensing REITs and public joint-stock companies and for setting out, to an extent, the licensing process and prerequisites. The CMA has the authority to investigate licensed entities and take disciplinary action against them by way of issuance of reminders and warnings, and by imposition of fines, suspension of dealings on the MSM for a period not exceeding three months and, finally, delisting such entities from the market. The CMA has the right to send observers to ensure compliance of unitholders' or shareholders' meetings with the procedures prescribed by law.

The CMA is also responsible for regulating issuances of *sukuk* in Oman and for the licensing of corporate entities seeking to issue *sukuk* in the country.

II COMMON STRUCTURES

i Deposit products

The great majority of Islamic banks and Islamic windows in Oman are domestic. There are currently two fully fledged Islamic banks, Bank Nizwa and Alizz Islamic Bank. Additionally, at the time of writing, there were six Islamic banking windows of conventional banks in Oman: Meethaq Islamic Banking (Bank Muscat), Muzn (National Bank of Oman), Maisarah Islamic Banking (Bank Dhofar), Sohar Islamic (Sohar International), AI Yusr Islamic Banking (Oman Arab Bank) and Ahli Islamic Banking (Ahli Bank).

Deposit accounts offered by Islamic banks and Islamic banking windows to customers in Oman generally comprise the following.

Islamic current account

This is essentially a *qardh hassan*-structured product (i.e., an interest-free loan structure), whereby the customer provides the bank with financing for the bank's *shariah*-compliant investment purposes. The principal financing amount is returned to the customer on demand without the addition of any profit or deduction of any losses.

Islamic savings account

This is an unrestricted *mudarabah*-based savings account (i.e., investment management-based) to which funds are transferred as capital by the customer, in its capacity as investor, to the bank as investment manager for the bank's *shariah*-compliant investment purposes. Should the bank achieve profit, this will be divided between the bank and the customer according to the pre-agreed rates. If, however, losses are incurred, these will be borne by the customer alone unless it can prove the bank's negligence, fraud or misconduct. There are many variants of this account (e.g., salary savings account, prize-draw savings account, term deposit account).

Wakala account

This is a *wakala*-structured account (i.e., an investment agency-structured account) whereby the customer, in its capacity as investor, transfers funds to the account maintained by the bank for the bank to invest on behalf of the customer in *shariah*-compliant investments. The bank performs its functions as investment agent for a predetermined fee. Should the profit achieved exceed the agreed profit rate, the bank becomes entitled to a portion of the profit as an incentive.

ii Consumer finance

The most popular form of *shariah*-compliant consumer financing in Oman is auto financing, commonly structured on the basis of *murabahah*. The customer requests that the bank acquire and sell the customer a specified car. The bank purchases the requested asset from a third-party supplier identified by the customer and resells it to the customer for a profit. Both the cost and profit margin (markup) are made known and agreed by all parties involved. The purchase price can be paid either on a deferred lump-sum basis or on an instalment basis. The bank typically appoints the customer as its agent for the purpose of dealing with the supplier and taking receipt of the car.

iii Home finance

Home financing is offered to customers in Oman through the *ijarah muntahiya bittamleek* structure. The bank purchases a property identified by the customer from a third-party seller, then leases it to the customer in exchange for payment by the customer of periodical rental instalments inclusive of profit component. The customer issues a binding undertaking to purchase back the leased asset from the bank at the end of the transaction. Upon final maturity, the bank exercises its right under the agreement to have the customer purchase the property.

In addition, home finance is also offered through the diminishing *musharakah* product, under which the customer and bank jointly acquire the asset on the basis that the customer will gradually buy out the bank's share of the asset.

iv Insurance

Takaful is *shariah*-compliant insurance whereby each participant (i.e., insured) contributes a specific monetary sum into a collective pool system (i.e., a *takaful* fund) for the collection of contributions from all *takaful* participants to protect and guarantee the other participants against loss. Each *takaful* participant's contribution is based on and determined according to the type of coverage sought (e.g., life, healthcare, property) and the participant's personal circumstances. The basis of *takaful* is mutual guarantee, cooperation, indemnity and protection of all participants covered by the *takaful* scheme. Thus, the objective of *takaful* is to diversify and distribute the risk of loss or damage among the participants.

Takaful companies in Oman are required by law to have the legal form of a public joint-stock company. The *Takaful* Insurance Law remains silent on the ability of foreign *takaful* companies to set up branches within Oman. *Takaful* companies offer the same types of products offered by their conventional counterparts. These include: family *takaful*, health *takaful*, creditor *takaful*, motor *takaful*, property all-risk *takaful*, fidelity guarantee,

contractor's plant and equipment *takaful*, contractor's all-risk *takaful*, personal accident *takaful*, workmen's compensation *takaful*, marine cargo *takaful*, travel *takaful*, and fire and perils *takaful*, among others.

v Investment funds

Investment funds can either be incorporated in the form of a joint-stock company or be an unincorporated entity with legal personality. In the latter case, they are required to be formed by a commercial bank or an investment company whose capital should be no lower than 5 million rial. An investment fund can be either open-ended (i.e., its capital is subject to changes and variation because of issuance and redemption of new units) or closed-ended (i.e., the fund issues a fixed number of units, redeemable only upon expiry of the fund's term, but the fund retains the right to issue new units). The fully paid-up capital of the investment fund should be no less than 2 million rial and the share of its sponsors should not be less than 5 per cent of its capital. Units held by the sponsors are subject to a lock-in period of three years.

The majority of investment funds in Oman are established as open-ended unincorporated funds. *Shariah*-compliant investment funds remain limited in number compared to conventional investment funds. Examples of *shariah*-compliant investment funds in Oman include Al Kawthar Fund (established by Tanmia, which is a state-owned investment company) and Al Hilal Mena Fund (established by Ahli Bank).

vi Real estate investments

Real estate investment is conducted either through real estate investment companies, which typically take the form of a joint-stock company or REIT. The CCL constitutes the main legislation governing joint-stock companies in Oman. The CCL is complemented by the Capital Market Law and the CMA rules and regulations and code of corporate governance with respect to public joint-stock companies. The minimum capital requirement for a public joint-stock company is 2 million rial and 500,000 rial for a closed joint-stock company. The CCL provides that *shariah*-compliant commercial companies (including those carrying out real estate investment activities) must comply with the principles of *shariah*. The CCL further requires the CMA (the regulator of public joint-stock companies) and the MOCI (the regulator of closed joint-stock companies and other types of commercial companies) to issue a regulation on the *shariah* auditing mechanisms to be implemented within such companies.

Real estate investment companies are the dominant participants in the field of real estate investment. The other type of real estate investment vehicle recently recognised in Oman is the REIT. REITs, similarly to conventional investment funds, can be established either in the form of a joint-stock company, or as an unincorporated entity enjoying legal personality. All REITs are required to be closed-ended. The issued capital requirement is much greater than that for other investment funds, as REITs are required to have capital of no less than 10 million rial (or its equivalent in another currency). If the REIT is intended to be *shariah*-compliant, the investment manager is required to form a *shariah* committee or to engage the services of a third-party *shariah* committee. The qualifications and character required of the members of the committee are set out in the REIT Regulation. The REIT is also required to be managed by professional managers who are licensed by the CMA and have their main duties set out in the REIT Regulation.

vii Sukuk-based financing

Ijara muntahiya bittamleek is the most prevalent form of *sukuk* in Oman and has been employed repeatedly by the government in the context of sovereign debt capital market issuances. *Ijara muntahiya bittamleek sukuk* certificates are issued by the issuer and each certificate represents a portion of ownership in the underlying *ijara* assets as well as a right to the periodic distribution amount and dissolution amount generated by these assets. The subscription monies are collected by the issuer, in its capacity as trustee, and are used to purchase underlying *ijara* assets from the originator. The *ijara* assets are added to the trust portfolio and are subsequently leased back to the originator, who issues a promise to purchase back (for the benefit of the trustee and the *sukuk* holders) the *ijara* assets upon final maturity or upon the occurrence of an event of default. The originator, in its capacity as lessee, makes periodic rental payments, which are distributed to the *sukuk* holders by the trustee as profit payments. Upon final maturity or the occurrence of an event of default, the trustee exercises its rights under the promise to purchase, and the originator purchases back the *ijara* assets and pays the agreed purchase price.

In Oman, the *ijara muntahiya bittamleek sukuk* usually adopts an asset-based structure (i.e., the originator would issue a binding promise to purchase the leased asset, which the *sukuk* holders can use as recourse against the originator in the event that it breaches its obligations), rather than an asset-backed structure (i.e., the *sukuk* holders would only have recourse against the leased asset).

III TAXATION

The main legislation relating to taxation in Oman is RD No. 28/2009 (the Income Tax Law), which governs both Islamic and conventional businesses. The Secretariat General for Taxation (SGT) at the Ministry of Finance is the body responsible for enforcement of the Income Tax Law and for ensuring compliance.

There is no special or separate law governing the taxation of Islamic financial institutions, but the Income Tax Law contains a chapter specific to the income generated from Islamic financial transactions. The aforementioned chapter was recently introduced by RD No. 9/2017, which amended the Income Tax Law for the purpose of, inter alia, clarifying the tax position of Islamic banks as part of an overall tax reform. In this regard, the Income Tax Law currently provides for the taxability of any amounts generated from an Islamic finance transaction obtained by a taxpayer in lieu of interest, which effectively makes virtually all Islamic financial transactions profits taxable on a par with their conventional counterparts.

The Income Tax Law further provides that if the purpose of the transaction is to purely achieve a *shariah*-compliant objective without the transaction including any financial aspect, such as the leasing of real estate or a movable asset, or establishing usufruct thereon, the transaction will not be taxable. Hence, income generated from such a transaction (excluding any interest-like payments) will not be deemed taxable in accordance with Article 76 *bis* (3) of the Income Tax Law. The chapter relating to taxation of income generated from Islamic finance transactions also provides special rules concerning deduction of donation amounts paid by the borrower, the impact of credit losses on the calculation of the taxable income, and the submission by the taxpayer of evidence regarding specific matters when submitting its fiscal declaration or during the course of SGT decision-making regarding any petition filed by the taxpayer.

In addition to the Income Tax Law, other laws contain special provisions granting Islamic finance businesses certain privileges and benefits with regard to payment of governmental fees. In this respect, the Banking Law exempts banks licensed to carry out Islamic banking from payment of the governmental fees imposed on transactions involving ownership and leasing of real estate and movable assets conducted by such banks in the context of Islamic finance transactions. Further, the Capital Market Law grants special purpose vehicles formed by originators for the purpose of issuing *sukuk* exemption from payment of taxes and fees imposed by all Oman government bodies; hence, they are exempt from payment of, inter alia, income and withholding taxes.

IV INSOLVENCY

There are no insolvency proceedings specific to Islamic finance in Oman. Both conventional and *shariah*-compliant commercial companies are subject to the bankruptcy provisions in RD No. 55/1990 (the Commercial Law). Bankruptcy is declared by the commercial court either *suo motu*, at the request of an insolvent commercial company or based on a claim filed by the creditors of an insolvent commercial company. As of the date of adjudication of bankruptcy, the bankrupt debtor would relinquish all rights and powers to a court-appointed trustee in bankruptcy for the latter to manage the bankrupt entity's assets, including those acquired or accrued post-declaration of bankruptcy, if any. A bankrupt may not dispose of any of its assets, nor make or receive any payment unless the sale or receipt of payment is for a bona fide commercial purpose. Upon the declaration of bankruptcy of a debtor, no suit may be brought against it or be proceeded with, except in specific instances enumerated by the Commercial Law.

With the issuance of RD No. 53/2019, a new Bankruptcy Law has been introduced to replace the insolvency provisions contained in the Commercial Law. The new Bankruptcy Law sets out the procedures for preventive composition, restructuring and bankruptcy. It should be noted that the new law specifically exempts all entities licensed by the CBO and insurance companies from its application, which suggests a new regulation may be issued by the regulators of these entities specifically in relation to applicable bankruptcy and insolvency procedures. The new law is scheduled to come into force within one year of its promulgation date.

V JUDICIAL FRAMEWORK

i Courts

Under the court system in Oman, as provided for by RD No. 90/1999, the Primary Court (Commercial Circuit) (the Primary Commercial Court) is the only body in Oman with primary jurisdiction in relation to commercial disputes (whether or not they relate to Islamic finance issues of a commercial nature); these are subject to appeals before the Appellate Court (Commercial Circuit) and the Supreme Court of Oman. Prior to the establishment of the Primary Commercial Court, the Commercial Court and the Authority for Settlement of Commercial Disputes were the judicial bodies with exclusive jurisdiction to adjudicate upon commercial matters. Although there is no court dedicated exclusively to Islamic finance disputes, there is a Shariah Circuit within the Primary Court, which adjudicates in personal

affairs matters such as marriage, divorce and inheritance. Similarly to the judgments of the Primary Commercial Court, the judgments rendered by the Shariah Circuit of the Primary Court are appealable before the Appellate Court (Shariah Circuit) and the Supreme Court.

Parties to Islamic finance-related agreements are free to agree to refer disputes to an arbitral tribunal and to specify the law governing their transaction and the arbitration rules governing arbitral proceedings. An Omani court would be required to dismiss a suit raised before it to adjudicate on a dispute in respect of which an arbitration agreement exists, provided the defendant in the suit were to plead for its dismissal on the basis of the parties having agreed on arbitration as the dispute settlement mechanism.

ii Cases

Because the legal and regulatory framework of Islamic finance is a relatively recent introduction, as at the time of writing there have been only a few cases that shed light on how the Omani courts perceive disputes relating to Islamic finance. In a judgment passed by the Supreme Court on appeal No. 83/2003, heard on 3 April 2004, the Supreme Court rejected the characterisation of an investment agreement as a *mudarabah* agreement by the Appellate Court. The Supreme Court stated that the principles of Islamic law constitute the basis on which the Court adjudicates on transactions. The Supreme Court referred to Islamic law and stated that *mudarabah* consists of the offering of funds by one party against the performance of an activity by the party receiving the funds; the offering and performance are based on the principle of sharing profits between the parties and, in the event of occurrence of losses, the person offering the capital would assume the losses in the absence of transgression or breach by the person investing the money.

The Supreme Court has further provided that profit should not take the form of interest as typically offered by banks; otherwise the *mudarabah* would be invalid. The Supreme Court referred to the contract provisions in question and provided that the presence of a clause according to which the person offering the capital was entitled to a profit share of no less than 5 per cent corrupted the *mudarabah* and rendered it invalid. The Supreme Court argued that *mudarabah* is an investment endeavour susceptible to both achievement of profits and incurrance of losses; thus any undertaking made by the *mudarib* to reimburse the person offering the capital regardless of whether or not losses had occurred would result in the *mudarabah* becoming invalid. The Court stated that should the *mudarabah* become invalid under Islamic law, the capital initially offered to the *mudarib* should be reimbursed by the latter to the counterparty; however, because of the invalidity of the *mudarabah* agreement, the counterparty shall not be entitled to receive any profits achieved by the investment project.

In a further judgment passed by the Supreme Court, on appeal No. 187/2003, heard on 31 March 2004, the court disregarded the appellant's characterisation of the disputed agreement (titled as an 'investment agreement') as a *mudarabah* agreement on the basis of Articles 4 and 5 of the Commercial Law, which provide that Islamic law (although a source of law that a judge may refer to when adjudicating on commercial disputes) should be applied only in the absence of relevant contractual provisions and after exhaustion of other sources of law relevant to the subject matter of the dispute. The Supreme Court distinguished between *riba* interest and compensatory interest, by stating that compensatory interest is determined by the Minister of Commerce and Industry on the basis of the Commercial Law, which provides that an interest rate may be charged on commercial debts within the limits specified

by the MOCI in coordination with the Oman Chamber of Commerce and Industry. Thus, the Supreme Court concluded that the agreement in question, although not a *mudarabah*, constituted a valid investment agreement, and not in breach of law.

VI OUTLOOK

The accelerated pace of legislative reform and developments in the area of Islamic finance over the past few years are a testimony to the Sultanate's goal to become a regional hub for the Islamic finance industry. This trend, although partially motivated by the country's programme for economic diversification, is also based on the government's view that Islamic finance remains an untapped source for investment opportunities and support for the country's economy, which has been affected by the global economic crisis and the crash in oil prices. The government's multiple *sukuk* issuances, with an aggregate value in excess of several billion dollars, are testament to the increasing interest in Islamic finance as an attractive alternative to its conventional counterpart. Additionally, Islamic banking's share of the market has been steadily increasing and rose to 12.6 per cent in June 2018, thanks to the government's encouragement and public interest.

The CBO has been keen on spreading awareness of Islamic finance and encouraging the industry by promising to launch a *shariah*-compliant version of the Banking Deposits Insurance Scheme, and to offer Islamic liquidity management solutions to the Islamic banking industry. The CBO has also been looking into ways to implement fintech in the Islamic banking sector, and to encourage conventional banks to convert their Islamic windows into fully fledged Islamic banks. In addition, the CMA has been at the forefront of introducing regulations to provide for a robust governance framework for Islamic finance in Oman. The introduction of the Sukuk Regulations, the Takaful Insurance Law and the REIT Regulations has certainly spurred consumer confidence and growth of the Omani Islamic finance industry. In light of this, we anticipate that in the near future, further reforms will be implemented in relation to Islamic banking, in particular to modernise this sector and take it to the next level, allowing for it to become an even stronger competitor to conventional financing.

PHILIPPINES

*Rafael A Morales*¹

I LEGISLATIVE AND REGULATORY FRAMEWORK

The Philippines officially recognised Islamic banking and finance some 40 years ago, when a legislative charter was granted to Al-Amanah Bank,² the first Islamic bank established in the country to cater to the banking requirements of the Muslim population. In 1990, that bank was reorganised and replaced with the Al-Amanah Islamic Investment Bank of the Philippines (AIIBP).³

Although Islamic banks are recognised as a distinct category of banking institutions under the General Banking Law of 2000,⁴ the AIIBP remains to date the only bank of its kind in the country. Also, within conventional banks, there are no Islamic windows or units. However, under the General Banking Law of 2000, the Bangko Sentral ng Pilipinas (BSP), if so minded, can authorise the establishment of Islamic banks other than the AIIBP, as well as Islamic units within conventional banks. This is because Subsection 3.2 of that Law empowers the BSP to make ‘other classifications of banks’, specifically mentioning ‘Islamic banks as defined in Republic Act No. 6848, otherwise known as the Charter of AIIBP’. As the reference in Subsection 3.2 is to ‘Islamic banks’ in the plural (not singular), there is a legislative intent for the BSP to enable the formation of more Islamic banks (and, for that matter, Islamic units within conventional banks), in addition to the AIIBP. In fact, the BSP is well aware of this, considering that Section 101(b)(6) of the BSP’s Manual of Regulations for Banks contains an enumeration of the services that Islamic banks can provide to their customers.

Nevertheless, the passage of Republic Act No. 11054, the Organic Law for the Bangsamoro Autonomous Region in Muslim Mindanao (the Bangsamoro Organic Law), should boost Islamic banking and finance, considering that the BSP, the Department of Finance and the National Commission on Muslim Filipinos are mandated therein to ‘jointly promote the development of an Islamic banking and finance system, to include, among others, the establishment of a Shariah Supervisory Board and the promotion and development of *shariah*-compliant financial institutions’.⁵ Further, there will be a review of ‘existing market

1 Rafael A Morales is the managing partner at Morales & Justiniano.

2 Republic Act No. 6848 is the Charter of the AIIBP.

3 See the chapter on the Philippines in *Getting the Deal Through: Islamic Finance & Markets 2016* (Rafael A Morales and Bishr Shibliq, contributing editors), at 38.

4 Republic Act No. 8791; see Subsection 3.2(f) thereof.

5 Bangsamoro Organic Law, Section 32; see also Rafael A Morales, ‘Philippines continues to foster Islamic finance development’, *Islamic Finance News* (4 May 2016).

environment policies' and the adoption of 'measures to enhance the competitiveness of Islamic finance products', so that 'Islamic financial players are not inhibited from introducing Islamic finance products'.⁶

What is more, House Bill No. 8281 has been passed by the House of Representatives, adopted by the Senate and is due to be signed of the President of the Philippines. Officially, it is called 'An Act Providing for the Regulation and Organization of Islamic Banks' in the Philippines (the Islamic Banking Law).

i Legislative and regulatory regime

The Islamic Banking Law constitutes the general legislative framework for Islamic banking and finance in the Philippines and the Bangsamoro Organic Law authorises 'the crafting of the Bangsamoro Islamic banking and finance framework by the Bangsamoro Parliament applicable within the Bangsamoro Autonomous Region'.⁷ However, as the operation of Islamic banks and financial institutions within the Bangsamoro Autonomous Region is also to be supervised by the BSP, uniformity of regulations on Islamic banking and finance both outside and within the Bangsamoro Autonomous Region is expected.

The BSP had already issued the regulations implementing the Charter of the AIIBP.⁸ Under the Islamic Banking Law, the BSP is also mandated to promulgate the necessary rules for the effective implementation of this Law.⁹ This new set of implementing rules will govern the operations of entities authorised by the BSP to perform banking, financing and investment operations designed to promote and accelerate the socioeconomic development of the country in accordance with *shariah* principles.¹⁰ The BSP is expressly empowered under the Islamic Banking Law to authorise the establishment of Islamic banks other than the AIIBP, as well as Islamic units within conventional banks.¹¹ This empowerment is more direct and explicit than that granted to the BSP by Subsection 3.2 of the General Banking Law of 2000.

It must be noted that, existing laws applicable to conventional banking, capital market and insurance can be considered as enabling Islamic banking and finance. Central to this is Article 1306 of the Civil Code of the Philippines,¹² which allows contracting parties to 'establish such stipulations, clauses, terms and conditions as they may deem convenient, provided they are not contrary to law, morals, good customs, public order or public policy'. This freedom in contract-making would allow the adoption of terms and conditions suitable

6 Bangsamoro Organic Law, Section 32.

7 Bangsamoro Organic Law, Section 34.

8 The implementing rules are contained in Appendix 40 to the Manual of Regulations for Banks.

9 Section 4.

10 According to the Fact Sheet of House Bill No. 8281 (the Islamic Banking Law), the Law is designed to promote 'greater financial inclusion, ethical banking, and socioeconomic development', expand 'the funding base for small and medium enterprises as well as large government infrastructure' and contribute 'to financial stability through the use of financial contracts and services that are founded on risk sharing'.

11 Section 3(c) of the Islamic Banking Law defines 'Islamic banking system' as including 'the Al-Amanah Islamic Investment Bank of the Philippines, other Islamic banks, designated Islamic banking units of conventional banks, and foreign banks that are authorised to conduct business in accordance with the principles of *shariah*'.

12 Republic Act No. 386, as amended.

to Islamic banking, capital market and insurance, with the approval of pertinent regulators, namely the BSP for banking, the Securities and Exchange Commission (SEC) for capital markets and the Insurance Commission for insurance.¹³

Interestingly, the absence of legislation or regulation on Islamic capital markets has not prevented the Philippine Stock Exchange (PSE) from releasing its list of *shariah*-compliant shares of stock, with a view to diversifying its investment base. The list is updated from time to time and published by the PSE on its website (www.pse.com.ph) by the fifth trading day of the month following every quarter.¹⁴

ii Regulatory and supervisory authorities

The BSP has sole supervision over the operations of banking institutions in the Philippines, including Islamic banks and financial institutions.¹⁵ On the other hand, the Insurance Commission is expected to regulate and supervise entities that will issue Islamic insurance in due time in the country.

It is reasonable to assume, too, that the SEC will be the regulator and supervisor of the Islamic capital market in the Philippines, once the rules for this have been promulgated. In fact, the SEC has already asserted its supervisory authority in this regard, by not interdicting the periodic issuance by the PSE (a stock exchange under the supervision of the SEC) of the list of *shariah*-compliant shares of stock. It is also expected that the SEC will regulate the issuance of *sukuk* in the domestic market, pursuant to its authority under the Securities Regulation Code¹⁶ to register securities issued and offered to the public in the Philippines.¹⁷

To date, there is no central authority in the Philippines responsible for ensuring that transactions or products are *shariah*-compliant. However, within the AIIBP, there is a five-member advisory council whose function is 'to offer advice and undertake reviews pertaining to the application of the principles and rulings of the Islamic *shariah* to the

13 See footnote 3.

14 The latest list was circulated through the PSE's Memorandum to the 'Investing Public and All Trading Participants' dated 5 July 2019. The PSE has engaged the services of IdealRatings, Inc in screening PSE-listed companies in accordance with the standards set by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). To be included in the list, a company must meet the following PSE criteria: (1) the nature of the company's primary business must not involve any of the prohibited activities in AAOIFI's Shariah Standard No. 21 – Rules for Dealing of Shares (i.e., conventional interest-based lending, financial institutions, conventional insurance, mortgage and lease, derivatives, pork, alcohol, tobacco, arms and weapons, embryonic stem-cell research, hotel, gambling, casinos, music, cinema and adult entertainment) or, if the company derives income from these prohibited activities, the income, on an aggregated basis, must not exceed 5 per cent of its gross revenues; (2) the company's interest-bearing debt, as well as its interest-bearing deposits or investments, must not exceed 30 per cent of its 12-month trailing average market capitalisation; and (3) the company's accounts receivable must not exceed 67 per cent of its 12-month trailing average market capitalisation.

15 General Banking Law of 2000, Section 4; Islamic Banking Law, Section 4; Bangsamoro Organic Law, Section 32.

16 Republic Act No. 8799.

17 It was reported that the National Home Mortgage Finance Corporation was planning to issue *sukuk*. See Rafael A Morales, 'Philippines continues to foster Islamic finance development', *Islamic Finance News* (4 May 2016).

Islamic bank's transactions'.¹⁸ Under the Islamic Banking Law, each Islamic bank is required to constitute its *shariah* advisory council.¹⁹ The challenge here is the current scarcity in the Philippines of experts or scholars on Islamic banking and finance.

II COMMON STRUCTURES

Islamic banks (including the AIIBP) have flexibility in structuring their *shariah*-compliant products and services, considering that they can 'undertake various investments in all transactions allowed by the Islamic *shariah* in such a way that shall not permit the *haram* (forbidden), nor forbid the *halal* (permissible)'.²⁰

i Consumer finance

In consumer finance, for instance, the AIIBP is authorised to 'provide financing with or without collateral by way of *al-ijarah* (leasing), *al-bai ul takjiri* (sale and leaseback) or *al-murabahah* (cost-plus-profit sales arrangement)'.²¹ Other Islamic banks²² can provide similar consumer finance.

In *al-ijarah*, the fund owner (such as a bank) purchases the asset required by the fund user (the consumer), who then acquires the right to use the asset through a lease for a fixed period, subject to the payment of rentals to the fund owner.²³ *Al-bai ul takjiri* is similar to *al-ijarah* except that the fund user will, at a point in time, purchase the leased asset at an agreed price with all the previously paid lease rentals considered as part of the purchase price.²⁴ In *al-murabahah*, the fund owner purchases the asset required by the fund user and then sells the same at an agreed mark-up to the fund user. In this arrangement, the fund user may be required to place a margin deposit, which will be used to pay part of the purchase price.²⁵

Even under existing law, the prohibition against charging or collection of interest (*riba*)²⁶ from consumers is not a problem, because Article 1956 of the Civil Code of the Philippines provides that: 'No interest shall be due unless it has been expressly stipulated in writing.' Thus, to comply with *shariah* principles, all that the contracting parties must do is not to stipulate any interest in their agreement.²⁷

18 Charter of the AIIBP, Section 5.

19 Islamic Banking Law, Section 5.

20 Section 101(b)(6)(k) of the Manual of Regulations for Banks; Section 6(7)(l) of the Charter of the AIIBP.

21 Section 7(i) of Appendix 40 to the Manual of Regulations for Banks.

22 General Banking Law of 2000, Subsection 3.2(f).

23 Section 44(3) of Appendix 40 to the Manual of Regulations for Banks.

24 Section 44(2) of Appendix 40 to the Manual of Regulations for Banks.

25 Section 44(6) of Appendix 40 to the Manual of Regulations for Banks.

26 As defined in Section 43(3) of Appendix 40 to the Manual of Regulations for Banks, the term '*riba*' includes 'the receipt and payment of interest in the various types of lending and borrowing and in the exchange of currencies on forward basis'.

27 Footnote 3, at 39.

ii Home finance

Al-murabahah can be used in home finance. Here, a bank can buy a house and resell the same in instalments to a buyer for profit. Given the strict avoidance of interest in *shariah*, the bank must take at least constructive possession of the house before reselling it to the buyer that the transaction can be characterised as an authentic asset-based trade rather than a conventional financing arrangement.²⁸

iii Insurance

There is as yet no *takaful* market in the Philippines. Further, there are no conventional insurance companies that can be adapted to be *shariah*-compliant.²⁹ It remains to be seen how the Insurance Commission will address or react to the introduction of the *takaful* concept in the local insurance market.

iv Private equity investments

Islamic banks can invest in equities of warehousing companies, leasing companies, storage companies and companies engaged in the management of mutual funds but not in mutual funds themselves.³⁰ Moreover, they can accept placements from a customer for investment, together with their own funds, in *shariah*-permissible transactions on a participation basis.³¹ Here, participation means ‘any agreement or arrangement under which the mode of joint investments of specific transactions shall not involve the element of interest charge other than as percentage share in profits and losses of business’.³²

v Real estate investments

Financing fixed-asset acquisitions (such as buying real estate) may be effected through *al-bai bithaman ajil* (deferred payment sale), pursuant to which the ownership of the asset is immediately transferred to the buyer but the purchase price is collected later, usually in instalments.³³

Real estate investment trusts (REIT), designed to promote the development of the capital market by broadening the participation of Filipinos in the ownership of real estate in the Philippines, have yet to take off in the Philippines because of problems in implementation, although the REIT Act was passed as early as 2009.³⁴

28 *ibid.*

29 *ibid.*

30 Section 101(b)(6)(o) of the Manual of Regulations for Banks.

31 Section 101(b)(6)(b) of the Manual of Regulations for Banks.

32 Section 43(10) of Appendix 40 to the Manual of Regulations for Banks.

33 Section 44(1) of Appendix 40 to the Manual of Regulations for Banks.

34 Republic Act No. 98501. The problems lie in the requirement for a REIT to have a minimum public ownership initially of 40 per cent and eventually 67 per cent, as well as the imposition of value added tax on the initial asset transfer.

vi Investment funds

Under BSP rules, Islamic banks can issue investment participation certificates, *muqaradah* bonds³⁵ and debentures to fund projects that will promote the economic development primarily of the autonomous region in southern Philippines.³⁶ Broadly, they can undertake various investments in all transactions that are *halal* and not *haram*.³⁷

One other arrangement is *al-mudarabah* (trust financing), wherein the fund owner provides full financing to the fund user, who contributes only his or her entrepreneurship and labour. The profit is shared by them at a pre-agreed rate or ratio, but if the venture fails, the fund owner bears all the losses even if the fund owner is not involved at all in the management of the venture.

vii Other areas

Islamic banks can open savings accounts for safekeeping or custody with no participation in profits or losses, unless the funds are otherwise authorised by the account holders to be invested.³⁸

An Islamic bank can also act as an agent for another for a fee, under an *al-wakalah* arrangement. Here, the bank may issue a letter of credit for an importing customer, who is required to place a 100 per cent margin deposit on an *al-wadi'ah* (safe custody) basis wherein the bank has full discretion to use the deposit to meet its obligations under the letter of credit.³⁹

On the other hand, in an *al-kafalah* (guarantee) arrangement, an Islamic bank can issue a standby letter of credit in respect of the performance of a task or the settlement of an obligation. Where a security deposit is required, it will be taken on an *al-wadi'ah* basis.⁴⁰

Furthermore, an Islamic bank can take security for an outstanding obligation, based on the *al-rah'an* principle. Although Islamic banks extend financing through partnership and trading assets, security may be taken as a precaution under that principle.⁴¹

III TAXATION

Under the Islamic Banking Law, the government is mandated to provide 'neutral tax treatment between Islamic banking transactions and equivalent conventional banking transactions'.⁴² This is aimed at providing a level playing field in terms of taxation between Islamic banking and conventional banking, so that Islamic banking transactions will not be disadvantaged tax-wise compared with their conventional counterparts.

35 As defined in Section 43(12) of Appendix 40 to the Manual of Regulations for Banks, *muqaradah* bonds are 'long-term non-interest-bearing bonds of definite denomination issued and floated by the bank on the basis of participation under the *mudarabah* principle to be used in financing projects for economic development'.

36 Section 101(b)(6)(m) of the Manual of Regulations for Banks.

37 Section 101(b)(6)(k) of the Manual of Regulations for Banks.

38 Section 101(b)(6)(a) of the Manual of Regulations for Banks.

39 Section 44(11) of Appendix 40 to the Manual of Regulations for Banks.

40 Section 44(4) of Appendix 40 to the Manual of Regulations for Banks.

41 Section 44(9) of Appendix 40 to the Manual of Regulations for Banks.

42 Islamic Banking Law, Section 14; see also Section 32 of the Bangsamoro Organic Law, which mandates the Bangsamoro parliament to 'enact laws that promote the growth of Islamic finance such as those that promote tax incentives and ensure tax neutrality of Islamic finance transactions in the Bangsamoro Autonomous Region'.

It is noteworthy that, during its first eight years of operation, the AIIBP was exempted from all taxes under the National Internal Revenue Code.⁴³ This tax exemption has lapsed. There appears to be no plan to have this exemption restored.

IV INSOLVENCY

There is no separate insolvency regime for Islamic finance participants in the Philippines, and Islamic finance products are not afforded special treatment under local insolvency rules.

The insolvency rules governing conventional banks under the New Central Bank Act⁴⁴ and the General Banking Law of 2000 are also applicable to Islamic banks. Initially, a conservator will be appointed by the BSP to take charge of the assets, liabilities and management of an Islamic bank that is in a state of continuing inability or unwillingness to maintain a condition of liquidity deemed adequate to protect the interest of bank depositors and creditors.⁴⁵ If the BSP determines that the bank cannot continue to operate on its own without involving probable loss to its depositors and creditors, then the conservatorship will be terminated and the BSP will appoint a receiver, who will determine whether the bank can still be rehabilitated or otherwise liquidated.⁴⁶

Similarly, the insolvency rules for conventional insurance companies under the Insurance Code⁴⁷ could be applied to *takaful* companies. The rules here also involve conservatorship and receivership prior to liquidation. In a nutshell, if the Insurance Commissioner determines that a company is in a state of continuing inability or unwillingness to maintain a condition of solvency or liquidity deemed adequate to protect the interests of its policyholders and creditors, he or she will appoint a conservator to take charge of the company's assets, liabilities and management.⁴⁸ If it is determined that the condition of the company is one of insolvency, the Insurance Commissioner will order the company to cease and desist from transacting business and designate a receiver and then a liquidator if the company cannot resume business with safety to its policyholders and creditors.⁴⁹

For other Islamic finance participants, the Financial Rehabilitation and Insolvency Act of 2010 applies.⁵⁰ As the name of this law indicates, corporate rehabilitation may be sought in court by or for a debtor company but the rehabilitation proceedings will be converted by the court into one for liquidation if there is no substantial likelihood of the company being successfully rehabilitated.⁵¹

43 Charter of the AIIBP, Section 37. The National Internal Revenue Code is set out in Republic Act No. 8424, as amended.

44 Republic Act No. 7653.

45 Section 29 of the New Central Bank Act; Section 67 of the General Banking Law of 2000. As defined in Section 43(5) of Appendix 40 to the Manual of Regulations for Banks, the term 'depositor' refers to 'a person or entity who has an account at an Islamic bank, whether the account is a current account, a savings account or any other deposit account; unless the context requires another meaning, a depositor corresponds to an investor in joint investment of the Islamic bank'.

46 Section 30 of the New Central Bank Act; Section 69 of the General Banking Law of 2000.

47 Presidential Decree No. 612, as amended by Republic Act No. 10607.

48 Section 255 of the Insurance Code.

49 Section 256 of the Insurance Code.

50 Republic Act No. 10142.

51 Section 12 et seq. of the Financial Rehabilitation and Insolvency Act of 2010.

V JUDICIAL FRAMEWORK

i Courts

No special court has exclusive jurisdiction over disputes involving *shariah*-compliant products and structures. Conventional or regular courts still have jurisdiction over these disputes.

There are *shariah* courts but they have jurisdiction only over cases relating to Muslim personal law (defined as ‘laws on personal status, marriage and divorce, matrimonial and family relations, succession and inheritance, and property relations between spouses’).⁵² These courts are under the administrative supervision of the Supreme Court of the Philippines, which has appellate jurisdiction over cases decided by them.⁵³

ii Cases

In the Philippines, judicial power is vested in the Supreme Court and the lower courts (such as metropolitan or municipal trial courts, regional trial courts and the Court of Appeals).⁵⁴ However, only the decisions of the Supreme Court form part of the legal system.⁵⁵ To date, there are no cases decided by the Supreme Court that affect or interpret Islamic finance products and structures in the Philippines. In fact, there is, as yet, no corpus of jurisprudence on Islamic banking and finance.

Shariah law generally applies only to Muslims in the Philippines and only in respect of Muslim personal law, as defined above. Commercial transactions are governed by the general law on contracts and commerce. This explains why existing Supreme Court decisions on *shariah* law relate only to Muslim family issues.

Within the AIIBP, disputes between and among shareholders, as well as those between shareholders and the bank itself, are settled by the board of directors, acting as arbitrators. The arbitral award is final and executory.⁵⁶

VI OUTLOOK

The prospects for Islamic banking and finance look promising, with the passage of the Bangsamoro Organic Law and the imminent enactment of the Islamic Banking Law. The BSP can already authorise, at the very least, the opening of Islamic units within conventional banks. Indeed, it is high time for the BSP to take bold steps to promote the growth of Islamic banking and finance in the Philippines. In line with the progress of economic integration within the Association of Southeast Asian Nations (ASEAN), the member nations have established the framework for an integrated financial and banking markets, including the formation of the qualified ASEAN banks (QABs). With the anticipated entry into the Philippine banking system of QABs from the other ASEAN members and with expertise in Islamic banking and finance, the BSP is expected to encourage and enable local banks and financial institutions to enhance their capabilities in Islamic banking and finance to be more competitive with their regional counterparts. This will come to fruition sooner rather than later with the enactment of the Islamic Banking Law.

52 Presidential Decree No. 1083, Section 7(i).

53 *ibid.*, Section 145.

54 Section 1, Article VIII, 1987 Constitution of the Philippines.

55 Article 8, Civil Code of the Philippines.

56 Charter of the AIIBP, Section 9.

UNITED ARAB EMIRATES

*Amjad Ali Khan and Rahat Dar*¹

I LEGISLATIVE AND REGULATORY FRAMEWORK

i Legislative and regulatory regime

The United Arab Emirates (UAE) has always provided an attractive environment from which to provide Islamic finance services and products into the Gulf Cooperation Council (GCC) and beyond. In addition to being an established and vibrant global financial centre and its geographical location in the centre of the Asian and Western financial markets, the UAE also provides a legal system and a judiciary that is familiar with the principles of *shariah*. The UAE's Constitution identifies *shariah* as a principle source of law and UAE Federal Law No. 5 of 1985 Concerning Civil Transactions (the UAE Civil Code), which is deeply anchored in *shariah*, recognises the basic Islamic financing contracts, including:

a *Murabahah* (cost-plus financing): Article 506 of the UAE Civil Code defines a *murabahah* sale as:

1. *A sale may be by way of resale with a profit, a loss or at cost price if the capital value of the thing sold is known at the time of the contract, and the amount of the profit or loss is specified.*
2. *If it appears that the seller has exaggerated in declaring the amount of the capital value, the purchaser may reduce (the amount) by the amount of the excess.*
3. *If the capital value of the thing sold is not known when the contract is made, the purchaser may rescind the contract when he learns of it, and the same shall apply if the seller conceals a matter affecting the thing sold or the capital value, and he shall lose his right to elect if the goods are sold or consumed or pass out of his ownership after delivery.*

b *Mudarabah* (trust financing): Article 693 of the UAE Civil Code states that a *mudarabah* is 'a contract whereby the person owning property puts in the capital, and the *mudarib* puts in effort or work, with a view to making a profit'.

c *Musharakah* (partnership financing): Article 654 of the UAE Civil Code identifies *musharakah* generally in the following statement: 'A company is a contract whereby two or more persons are bound each to participate in a financial project by providing a share of property or work for the exploitation of that project and the division of any profit or loss which may arise thereout.'

¹ Amjad Ali Khan is a senior consultant and Rahat Dar is a senior associate at Afridi & Angell.

- d *Ijarah* (leasing): Article 742 of the UAE Civil Code defines *ijarah* as ‘the conferring by the lessor on the lessee of the right of use intended for the thing hired for a specified period in consideration of an ascertained rent’.
- e While there is no specific article in UAE law that expressly refers to and deals with *istisnah*, the official commentary to the UAE Civil Code stipulates that the *shariah* principles of *istisnah* are applicable in the case of construction contracts (*muqawala*), which are defined in Article 872 as ‘a contract whereby one of the parties thereto undertakes to make a thing or to perform work in consideration which the other undertakes to provide’.

While the emirate of Dubai has established itself as a major centre for business and commerce, the UAE is a relatively young country and the laws and regulations applicable to financial products and services (including Islamic finance) are rudimentary – often just providing a mandate for the formation of regulatory authorities to govern the provision of the relevant financial products and services in the UAE. Consequently, the detailed rules, regulation and policies relating to financial products and services are left to the discretion of the relevant regulatory authorities. The internal rules, policies and guidelines implemented by the authorities relating to the relevant financial products are not always made public. The laws relevant to Islamic financial services are in many cases diffused in multiple pieces of legislation and the coverage of issues (including consumer protection) is general rather than comprehensive.

Islamic banking

The UAE is one of the largest Islamic banking markets in the world, after Saudi Arabia and Malaysia. According to the UAE Central Bank’s annual report for 2018, as at December 2018, 20.3 per cent (583 billion UAE dirhams or approximately US\$158.72 billion) of all banking assets and credit in the UAE are *shariah*-compliant, which represents a steeper growth rate for Islamic finance than that for conventional bank loans.

The principal governmental and regulatory policies that govern the UAE banking sector, including Islamic banks (except in the Dubai International Financial Centre (DIFC), where the regulatory authority is the Dubai Financial Services Authority), are UAE Federal Law No. 14 concerning the Central Bank and Organisation of Financial Institutions and Banking (the Banking Law), which came into force on 30 September 2018 and repealed UAE Federal Law No. 10 of 1980 concerning the UAE Central Bank, the Monetary System and the Organisation of Banking and UAE Federal Law No. 6 of 1985 concerning Islamic Banks, Financial Establishments and Investment Companies), UAE Federal Law No. 18 of 1993 as amended (the Commercial Code) and the various circulars, decisions, notices and resolutions issued by the board of governors of the UAE Central Bank, from time to time, and which deal with various aspects of banking, including bank accounts, maintaining of certain reserve ratios, capital adequacy norms and reporting requirements to the UAE Central Bank. (Under the Banking Law, all existing UAE Central Bank circulars, decisions, notices and resolutions will remain in full force for a period of three years, unless replaced by new circulars, decisions notices or resolutions).

The Banking Law is the primary legislation giving the UAE Central Bank the authority to regulate financial services (including Islamic financial services) in the UAE. According

to the Banking Law, the UAE Central Bank has the power to license and regulate a wide variety of financial institutions operating in the banking and financial sector in the UAE. In particular, the following institutions are regulated:

- a* banks, which are defined to include institutions licensed primarily to carry on the activity of accepting deposits and other licensed financial activities, such as granting loans, issuing and collecting cheques, placing bonds, trading in foreign exchange and precious metals or carrying on other operations allowed by law or by customary banking practice;
- b* exchange houses and money intermediaries (i.e., foreign exchange dealers who purchase and sell currency);
- c* Islamic financial institutions; and
- d* other financial institutions.

With respect to Islamic financial institutions, permissible activities are not specified in the Banking Law, which provides that 'Islamic financial institutions' means financial institutions licensed to undertake all the activities of a commercial bank but in accordance with the principles of Islamic *shariah*. The Banking Law provides that licensed Islamic financial institutions may undertake any of the following activities, provided they are done in a *shariah*-compliant manner:

- a* taking deposits of all types, including *shariah*-compliant deposits;
- b* providing credit facilities of all types;
- c* providing funding facilities of all types, including *shariah*-complaint funding facilities;
- d* providing currency exchange and money transfer services;
- e* providing monetary intermediating services;
- f* providing stored values services, electronic retail payments and digital money services;
- g* providing virtual banking services;
- h* arranging or marketing licensed financial activities; and
- i* acting as a principal in financial products that affect the financial position of the licensed financial institution, including but not limited to foreign exchange, financial derivatives, bonds and *sukuk*, equities, commodities and any other financial products approved by the UAE Central Bank.

The concept of a higher *shariah* authority was first contemplated under Article 5 of UAE Federal Law No. 6 of 1985 concerning Islamic Banks, Financial Establishments and Investment Companies, which provided that this authority should incorporate 'legal and banking personnel to undertake higher supervision over Islamic banks, financial institutions and investment companies to ensure legitimacy of their transactions according to the provisions of Islamic *shariah* law, and also to offer opinion on matters that these agencies may come across while conducting their activities. The opinion of the said higher *shariah* authority shall be binding on the said agencies'.

In 2017, the UAE cabinet approved the formation of the board of the higher *shariah* authority to strengthen consistency in the Islamic finance industry across the UAE. At its first meeting, the board identified a number of core objectives for the higher *shariah* authority, in particular (1) issuing *fatawa* (opinions) and ensuring the legitimacy of the products, services and activities of institutions providing Islamic services; (2) introducing and approving new and existing *shariah* standards and uniform documents relating to best practices for global Islamic financial services; (3) notifying the UAE Central Bank of *shariah* matters concerning

preventive systems related to global Islamic financial services, as well as *shariah*-compliant instruments and ways to develop these; (4) conducting *shariah* research regarding Islamic financing and ways of supporting it; and (5) communicating and cooperating with other international organisations that currently set *shariah* regulations and standards for the Islamic financial industry.

The Banking Law seems to have formalised the establishment, and expanded the mandate, of the existing higher *shariah* authority (the Higher Authority). The Higher Authority shall consist of at least five members (but not more than seven) with sufficient knowledge and experience in *shariah* and Islamic financial transactions. The Higher Authority will, among other things, determine the rules, standards and general principles applicable to Islamic financial institutions and will undertake supervision and oversight of the *shariah* committees (see below). The *fatawa* issued by the Higher Authority shall be binding on both *shariah* committees and all Islamic financial institutions undertaking part or all of their business in accordance with the principles of *shariah*. As the Higher Authority is a recent development, it remains to be seen how its role will develop and how it will interact with, and impact, other key stakeholders, in particular the *shariah* committees overseeing *shariah* compliance at financial institutions (see below).

Each Islamic financial institution must appoint and maintain a *shariah* committee, called the 'internal *shariah* supervision committee' (the *shariah* committee); these committees mirror the activities of *shariah* supervisory boards (SSBs) under the earlier banking regime, consisting of experienced experts in Islamic finance jurisprudence. The *shariah* committee shall undertake *shariah* supervision of all business, products, services and the business conduct of the Islamic financial institution, to ensure that its operations and products comply with the rules and principles of *shariah*, as set by the Higher Authority. The *shariah* committee will review all proposed financial products and related documents and issue a *fatwa* on their *shariah* compliance. Once a financial product has received the approval of the *shariah* committee, it can be offered by the Islamic financial institution to the public in the UAE. In the event that there is any disagreement, either between the members of the *shariah* committee or between the *shariah* committee and the board of the Islamic financial institution in connection with compliance with principles of *shariah*, the dispute shall be referred to the Higher Authority, whose ruling shall be final.

Capital markets

The capital markets in the UAE are still in their infancy and there are very few Islamic products listed on the local exchanges. While the UAE Central Bank is the principal financial services regulator for banks and financial institutions in the UAE, these entities are also subject to additional registration and licensing requirements at the federal and emirate levels. The Emirates Securities and Commodities Authority (ESCA) is the regulator in relation to listed securities (including *sukuk*). As with other jurisdictions in the GCC, the laws and regulation relating to the provision of financial products on the local capital markets are supplemented to a large extent by the regulatory regime implemented on the individual exchanges. In the UAE, while the regulators will provide the broad requirements for issuing securities, it is the individual regulators of the exchanges (such as in the Abu Dhabi Stock Exchange and the Dubai Financial Market) that will provide the detailed framework for the listing of the relevant financial products on these exchanges. A detailed review of the rules and regulations of the individual stock exchanges in the UAE and the DIFC is beyond the scope of this chapter.

While the UAE equity capital markets have been near inactive in the past few years, with only a handful of primary listings on the local exchanges, *sukuk* (or Islamic bonds) have bucked the trend and emerged as the fastest-growing segment of the UAE Islamic capital markets. The UAE is also a popular destination for listing *sukuk*. At the end of 2018, the total value of *sukuk* listed on NASDAQ Dubai stood at US\$51.2 billion, with 14 new *sukuk* listings with an aggregate value of US\$11.99 billion in 2018.

Decision No. 16 of ESCA's Board of Directors of 2014 Concerning the Regulation of Sukuk (the Sukuk Regulations) provides specific guidelines for the issuance of *sukuk* in the UAE and the listing of *sukuk* on the local capital markets. In particular, the Sukuk Regulations provide that:

- a* all retail *sukuk* (i.e., *sukuk* where the maximum value of each *sukuk* certificate is 100,000 UAE dirhams and is offered to the public through a public subscription) shall only be issued in the UAE through public subscription and shall be listed on a local market;
- b* the obligor (i.e., the company that will receive the funds from the issuance of the *sukuk* certificates) must obtain ESCA's approval before issuing or listing *sukuk* on a regulated market;
- c* for a primary listing of a *sukuk*, the obligor must ensure that the *sukuk* has been approved by its SSB. If the obligor does not have an SSB, the *sukuk* must be approved by a *shariah* committee approved by ESCA;
- d* unless ESCA provides otherwise, the nominal value of a listed *sukuk* must be above 10 million UAE dirhams or its equivalent in any foreign currency accepted by ESCA and the relevant capital market;
- e* the issuer must appoint a UAE licensed bank to act as the paying agent in the UAE;
- f* the obligor must provide a prospectus (prepared in accordance with the guidelines in the Sukuk Regulations) for a primary listing of a *sukuk*;
- g* the obligor must comply with detailed continuing obligations in connection with a listed *sukuk*, including notifying ESCA and the relevant market of any information that may be expected to materially affect market activity, the price of the listed *sukuk*, or the ability of the obligor or issuer to meet its commitments under the *sukuk*; and
- h* ESCA shall respond to any application for the listing of a *sukuk* within five business days. If no response is received in this time frame, the application shall be considered rejected. ESCA shall have the right to attach any conditions, to any listing approval, that it deems necessary to protect the public interest.

ESCA's Board of Directors Decision No. 20 of 2018 Concerning the Offering or Issuance of Islamic Securities (the Offering Regulations) also imposes various obligations in relation to the issuance or offering of any *shariah*-compliant securities in the UAE (including by foreign entities) or outside the UAE by UAE-based issuers. In particular, the Offering Regulations set out the minimum information that an issuer wishing to offer or issue an Islamic security inside or outside the UAE (as well as a foreign issuer wishing to offer an Islamic security in the UAE) will have to incorporate in the offering document or prospectus and the information that must be disclosed to ESCA and the market in connection with such an issuance or offering.

Takaful insurance

The growth in *takaful* is far outstripping that of conventional insurance. In the wider Middle East, the *takaful* market segment is growing by 20 per cent a year. Currently, there are more than 60 *takaful* companies operating in 23 countries worldwide, generating *takaful* premiums estimated to be in excess of US\$2 billion.

Under Federal Law No. 6 of 2007 regarding the Establishment of the Insurance Authority and Organisation of its Operations (the Insurance Law), the UAE Insurance Authority (the Insurance Authority) was appointed as the regulator for the insurance industry in the UAE (outside the free zones), including *takaful* insurance, and tasked with promoting the role of the insurance industry to indemnify persons, property and liabilities against risks to ultimately protect the national economy; to accumulate and grow national savings and invest them to support economic development in the UAE; to encourage fair and effective competition; to provide the best insurance services with appropriate coverage at a affordable rates; and to achieve job emiratization (i.e., job creation for Emiratis) in the UAE insurance market.

Takaful insurance companies are required to comply with the provisions of the Insurance Law, and the *takaful* regulations (below) must be read in conjunction with the Insurance Law.

The Insurance Authority issued Board of Directors Resolution No. 4 of 2010 concerning the Takaful Insurance Regulations, which outlined rules designed to regulate the work of *takaful* insurance companies and can be summarised as follows:

- a* All insurance and investment transactions by the *takaful* insurance company must be compliant with the provisions of *shariah*. Pursuant to the 2010 Regulations, all premiums should be invested in accordance with *shariah*. We are not aware of any instance where this is not the case. We are not aware of *takaful* companies investing *takaful* funds with conventional insurers or using conventional insurers for reinsurance purposes.
- b* *Takaful* products may not be offered through an ‘Islamic window’ of a conventional insurance company.
- c* Risk management operations and investment business shall be conducted by the company on *wakalah* or *wakalah* and *mudarabah* together.
- d* Family *takaful* insurance and general insurance may not be combined in one *takaful* insurance company. The existing *takaful* insurance companies currently engaged in both types were given a specific deadline to adjust their positions.
- e* The insurance company is committed to provide a *qard hasan* to the participants’ fund in the event of a deficit in the assets of this fund.
- f* The maximum amount of *qard hasan* is the sum of the shareholders’ equity.
- g* The amount of *wakalah* fees and how it is calculated, as well as the *takaful* insurance company’s share of *mudarabah*, must be stated in advance.
- h* An SSB must be formed in each *takaful* insurance company.
- i* The Supreme Committee for Fatwa and Sharia Oversight was formed within the Insurance Authority.
- j* It is necessary to appoint a *shariah* controller within each *takaful* insurance company.

The Insurance Authority’s Board of Directors’ Decision No. 26 of 2014 Pertinent to Financial Regulations for Takaful Insurance Companies (the 2014 Regulations), which was largely inspired by the EU’s Solvency II standards, outlined various financial standards required for *takaful* insurance companies, including the following:

- a* The introduction of solvency margins and a guarantee fund. The previous minimum capital requirements (MCR) of 100 million and 250 million UAE dirhams, required for insurers and reinsurers respectively, have been supplemented with the following capital requirements:
- a minimum guarantee fund (MGF), comprising an amount that is the higher of (1) not less than one-third of the solvency capital requirement (SCR); or (2) the higher of a minimum amount to be specified by the Insurance Authority for each type of business and a specified percentage of the net earned premium for each type of business; and
 - an SCR, which is a risk-based capital calculation that utilises the solvency template published by the Insurance Authority. The SCR introduces, for the first time in the UAE, a risk-based capital component for insurers.
- b* The requirement for *takaful* operators to maintain the higher of the MCR, the MGF and the SCR. In practice, it is likely that the MCR will remain the key requirement for much of the *takaful* industry given the relative youth and lack of scale of the *takaful* operators in the UAE.
- c* The basis for calculating the financial provisions required by *takaful* insurance companies to meet their obligations towards participants and their beneficiaries, including unearned contribution reserves, outstanding loss reserves and unexpired risk reserves (all as defined in the 2014 Regulations);
- d* A determination as to the *takaful* operator's assets that meet the accrued insurance policies. The *takaful* operator must develop investment and risk management policies, including strict limitations on each class of asset that may be held by a single counterparty, to address concentration risk. For example, maximum limits set by law include (1) a 30 per cent limit on real estate assets; (2) a 30 per cent limit on equities – only one-third of this may be invested in a particular class of assets; and (3) a 20 per cent limit on mutual fund investment – only half of this may be invested in a particular asset class;
- e* The accounting standards to be adopted by *takaful* operators.
- f* The records and documents to be maintained by *takaful* operators, which shall be made available to the Insurance Authority upon request.

While the above developments will enhance consumer protection, they will also cause some hardship for *takaful* operators, particularly for the smaller operators who may find it difficult to meet the extensive reporting requirements and limitations on the types of assets in which they may invest. It is expected that these requirements will encourage smaller *takaful* operators to merge and consolidate their business, to manage the new solvency and reporting requirements.

Investment funds

The vast majority of funds (including Islamic investment funds) marketed in the UAE (whether to retail customers, high net worth individuals or institutional investors) are organised offshore and the number of onshore funds is extremely low.

There are no laws in the UAE that deal specifically with Islamic investment funds. Therefore, the legal and regulatory regime applicable to investments in general will also apply to Islamic investment funds.

The principal financial services regulator in the UAE is the UAE Central Bank. Important UAE legislation applicable to investment funds includes:

- a* the Banking Law;
- b* UAE Central Bank Resolution 164/A/94 (regarding the regulation of financial companies and banking, and financial and investment consultation establishments or companies);
- c* UAE Central Bank Resolution 89/3/2000 (regarding amendment to regulation of investment companies and banking and financial investment consultation establishment of companies);
- d* UAE Central Bank Resolution 58/3/96 (regarding the regulation of finance companies);
- e* UAE Central Bank Resolution 21/2/88 (regarding the system of investment banks in the state);
- f* ESCA Resolution 3 of 2000 (concerning regulations on disclosure and transparency);
- g* ESCA Resolution 4 of 2000 (concerning the Emirates securities and commodities authority and market);
- h* ESCA Resolution 48 of 2008 (concerning financial advice and analysis); and
- i* ESCA Board of Directors Decision No. 9 of 2016 (concerning the regulation of mutual funds) (the Investment Funds Regulation).

The Investment Funds Regulation further confirmed the transfer from the UAE Central Bank to ESCA of responsibility for the licensing and marketing of mutual funds (including any Islamic investment funds), which are defined as financial pools engaged in the activity of accumulating investors' assets for the purpose of investment against the issue of fund units of equal value, and a number of related activities. ESCA approval is required for the sale, marketing and promotion of foreign securities and funds in the UAE and the establishment of domestic funds. In particular, the Investment Funds Regulation provides that:

- a* all foreign mutual funds (which are the most common type of investment fund in the UAE) must be approved by ESCA to be marketed in the UAE. The fact that a foreign fund may only be offered to institutional investors does not provide an exemption from the requirement to obtain ESCA approval;
- b* a foreign mutual fund may not be marketed to the public in the UAE unless the foreign fund is (1) subject to the supervision of an authority equivalent to ESCA in its jurisdiction of incorporation and (2) authorised to make offers to the public in its jurisdiction of incorporation;
- c* all approved foreign mutual funds, whether public or private, must be promoted by a local promoter, which includes (1) banks and investment companies licensed by the UAE Central Bank and (2) companies licensed to be local promoters by ESCA. The local promoter will act as an intermediary between the foreign fund and the persons to whom units in the fund are promoted in the UAE. The local promoter will also be responsible for a broad range of issues, including:
 - continuous monitoring of the operations of funds to safeguard the investment of the unitholders;
 - keeping records of the units distributed by the fund;
 - providing subscribers with copies of the foreign fund's offering document;
 - ensuring timely disclosure of material information and financial statements relating to the foreign fund to investors in the UAE; and

- distributing dividends and redemption proceeds to the unit holders in accordance with the foreign fund's documents; and
- d* an entity establishing a local fund must be a UAE joint-stock company or a UAE branch of a foreign company. The company or branch must have a minimum capital of 5 million UAE dirhams.

The investment policy of the investment fund must specify, among other things, proposed investment instruments, investment risks relevant to the proposed investment instruments, restrictions on types of investments and borrowing controls. The Investment Funds Regulation also prescribes certain restrictions on investment of the fund's assets, in line with the investment nature of the fund, covering:

- a* investment in tradable securities (stocks, bonds and cash instruments) or high liquid non-tradable securities;
- b* financial derivatives on tradable securities to control the level of risk set out in the fund's prospectus or for hedging in an amount not greater than the total net asset value and subject to disclosure;
- c* declared indexes or bank deposits to ensure liquidity with a maximum maturity of 12 months with licensed banks;
- d* open-ended mutual funds, subject to determining the investment ratio (such funds must be licensed by an entity similar to ESCA); and
- e* immovable assets of high liquidity.

Any application for a licence from ESCA for either the establishment of a fund or the establishment of a local promoter company requires the submission of a letter of application, various constitutional documents from the applicant and a business plan of some sort. The exact documents are not prescribed by the relevant authority; rather, the normal practice is for ESCA to notify the applicant of such additional documents as it might require on an ad hoc basis. ESCA requires an applicant seeking approval for promotion of a foreign mutual fund to submit the fund's key information, an undertaking from the local promoter, a signed promotion agreement, the fund offering document and the constitutional documents, and the applicant's previous two years' audited financial statements (although additional documents may be requested).

ii Regulatory and supervisory authorities

While the authorities identified in Section I.i have the power to regulate the provision of financial services in and from the UAE, in practice, day-to-day *shariah* supervision and compliance is still left to the individual Islamic financial institution. Currently in the UAE, *shariah* compliance is achieved in various ways, including by way of adopting national regulation, voluntary *shariah*-compliant standards and *fatawa*, and directives and resolutions of the Islamic financial institution's internal *shariah* committee. However, it is anticipated that the decisions and regulations issued by the Higher Authority will soon become the dominant authority in the regulatory regime governing Islamic financial institutions.

Previously, the adherence to the voluntary standards issued by standard setting bodies such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board varied among individual Islamic banks and financial institutions in the UAE. However, this has changed following the recommendation by the higher *shariah* authority (now the Higher Authority) that all banks and financial

institutions offering *shariah*-compliant products in the UAE comply with the requirements of the AAOIFI's standards with effect from 1 September 2018. For now, Islamic financial institutions continue to seek guidance from their internal *shariah* committee; this can be problematic when arranging syndicates of Islamic banks or financial institutions, as there may be differences of opinion between the different committees on the application of *shariah* principles to the financing structure.

In determining whether an Islamic financial instrument is *shariah*-compliant, the *shariah* scholars generally adhere to the following process:

- a* review the product concept description created by the product development team;
- b* review the market conditions identified by the product development team;
- c* review the product development team's views on the Islamic principles on which the transactions will be based; and
- d* review the product development team's proposals and issue *fatawa*.

The scholars' resulting *fatwa* is then reviewed by the product development team and can be followed by a discussion between the scholars and the product development team to finalise the product. The need for a constant dialogue between the product development team and the scholars throughout this process should be stressed. In line with the majority of countries where *shariah*-compliant financial services are offered, each financial institution in the UAE has its own *shariah* committee, making individual decisions for the institution. It remains to be seen whether the establishment of the Higher Authority will ultimately result in the UAE becoming the latest country to adopt a fully centralised *shariah* compliance regime, like those in place in other jurisdictions, such as Malaysia and Sudan, where *shariah* compliance is centralised within the central bank.

Originally pioneered by the Malaysian Central Bank (Bank Negara Malaysia), other central banks (e.g., in Oman, Nigeria and Pakistan) have more recently established a centralised SSB within their central bank or financial regulator. The central SSB is responsible for the approval of all *shariah*-compliant financial transaction structures in the country. The responsibility of the SSB of the individual financial institutions is to ensure the transactions undertaken by the institution are compliant with these rules. Any amendments requested by individual institutions will have to be presented to the central SSB for ratification. The centralised SSB and Bank Negara Malaysia maintain a register of approved scholars. Scholars cannot be a member of more than one board per type of financial institution. As a result, a scholar could, for example, be a member of the SSB of a retail bank and an investment bank, but not of two retail banks.

II COMMON STRUCTURES

i Consumer finance

Islamic banks provide a comprehensive range of core consumer banking services similar to those offered by their conventional counterparts, in particular:

- a* Islamic banks accept deposits into current accounts for safe custody of their funds, as well as convenience and use. The bank may levy a charge for providing this service. These deposits are not subject to any conditions on drawing or depositing. The bank may use such deposits at its own risk and responsibility in respect of profit or loss.
- b* Savings accounts are operated similarly to current accounts. However, customers may be restricted as to the frequency with which they can withdraw their funds or may be

required to give notice to the bank and observe a notice period prior to the withdrawal. The bank, at its discretion, may reward its customers with a profit-share generated from their deposits at the end of its financial year.

- c Islamic banks open investment accounts into which they accept deposits from customers seeking investment opportunities for their funds using the *mudarabah* contract. Deposits are held for a specified period. While the profits generated by the bank from the investment of the funds are shared between both the bank and the customer, according to a predetermined ratio, any losses must be borne by the customer, unless the loss was attributed to any fault by the bank.
- d Islamic banks are unlikely to give an overdraft facility to their customers since they will not charge interest for such a service. Instead, the bank may give a *qard hasan* to customers in cases of hardship to enable them to meet certain obligations.
- e To provide trade finance facilities, the Islamic bank uses either the conventional letter of credit or the *murabahah* contract. In practice, Islamic banks tend to open a letter of credit only for customers who have an equivalent credit balance with the bank and in return for a fee. The Islamic bank is likely to use the *murabahah* contract for trade financing where the customer does not have adequate credit with the bank. As mentioned, under a *murabahah* contract, the bank earns its return from the markup profit.

ii Home finance

For the acquisition of completed properties an Islamic bank will generally provide funding by using the *murabahah* structure. However, for properties under construction, banks generally use the *istisnah* and forward *ijarah* structure.

For a *murabahah* financing the bank will (1) acquire title to the asset from a third party and (2) transfer title to the customer (subject to a mortgage over the land or flat, etc.).

Under an *ijarah* financing, once the asset is completed the title will first pass to the customer and then (following entry into the *ijarah* financing) pass to the bank. Once the lease term is completed, the title should revert to the customer (assuming that the customer has complied with its obligations under the *ijarah*).

iii Insurance

The participants jointly donate funds (on a *tabarru'* basis) to a pool for the purpose of providing mutual indemnity and protection to the participants exposed to defined risks under the *takaful* policy. The *takaful* contract is a combination of, on one hand, *tabarru'* (donation) and *dhaman* (indemnity) contracts between the individual insured and the pool of insured (policyholders) as represented by the *takaful* and, on the other hand, agency (*wakalah*) or profit-sharing (*mudarabah*) contracts between the insured and the *takaful* operator.

iv Project finance

Many investors get together to become shareholders in large financial projects through the mechanism of the *mudarabah*. The Islamic bank's role in these funds is to act as the *mudarib* and to use these funds to finance a large project. This *mudarabah* fund can be utilised by the bank in conducting its business using any of the Islamic contracts, such as *murabahah*, *ijarah*, *salam* or *istisnah*.

v Asset finance

Islamic banks finance acquisition of assets by using the *ijarah* contract and the *ijarah wa iqtina* for longer-term assets. This technique is particularly popular for vessel financing by Islamic banks. The title to the asset will pass from the customer to the bank. The asset will be leased back to the customer for the term of the lease. At the end of the lease period, the title to the asset will revert to the customer.

vi Investment funds

The Islamic structure used for a fund will depend on the underlying objectives of the fund. Fixed-income funds usually invest in *murabahah* (commonly commodity *murabahah*), *sukuk* and *ijarah*, with the investors investing their funds with *mudarib* using a *mudarabah* or *wakalah* contract (which governs the relationship between the investors and the *mudarib*). The *ijarah* fund structure is favoured as it can generate higher returns.

III TAXATION

Legislation establishing a general corporate income tax regime is currently in force in the UAE. The regime is, however, only applicable to companies active in the hydrocarbon industry and branches of foreign banks operating in the wider UAE. Under current legislation, there is no requirement for withholding or deducting for or on account of UAE taxation in respect of payments of accrued return or principal on investments.

The Constitution of the UAE specifically reserves to the federal government of the UAE the right to raise taxes (such as VAT) on a federal basis, for the purposes of funding its budget. It is not clear how or if such taxes will affect Islamic finance agreements or institutions. This will only become clear once the relevant laws are passed.

IV INSOLVENCY

There is no separate insolvency regime for Islamic finance participants in the UAE.

V JUDICIAL FRAMEWORK

i Courts

Although the UAE has *shariah* courts, these courts only deal with family law-related issues, including marriage, divorce and intestacy. Any commercial disputes in the UAE (including Islamic finance disputes) are resolved through litigation in the UAE civil courts or arbitration. Consequently, should a commercial dispute be brought before a UAE court, the court is unlikely to apply a different treatment to the dispute solely on account of the transaction being *shariah*-compliant. The dispute will be subject to the same processes and procedures as a conventional financing counterpart. The courts will also apply the laws of the UAE in determining the case. Furthermore, if a document purports to be governed by *shariah* law, courts will likely disregard this choice of law and will instead apply the applicable UAE laws.

The UAE is a federation of seven emirates. All member emirates, except Dubai and Ras al-Khaimah, are part of a federal judicial system; Dubai and Ras al-Khaimah have

independent judicial systems. In every emirate, the court system consists of the Court of First Instance, the Court of Appeal and the Court of Cassation (Ras al-Khaimah, however, does not have a Court of Cassation).

Commercial disputes in the UAE (including Islamic finance disputes) are generally resolved through litigation in the UAE civil courts or arbitration. It is common for UAE banks and financial institutions to choose UAE law (or the law of a particular emirate) as the governing law of the transaction documents and the UAE courts as having exclusive jurisdiction over all related disputes.

The UAE operates under a civil law system. The civil court (or Court of First Instance) hears all claims ranging from commercial matters (including debt recovery cases) to maritime disputes. After judgment has been delivered, the parties have the right to appeal to the Civil Court of Appeal on factual or legal grounds, or both, within 30 days of the date of judgment. It is possible to introduce additional evidence to the Court of Appeal and request that additional witnesses be called to testify. Thereafter, parties may appeal on points of law alone to the Court of Cassation (the highest court in Dubai), which is usually composed of five judges. The appeal must be filed within 30 days of the date the parties were notified of the judgment of the Court of Appeal. All decisions of the Court of Cassation are final and are not subject to appeal.

Each case is decided on its own merits and facts. All court proceedings are in Arabic. All non-Arabic documents filed in court by the litigants must be translated into Arabic by a translator licensed by the Ministry of Justice. The judicial system in the UAE is essentially inquisitorial in nature. In each case, the judge will investigate the facts and apply the law to the facts in reaching his or her judgment. There is no concept of a jury trial.

All proceedings in UAE civil matters are based on the written pleadings of the parties, supported by documentary evidence. In general, there is no oral hearing in civil cases. There is a widespread practice for both the federal and the Dubai courts to refer matters to court-appointed experts for findings of fact in a variety of areas, including finance, accounting and other technical matters. Experts' reports (including reports from *shariah* scholars) are not binding and can be challenged by the parties, but they are usually considered persuasive by the courts. Oral evidence can only be given to establish a fact in a civil case with the permission of the court and the right to cross-examine witnesses is severely restricted.

The UAE courts do not adhere to the traditional common law standards of proof such as the balance-of-probability test in civil claims or the beyond-all-reasonable-doubt test in criminal matters. The final decision in any case is at the discretion of the judge or judges hearing the case.

All commercial cases are heard by the civil courts, usually consisting of three judges in the Court of First Instance, three judges in the Court of Appeal and five judges in the Court of Cassation.

These judges may not have specialist knowledge of commercial matters. However, commercial disputes must first be referred to a Reconciliation and Settlement Committee (the Committee), appointed by the Ministry of Justice (Federal Law No. 26 of 1999 regarding establishing reconciliation committees in the Federal Courts (the Reconciliation Committee Law)). The Committee facilitates settlement and usually hears parties in person. If a claim cannot be settled, the claimant can file a claim in the Court of First Instance. If the parties reach a settlement, they record and sign its terms. This agreement is binding and enforceable.

This procedure does not apply in Dubai or Ras al-Khaimah. Dubai recently passed a law creating the Centre for Amicable Settlement of Disputes, to which certain cases must be referred before initiating court action.

To maintain the legal enforceability of an agreement, it is advisable for all the elements necessary for *shariah* compliance purposes to be incorporated into the agreement itself. Under the UAE Civil Code, where the intention of the parties is clear from the language of the contract, the courts will not imply any further meaning or additional terms to the contrary. Save in the cases where the contract was unclear and the provisions of the law and customary practice are silent on an issue, the UAE courts are unlikely to examine the *shariah* aspects of a document.

In addition to the civil courts, the parties may choose to resolve a dispute through the International Islamic Centre for Reconciliation and Commercial Arbitration (IICRCA). The IICRCA is a dispute resolution forum for the Islamic finance industry, based in Dubai. The IICRCA was established for the purpose of assisting in resolving financial and commercial disputes that may arise between financial and commercial institutions or between such institutions and their clients or third parties through reconciliation or arbitration in accordance with the principles and rules of the Islamic *shariah*. The IICRCA handles commercial disputes in the Islamic financial industry from across the GCC as well as Malaysia. The agreement of the parties is required for the IICRCA to have jurisdiction. The IICRCA is not commonly used.

There are other regional arbitration centres, in Sharjah and Ras al-Khaimah, such as Sharjah International Commercial Arbitration Centre and Ras al-Khaimah Centre of Reconciliation and Commercial Arbitration. These arbitration centres are not commonly used.

ii Cases

We are not aware of any significant case law regarding the interpretation of Islamic financial products. Furthermore, note that the UAE does not follow the principle of *stare decisis* and judgments of the UAE courts are not always published.

VI OUTLOOK

i Higher Authority

The Higher Authority has taken major steps in developing the Islamic finance industry in the UAE, such as recommending that all banks and financial institutions offering *shariah*-compliant products in the UAE comply with the requirements of the AAOIFI standards with effect from 1 September 2018. Existing products and services will also have to be revised to comply with the AAOIFI standards. This is a key development and provides consistency and uniformity in the cross-border approach to offering *shariah*-compliant products and services and will bring the UAE in line with other countries in the region, such as Bahrain and Jordan, where financial products and services also adhere to the AAOIFI standards.

It is also hoped that establishing a centralised *shariah* regulator such as the Higher Authority will help to address the ongoing controversy surrounding ‘*fatwa* shopping’ in the UAE (i.e., the practice by financial institutions of approaching multiple *shariah* scholars to review their proposed financial products and choosing the *shariah* scholar who offers the most favourable *fatwa*).

ii Investment regulations

In 2015, ESCA's research department circulated draft regulations for (1) private equity funds, (2) real estate investment funds, and (3) investment funds. These draft regulations detailed rules and procedures on a variety of issues relating to the particular types of fund, including the offering, operating and management of such funds in and from the UAE. However, following the issuing of the less detailed Investment Funds Regulation, it is no longer clear whether ESCA still intends to proceed with the above draft regulations.

UNITED KINGDOM

*John Dewar and Munib Hussain*¹

I LEGISLATIVE AND REGULATORY FRAMEWORK

i Legislative and regulatory regime

Islamic finance has been developing rapidly in the UK for over a decade and the government has taken a leading role in legislating for its development and promotion. The UK hosted the first stand-alone Islamic financial institution in the EU and, according to the latest Islamic Finance Country Index (2018), the UK is ranked 17th of 48 countries in terms of its overall Islamic finance offering. This puts it in first place in Europe and in first place among non-Muslim-majority nations. The UK has a strong and proud tradition of openness and flexibility, which, combined with London's position as a leading international financial centre and the UK's significant Muslim population (just over 5 per cent of the UK population according to the 2011 census), provides a strong foundation for growth. As a result of its standing, London has long been perceived as the Western hub for Islamic finance.

Rather than regulating Islamic finance products with separate legislation, the UK's approach has been to adapt pre-existing legislation and regulations governing conventional financial instruments to cater for the structures commonly used in Islamic finance. In so doing, the UK's approach has been to ensure a level playing field for Islamic finance products and conventional instruments, and so the UK has proactively monitored and responded to any unequal treatment between the two by introducing remedial legislation and regulations. For example, as early as 2003, the government introduced special exemptions to stamp duty land tax to relieve the unintended double taxation charge that arose as a result of structures used by Islamic mortgages and was also quick to remedy the adverse tax treatment of *sukuk* to place them on a level playing field with conventional debt instruments. This approach leaves the application of Islamic principles as a matter of conscience for the parties concerned, reflecting both the lack of a single codified body of Islamic law and the fact that there are differences of opinion among scholars as to how Islamic principles should be applied to modern-day financial instruments. As discussed in more detail below, the English courts have taken an approach consistent with this in considering only English law (to the extent that this is the governing law of the relevant contracts) when ruling on disputes involving Islamic finance transactions.

The primary legislation that governs Islamic finance in the UK is set out in the Finance Act 2005 as amended by the Finance Act 2007. The Finance Act 2005 characterises Islamic finance transactions as 'alternative finance arrangements' and takes a relatively straightforward approach to folding Islamic finance instruments into the conventional legislative

¹ John Dewar is a partner and Munib Hussain is a senior associate at Milbank LLP.

environment. For example, anything described in an Islamic finance instrument as ‘profit’ will be treated in the same manner as the provisions of previous Finance Acts that deal with ‘interest’; this is particularly important when considering the tax treatment of Islamic finance instruments. Further, given that the Finance Act 2005 was generally aimed at bank financing with a specific focus on consumer financing, particularly Islamic mortgages, the Finance Act 2007 expanded the scope of the Finance Act 2005 to include *sukuk* (defined as alternative finance investment bonds (Section 53, Finance Act 2007)) with the intention to pave the way for the inaugural *sukuk* issuance by the UK government (discussed in more detail below) by responding to the anomaly created by previously not providing for tax deductibility of profit distributions under a *sukuk*, making it a more expensive way to raise finance when compared to a conventional bond with tax-deductible interest payments.

Prior to the introduction of the Finance Act 2007, an issue that arose in connection with a potential *sukuk* issuance by a UK issuer was whether, for the purposes of the Financial Services and Markets Act 2000 (FSMA), a *sukuk* would be considered to be the equivalent of a conventional bond or of a collective investment scheme (CIS). The issue arose because *sukuk* contemplate the investment by the issuer of the issue proceeds received from *sukuk* holders in certain assets – these are all features of a CIS. Market practitioners had long taken the view that a *sukuk* should be treated in the same manner as a conventional bond (with the investment in the assets being in satisfaction of *shariah* (not investor) requirements), but for such treatment to be given in the UK, an assessment would have to be made by the regulator in respect of each individual case – this was clearly not a practical solution. The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2010 (the 2010 Order) introduced a number of amendments to clear up this issue and to confirm that *sukuk* should be regulated in the same manner as conventional bonds. The 2010 Order amended the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 to specifically state that alternative finance investment bonds are to be categorised as ‘specified investments’ in the same manner as financial instruments that create or acknowledge indebtedness. The 2010 Order also amended the Schedule to the Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001 to specifically exclude alternative finance investment bonds from the definition of CIS and introduced a new Section 77A, which created a definition of alternative finance investment bonds. This definition is consistent with that set out in the Finance Act 2007.

Notably, the 2010 Order made a number of consequential amendments to other legislation and regulations, including the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, the Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) Order 2001 and the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005. These amendments extend the scope of those regulations to include alternative finance investment bonds. The amendments illustrate a consistent approach taken by successive UK governments in treating Islamic finance as a subset of the universe of conventional financial instruments. This approach indicates that the Islamic finance industry will be held to the same standards as the conventional finance industry in the UK and contracting parties should expect to be subject to the same levels of scrutiny from the English regulators and courts as their conventional peers.

ii Regulatory and supervisory authorities

The two principal authorities charged with the oversight of Islamic finance institutions (to the extent that such institutions perform ‘regulated activities’) are the Financial Conduct Authority (FCA) and the Prudential Regulatory Authority (PRA). The FCA is the conduct regulator with supervisory responsibility for Islamic finance in the UK, and all Islamic banks in the UK are required to be authorised and licensed by the FCA. The PRA holds responsibility for the prudential regulation of banks, building societies, credit unions, insurers and major investment firms – including Islamic banks in the UK. The FCA and the PRA each hold Islamic banks and financial institutions to the same standards of regulation as conventional banks, and Islamic banks in the UK are considered to be ‘financial institutions’ for the purposes of the FSMA. Islamic banks are subject to sanctions and fines in the same manner as conventional banks. The FCA’s and the PRA’s approach to regulation can be summed up as ‘no obstacles, but no special favours’.

Unlike certain other regulatory authorities, such as Malaysia’s, the FCA does not have *shariah* scholars who review the *shariah* compliance of a product offered by an Islamic finance institution. Consistent with the UK approach of treating Islamic finance institutions in the same way as conventional firms, the Islamic finance institution would require authorisation to carry on regulated activities and obtain the necessary permissions from the FCA in the ordinary way. However, an Islamic finance institution may have to provide additional information to the FCA in certain circumstances, such as the role, if any, that its *shariah* board performs in relation to operational and financial matters. In addition, UK regulatory bodies have stated that they intend to work with international industry bodies, such as the International Organization of Securities Commissions, which have their own Islamic finance initiatives. The UK’s Financial Services Authority (which was the sole UK regulator prior to its split into the FCA and the PRA) also supported moves to develop common *shariah* standards by organisations such as the Islamic Financial Services Board and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). While neither of these standards have been formally adopted in the UK (and therefore do not have any binding legal effect), they are certainly useful in identifying best practice.

Finally, it is worth noting that financial transactions entered into with an individual and not otherwise subject to regulation under FSMA may be subject to regulation under the Consumer Credit Act (CCA) 1974, unless that agreement is entered into wholly or predominantly for business purposes, or one of the other exemptions under the CCA 2006 applies.

II COMMON STRUCTURES

i Consumer finance

Shariah-compliant consumer finance providers in the UK currently occupy a niche space advancing funds to customers in the form of simple *murabahah* financing and offering deposit investments in the form of profit-sharing investment accounts based on the principle of *wakalah*. Prominent consumer finance banks in the UK include Gatehouse Bank, the Bank of London and the Middle East as well as branches of some well-known Middle Eastern banks, such as Abu Dhabi Islamic Bank, Al Rayan Bank and QIB UK.

An interesting recent development in Islamic consumer financing has been the establishment in the UK of Beehive, a peer-to-peer financing platform that includes a *shariah*-compliant window. Beehive’s *shariah*-compliant window uses commodity *murabahah*

financing backed by the Dubai Multi Commodities Centre's Tradeflow commodities trading platform, based in the Dubai International Financial Centre (DIFC). If an investor wishes to invest in *shariah*-compliant transactions only, it can indicate that preference in its profile.

Beehive uses the Shariyah Review Bureau, which is licensed by the Central Bank of Bahrain, as its *shariah* board to review potential opportunities for investment. Any investments that are not approved as *shariah*-compliant by Beehive's *shariah* board are not made available to the Islamic investor – these are made available only to conventional investors. Assuming an investment is *shariah*-compliant, Islamic investors may place bids on the Beehive platform to enter into a financing with the end user in much the same manner as a conventional peer-to-peer lending platform. If successful in its bid, the Islamic investor then enters into a *murabahah* contract with that counterparty.

ii Home finance

The primary structures used in home finance in the UK are *ijarah* and an *ijarah* with diminishing *musharakah* structure, which contain many of the features of a conventional repayment mortgage. Under the terms of an *ijarah* mortgage, the bank purchases the property (with title in and to the property registered in the name of the bank) and leases it to the homeowner for a specified period. The homeowner gives an undertaking that, at the end of the specified period, it will purchase the property from the bank using the final lease payment, following which legal title is transferred to the homeowner and title in and to the property is registered in the name of the homeowner. Under the terms of an *ijarah* with diminishing *musharakah* structure, the bank and the homeowner together purchase the property in proportion to the capital put forward by each of them. However, title in and to the property is registered solely in the name of the bank. The homeowner pays the bank rent for the use of that part of the property that is owned by the bank under the terms of the *musharakah*. The homeowner also makes periodic payments to the bank to purchase its remaining interests in the *musharakah* such that the bank's interest diminishes until the homeowner is the sole owner of the property. Once the homeowner has purchased all the bank's interests in the *musharakah* (and thus is the sole owner of the property), title in and to the property is registered in the name of the homeowner and the mortgage terminates.

Islamic banks in the UK also offer rent-only *ijarah* mortgage packages that contain features similar to a conventional 'interest-only' mortgage. In this scenario, the homeowner pays the bank rent for that portion of the property owned by the Islamic bank through the *musharakah* term. At the end of the *musharakah* term, the homeowner is obliged to purchase all the bank's interests in the *musharakah* in one go.

Much of the growth in the *shariah*-compliant home finance market was facilitated by an amendment to the tax laws in the UK in 2003 that removed what had previously been a double charge to stamp duty land tax: once at the date of the joint purchase of the property by the bank and the homeowner (and registration of title in the name of the bank) and a second at the date of the purchase by the homeowner of all the bank's interest in the *musharakah* (and registration of title in the name of the homeowner). This change in tax law is discussed in Section III.

iii Insurance

Insurance companies in the UK offer *takaful* products to Muslim customers using structures typical to the *takaful* market. As with many other facets of Islamic finance, London is seeking to become a hub of *takaful* and the Islamic Insurance Association of London (IIAL) was launched in July 2015 with the aim of promoting that goal. Lloyd's of London is a founding member of the IIAL and launched an office in the DIFC in March 2015.

Friendly societies and other mutual insurance companies are potential vehicles that could be adapted to provide *takaful*. Friendly societies in particular have an affinity with *shariah* principles because all contributions to a friendly society are made voluntarily. Friendly societies have evolved in different ways over the years. Since 1992, most have taken advantage of the ability to incorporate, which allows them to undertake a defined range of activities. There would be significant challenges in establishing a new *shariah*-compliant friendly society since, to be authorised by the Financial Services Authority to carry on regulated activities in the UK, the friendly society would require significant amounts of regulatory capital. As a mutual institution, a friendly society does not have shareholders that might provide that capital. On the contrary, Section 5(2)(b)(i) of the Friendly Societies Act 1992 provides, in effect, that only members (or persons connected with members) can receive benefits from the society and the converse of this is also generally held to be true, namely that a person cannot be a member of a friendly society unless he or she (or a person connected) receives insurance or similar benefits from the society.

iv Private equity investments

The leverage that private equity funds obtain in connection with investments normally presents an insurmountable barrier to entry for Islamic investors who, as a result, are unable to invest in conventional private equity funds. Fully *shariah*-compliant funds require tight restrictions on debt and the appointment of a full-time *shariah* supervisory board to approve individual investments, and they are expensive to establish. The demand does not appear to have been sufficiently high to make overcoming these obstacles economically viable and, as a result, the Islamic private equity space has not grown with any conviction. Opportunities exist in the synthetic feeder fund space in relation to specific identifiable investments, but this is yet to become a significant tool in the UK private equity market.

v Real estate investments

UK real estate is one of the most popular asset classes for both international and domestic Islamic investors. Local players, Gatehouse Bank and 90 North Square, have offered *shariah*-compliant real estate investment products to Islamic investors for a number of years.

In February 2018, independent real estate investment adviser 90 North Group – Real Estate Partners completed the sale of Lenovo's headquarters campus in the United States for US\$135.3 million. The buyer was Bahrain Mumtalakat Holding Company, Bahrain's sovereign wealth fund, in partnership with Sentinel Real Estate Corporation. The sale was executed by 90 North Group in conjunction with its partner Dubai-based Arzan Wealth.

Real estate investments typically apply a *wakalah*, *mudarabah* or *musharakah* structure to invest in an underlying portfolio of real estate assets, as well as *shariah*-compliant real estate investment trusts. However, care must be taken around certain *shariah* red flags, including any terms of any underlying leases that may include late payment interest charges. For new assets that are yet to be rented, late payment interest can generally be restructured as a late payment administrative charge – an approach that is common in *shariah* structures. However,

with established assets (especially those held by conventional landlords), late payment interest may be embedded in the contracts and amending such contracts is both impractical and undesirable. In this situation, the documents governing the Islamic investment typically provide that if any *haram* income exceeds a *de minimis* threshold (typically 5 per cent of the total income from the real estate assets) then those amounts should either be directed solely to a conventional co-investor (if there is one) or otherwise to charity.

vi Investment funds

As noted above, the specific requirements of *shariah*-compliant investment funds (such as the requirement for a *shariah* supervisory board), the restrictions on any leverage that may be applied to investments in assets and the need for an annual *shariah* audit have meant that the UK has not seen a high number of *shariah*-compliant investment funds established.

vii Other areas

The UK government became the first sovereign national government outside the Islamic world to issue a *sukuk* with Her Majesty's Treasury's £200 million *sukuk* issuance in June 2014. The *sukuk* was structured as a *sukuk al-ijarah* (being the simplest and most widely accepted Islamic finance structure) and pays out profits based on the rental income from three government-owned properties in lieu of interest. The £200 million sale was more than 10 times oversubscribed by investors in the UK, the Middle East and Asia, attracting orders of £2.3 billion. The interesting aspect of the structure is that it did not adopt the delegate model (the Islamic equivalent of a conventional bond trustee) but opted instead to replicate the structure used for UK government gilts. While a comparatively small issuance by the standards of the UK government, the *sukuk* was intended to act more as a marketing tool for the UK government in its push to promote the UK and London as a centre for Islamic finance.

Following on from that, UK Export Finance participated as guarantor of Emirates Airline's issuance of US\$913,026,000 *sukuk* in March 2015. The proceeds of the *sukuk* issuance were to be used to purchase four new Airbus A380-800 aircraft, which would become the *ijarah* assets. In addition to being the world's first *sukuk* supported by an export credit agency, what was particularly interesting about this transaction was that there was a lead time between the issuance of the *sukuk* and the Airbus aircraft being available for delivery. As a result, for the period between the issue date and the relevant aircraft delivery dates, the proceeds of issuance were invested in what were known as 'rights to travel' on Emirates aircraft. This was an example of the UK government seeking to promote Islamic finance in tandem with the interests of British industry (the wings for the Airbus A380 are manufactured in Filton, near Bristol, and Broughton, in North Wales). It is also another example of alternative assets – the rights to travel – being used to underpin *sukuk* and builds on the success of issuances by Axiata Telecom (which utilised airtime vouchers) and FWU Group (which utilised the intellectual property in computer program source code) of *sukuk* backed by alternative assets.

III TAXATION

Reforms to tax law and regulation have led the way in terms of the accommodation of Islamic finance within the laws of the UK. In 2003, Parliament passed the Finance Act 2003, which introduced the concept of alternative property finance to cure the double charge to stamp duty land tax that had affected the Islamic mortgage market up to that point. Under *ijarah*

and diminishing *musharakah* structures there are effectively two sales of the property being financed: the first when the bank buys the property from the vendor and the second when the homeowner completes repayment of the financing and buys the property back from the bank. Each of these purchase transactions previously gave rise to a charge to stamp duty land tax, which made the Islamic mortgage market prohibitively expensive. The Finance Act 2003 introduced specific exemptions for Islamic mortgages to ensure that they incurred only one charge to stamp duty in the same manner as a conventional mortgage.

The introduction of the various regulations to facilitate *sukuk* issuance in the UK between 2007 and 2010 also gave rise to a need to include changes to tax law on the basis that the most common structure used for *sukuk* (and the one used for the UK government's *sukuk*) is *ijarah* based on property. The Stamp Duty Land Tax (Alternative Finance Investment Bonds) Regulations 2010 fixed a point of confusion by clarifying that the exemption from stamp duty land tax that applies to a transfer of leases as part of an alternative finance income bond structure will not be denied on the basis of other provisions of those regulations that would otherwise deem such a transfer to be a grant for stamp duty land tax purposes (i.e., the exemption is extended to ensure that an *ijarah*-based Islamic finance instrument is treated in the same manner as its conventional equivalent). These regulations are further supplemented by the Alternative Finance Investment Bonds (Stamp Duty Land Tax) (Prescribed Evidence) Regulations 2009, which prescribe the evidence that has to be provided to Her Majesty's Revenue and Customs in relation to claims for relief from stamp duty land tax in these circumstances.

The common purpose of this legislation has been to allow Islamic instruments the same treatment as conventional ones by making a distinction between the transfer of ownership of land for the purposes of occupancy or other use and the transfer of a form of ownership of land that is intended purely to facilitate a *shariah*-compliant transaction.

IV INSOLVENCY

There are various structures that can be adopted for a *sukuk* that may affect how it is classified for insolvency, tax and regulatory purposes. *Sukuk* are, however, typically structured to have the same economic effect as a conventional bond and are treated as such for International Financial Reporting Standards purposes. To date, the treatment of Islamic finance instruments in insolvency remains untested in the UK. Further, no Islamic institution has filed for insolvency or any insolvency-related procedure in the UK, meaning that it is not clear how the English courts would treat any situation of this kind. Whether a *sukuk* is treated as an equity or a debt instrument depends on the structure and the risks and rewards of the *sukuk*. In particular, whether the *sukuk* is asset-based or asset-backed could affect this analysis. Often, it is the case that, from the originator's perspective, the *sukuk* are shown as a financial liability on its balance sheet because it retains control over the issuer entity. From the *sukuk* holders' perspective, the holding would have to be classified into certain categories, such as an instrument held to maturity or a loan and receivable. Legislation now provides that, where certain conditions are satisfied, the return paid to *sukuk* holders is tax-deductible by the issuer, consistent with the treatment afforded to conventional bondholders.

However, it is worth noting that the Financial Services and Markets Act 2000 (Regulated Activities) Order 2010 made certain consequential amendments to legislation necessitated by the inclusion of a new definition of alternative finance investment bonds. These included amendments to the Insolvency Act 1986 to broaden the scope of the definition of 'bond'

to include alternative finance investment bonds. This appears to indicate clearly that the intention of lawmakers in the UK is for *sukuk* to be treated in the same manner as conventional bonds and from that we may extrapolate that in the event of insolvency under English law, *shariah*-compliant instruments would be treated in the same manner as their conventional counterparts. Much of this is based on the economic effect of those instruments as well as their legal form, but it is clear that there is no current intention for a separate insolvency regime to be introduced for *shariah*-compliant instruments.

V JUDICIAL FRAMEWORK

i Courts

As a general comment, *shariah* is not applied in the UK and English law does not recognise *shariah* as a system of law capable of governing a contract, on the basis that English law does not provide for the choice or application of a system of law other than a system of national law. This is based on the Convention on the Law Applicable to Contractual Obligations 1980 (the Rome Convention), which requires that a governing law of an agreement must belong to a country (see below on the *Shamil Bank* case). The English courts have, however, taken the (uncontroversial) view that they have jurisdiction to decide cases involving *shariah*-compliant products and structures that are documented under contracts governed by English law. The main questions that arise are how English courts – being courts in a non-Muslim jurisdiction – will address matters that concern *shariah* compliance and, in particular, how English courts will consider matters of *shariah* law in reaching a judgment.

The *Shamil Bank* case² looked at the question of conflict of laws between English law and *shariah* law. The full facts of the case are not relevant to the discussion on this topic; what is important is the wording of the governing law clause in the agreements that were in dispute. That clause read as follows: ‘Subject to the principles of the Glorious Sharia’a, this Agreement shall be governed by and construed in accordance with the laws of England.’

The defendants advanced a defence that, for the agreements in dispute to be enforceable, the above governing law clause required that they be valid and enforceable both in accordance with the principles of *shariah* and in accordance with English law.

The judge considered whether this gave rise to a conflict of laws point, noting that it is not possible for a contract to be governed by two systems of law. In rejecting the defendants’ claim and deciding that the relevant agreements were not governed by *shariah* law, the judge focused on the Rome Convention, which states at Article 3.1 that a contract ‘shall be governed by *the* law chosen by the parties’ [emphasis added] and which makes clear at Article 1.1 that the reference to the parties’ choice of law to govern a contract is a reference to ‘the law of *a* country’ [emphasis added].

In his ruling, Lord Justice Potter stated that *shariah* is a non-national system of law and agreed with the view of Mr Justice Morison in the original trial that the principles of *shariah* are ‘not simply principles of law but principles which apply to other aspects of life and behaviour’. As is noted in many articles and texts on Islamic finance, *shariah* is not a codified body of law; rather it is a collection of strands of jurisprudence developed by separate schools of Islamic thought, based on each school’s interpretation of the cornerstones of Islam: the Quran, the Sunnah and the Hadith. These interpretations are often not consistent and

2 *Shamil Bank of Bahrain EC v. Beximco Pharmaceuticals Limited and others* [2004] EWCA Civ 19.

sometimes openly contradictory. As such, it is not clear how the reference to ‘Subject to the principles of the Glorious Sharia’a’ should be interpreted by a judge. As noted by Morison J in his original judgment in this case, ‘the application of [*shariah*] principles in relation to matters of commerce and banking were plainly matters of controversy’.

Potter LJ went on to consider whether, instead, the principles of *shariah* had been included in the disputed agreements as a matter of contract. In considering this point, the judge noted that:

The doctrine of incorporation can only sensibly operate where the parties have by the terms of their contract sufficiently identified specific ‘black letter’ provisions of a foreign law or an international code or set of rules apt to be incorporated as terms of the relevant contract such as a particular article or articles of the French Civil Code or the Hague Rules.

Potter LJ again cited the differences of opinion that are such a particular feature of Islamic finance and noted the lack of any specificity as to which aspects of *shariah* were intended to apply to the agreements in dispute. He therefore held that the principles of *shariah* were not ones to be considered by the court and that ‘the validity of the contract and the defendants’ obligations thereunder fall to be decided according to English law’.

The *Shamil Bank* case has therefore set the standard under English law that the English courts will consider disputes under English law-governed *shariah*-compliant contracts as matters of English law to the exclusion of questions of *shariah*.

While speculative, it is worth considering whether the judge may have taken a different view as to the application of *shariah* to the contracts had the parties, as an example, specified that the *shariah* principles codified by the AAOIFI in its Shari’ah Standards should apply. AAOIFI’s Shari’ah Standards represent one of the few attempts to codify *shariah* and is a standard set of principles to which most Islamic financial institutions elect to adhere.

The position in *Shamil Bank* is supported by the earlier *Symphony Gems* case,³ in which Mr Justice Tomlinson stated that ‘it is important to note – indeed, in my judgment, it is absolutely critical to note – that the contract with which I am concerned is governed not by *Shariah* law but by English law’. This case involved some dispute as to whether an agreement that had been labelled a *murabahah* contract was, in fact, a *murabahah* contract and therefore whether or not the agreement was *shariah*-compliant. That question had wider implications for the case but as to the question of how an English court will review an English law agreement (whether or not it is expressed to comply with *shariah*), the judge continued: ‘it seems to me that it is not of any relevance to the issues which I have to decide what are the essential features of a Morabaha [sic] contract . . . it is a contract governed by English law. I must simply construe it according to its terms as an English contract.’

While by no means a weighty corpus of precedent, the fact that there is case law available from the English courts provides comfort to international market participants as to the treatment of Islamic finance contracts that are, for the most part, governed by English law.

ii Cases

As well as the governing law issues considered above, another issue that has been considered by the English courts is whether a claim for ultra vires can be made on the basis that

³ *Islamic Investment Company of the Gulf (Bahamas) Ltd v. Symphony Gems NV & Others* Unreported, 13 February 2002.

a contracting party (who is only permitted to enter into contracts that comply with *shariah*) entered into a contract that purported to be a *shariah*-compliant contract but that may, on its facts, be non-compliant with *shariah*.

The best-known case on this is *Blom Bank*.⁴ The facts of the case are, briefly, that Blom Development Bank SAL (Blom Bank) entered into a *wakalah* contract with The Investment Dar (TID), a Kuwaiti investment company. Under the terms of the *wakalah* agreement, Blom Bank was to be paid a return on its *wakalah* investment that purported to be linked to the profits of the underlying investment (i.e., profit amounts may be lower than anticipated (including zero) and are not guaranteed), but that, according to the terms of the agreement, provided for a fixed return. This meant that rather than taking investment risk, Blom Bank took only insolvency risk on TID. TID is a *shariah*-compliant investment company that is required by its articles to contract only in a manner that is *shariah*-compliant, with those articles stating: ‘None of the objectives shall be construed and interpreted as permitting the company to practice directly or indirectly in any usury or non-*shariah* compliant activities.’ Blom Bank brought a case for summary judgment, seeking the return of the principle amount invested plus all profit accrued. TID argued that the *wakalah* arrangement was not a true *wakalah* arrangement but rather disguised lending at what amounted to an interest rate. Since this was specifically prohibited by TID’s objects, the transaction was ultra vires TID.

What is important to note about this case is that no ruling was made on the question of ultra vires. Instead, the issue was declared to be unsuitable for summary judgment and referred as a matter for trial. What is equally interesting is that the judgment declared that if the contractual claim that Blom Bank had made against TID for payments due to it under the *wakalah* contract failed as a result of the ultra vires defence, a claim in restitution (which Blom Bank added to its appeal in response to the ultra vires argument) was likely to succeed. Blom Bank was awarded summary judgment for the principal amount it invested with the question of ultra vires and whether or not Blom Bank had a claim for its profit left as questions for trial. This was because the question of ultra vires was one for expert determination at trial involving consideration of Kuwaiti law, being the jurisdiction of incorporation of TID. At the time of this case, TID was in considerable financial distress and, having been placed under the protection of the Kuwaiti Financial Stability Law, the case went no further.

What distinguishes the *Blom Bank* case from both the *Shamil Bank* case and the *Symphony Gems* case is the willingness of the court to consider issues of *shariah* compliance in front of an English court, albeit on the limited basis of the consideration of an ultra vires defence. As the *Blom Bank* case went no further, it does not provide a conclusive or even compelling guide as to how the English courts will consider issues of ultra vires and *shariah* compliance. However, one should also bear in mind that the judge was clear that, in his view, were an ultra vires defence to succeed, a claim for restitution would be successful. This may be read to confirm the view that English courts will consider English law-governed Islamic finance contracts as questions of English law only.

This approach was reaffirmed in a recent English High Court case.⁵ Dana Gas (an issuer based in the UAE) attempted to render its *mudarabah sukuk* unenforceable on a number of grounds, one of which was that the *sukuk* were not *shariah*-compliant. Although Dana Gas had sought to bring proceedings to adjudicate on this matter in the Sharjah Federal Court of First Instance, a number of the *sukuk* documents were governed by English law and so Dana

4 *The Investment Dar Company KSCC v. Blom Development Bank SAL* [2009] EWHC 3545 (CH).

5 *Dana Gas PJSC v. Dana Gas Sukuk Ltd & Ors* [2017] EWHC 2928.

Gas also sought and obtained an interim injunction in the English High Court preventing the *sukuk* holders from declaring an event of default or dissolution event in relation to the *sukuk*. In its injunction claim, Dana Gas has referred to the *Ralli Bros* principle, which provides that an English law contract that requires performance of an act that is unlawful in the place of its performance will not be enforced by an English court. On 17 November 2017, the English High Court ruled against Dana Gas on all grounds.

VI OUTLOOK

The UK has been the most prominent non-Muslim jurisdiction that has sought to promote Islamic finance and has taken concrete steps both through legislation and government-led transactions to promote Islamic finance. On its website, the London Stock Exchange (LSE) boasts that over US\$50 billion has been raised through 66 *sukuk* issuances that have been listed on the LSE and such securities can be admitted on either the Main Market, which is a regulated market under the EU Markets in Financial Instruments Directive (2004/39/EC), or the Professional Securities Market, which is a platform reserved for professional investors and is not a regulated market. Further, several *shariah*-compliant institutions are listed on the Alternative Investment Market, enabling the purchase of *shariah*-compliant shares and there are numerous *shariah*-compliant exchange-traded funds based on Islamic indices.

London remains one of the world's premier financial capitals, and is expected to remain as such in a post-Brexit environment, and its expertise in creating complex structured finance products puts it in a strong position to be at the forefront of the development of Islamic finance globally. While no new Islamic finance-specific legislation is expected in the near-term, the UK government has a track record in reacting to the demands of the market as they arise.

In terms of commercial and transactional development, fintech is one of the main focus areas in finance at present and Islamic finance is not immune to this trend. Peer-to-peer financing and crowdfunding would appear to capture the very essence of Islamic finance and the introduction of a *shariah*-compliant platform on Beehive should be the first of a number of similar initiatives. The UK government has done its part to encourage Islamic finance through the issuance of *sukuk*, which has paved the way for UK corporate issuers to follow suit. There can be no question that the legal system in the UK has been suitably adapted to facilitate the growth of Islamic finance and so its future development in the UK looks very positive.

UNITED STATES

*Mona E Dajani*¹

I OVERVIEW

Islamic finance in the United States dates from the 1980s, when two institutions opened on the West Coast. Their services were limited to investment and home finance and were available only regionally. From the late 1990s, the market size grew significantly, paralleling the growth of the Muslim population in the US: from 50 per cent in the 1990s to 66 per cent in the 2000s.

There are currently 25 Islamic financial institutions in operation in the US, the top three of which, according to asset size, are the American Islamic Finance House, University Bank (through its subsidiary University Islamic Financial) and Harvard Islamic Finance Program. In 2013, JP Morgan started to offer Islamic banking services. Investment banks such as Standard Chartered Bank followed and now offer Islamic banking products in Asia, Europe, the Middle East and the US. Recently, in the US commercial real estate sector, banks such as Malaysia-based Maybank, Kuwait-based Warba Bank and National Bank of Kuwait, Italian bank Intesa Sanpaolo and MASIC, a Saudi private equity investment firm controlled by the Al Subeaei family, have participated in commercial Islamic finance transactions in the US in connection with commercial real estate.

Retail banks operate in several states: University Islamic Financial (a subsidiary of University Bank), based in Ann Arbor, Michigan, is the first and only exclusively *shariah*-compliant bank in the US; Devon Bank in Chicago regularly offers Islamic finance services; Guidance Residential, in Reston, Virginia, is the biggest non-bank financial institution that offers Islamic finance services; and another large Islamic mortgage lender is LARIBA, in California, which also provides business financing.

Shariah requirements have made further proliferation of Islamic finance difficult. Possibly because US investors are still unfamiliar with *shariah*-compliant products, the secondary market for Islamic financial products is smaller in general. The result has been that Islamic mortgage lenders have had difficulty in remaining liquid, stemming further growth of the market. Starting in 2001 and 2003 respectively, Freddie Mac and Fannie Mae, the US housing agencies, had bought Islamic mortgage products to provide extra liquidity in the US Islamic finance market. They have now grown to become the main investors in Islamic mortgages – by 2007, Guidance Residential had been relying on Freddie Mac for more than US\$1 billion in financing.

¹ Mona E Dajani is a partner at Pillsbury Winthrop Shaw & Pittman LLP.

II LEGISLATIVE AND REGULATORY FRAMEWORK

i Legislative and regulatory regime

Unlike the United Kingdom, where there is a plethora of Islamic financing services, there are no US laws specifically addressing Islamic banking in the US. Moreover, the US market for Islamic financial products is much smaller than that of the United Kingdom, where there are US\$19 billion worth of assets owned by Islamic financial institutions, and more than 20 banks, six of which exclusively provide *shariah*-compliant products. The number of Islamic finance services in the United Kingdom is also larger than in the US. Five of the services in the United Kingdom are *shariah*-compliant and are behind some of the biggest building projects in London (including the Shard, the Olympic Village, Chelsea Barracks, the Battersea Power Station site), the north-west and the Midlands (more than 6,500 new homes). In fact, although Islamic finance transactions constitute only 1 per cent of global financial assets, about a quarter of the world's population is Muslim, which is a leading indicator of the growth potential in the US. Another unexpected leading indicator that has already shown signs of an uptick in the US market is Brexit, whereby London's euro clearing market is expected to cut almost 40,000 jobs in its banking industry.

The same stringent licensing and supervision standards that are applicable to the conventional US financial institutions also govern financial institutions offering Islamic finance services. Therefore, Islamic financial institutions (IFIs) operate as state-chartered entities subject to state and federal laws regulating corporate governance and banking and insurance operations.²

Conventional banking institutions typically use their subsidiaries for Islamic finance transactions. The principal challenge faced by Islamic finance service providers in the US is therefore to offer products that comply with both *shariah* and the applicable state and federal banking regulations. However, unlike conventional US banking regulation, regulation of Islamic finance in the US is market-driven; federal and state regulators respond on a case-by-case basis to applications and inquiries from IFIs that want to offer Islamic financial products in the US. Consequently, any organiser of a *shariah*-compliant bank in the US must confront the challenge of introducing new financial products or services to regulators, and must meet significant creditworthiness requirements.

Another regulatory challenge might be the limited number of permissible investments that commercial banks are allowed to make. In the US, any investment made by banks must be limited to fixed-income, interest-bearing securities, which *shariah* prohibits. Moreover, US consumer credit laws require that commercial banks have reporting and disclosure requirements that may be inconsistent with *shariah*. For instance, the Truth in Lending Act of 1968 requires that banks disclose annual interest percentage rates, which is strictly prohibited by *shariah* law. On the other hand, a US financial institution may have a hard time employing *murabahah* or *ijarah* structures to finance the purchase of an asset (e.g., a car or home) if required under the state law to qualify as a licensed leasing company or auto lender.

² See the US chapter in *Getting The Deal Through: Islamic Finance & Markets*, 2017 (contributing editor John H Vogel), at 55.

ii Supervisory regulatory authorities³

As stated above, both federal and state laws regulate the banking industry in the US whether conventional or Islamic. The national regulators include the Board of Governors of the Federal Reserve System (the Federal Reserve), the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC), and the state regulators are responsible for banking activities in each state. A bank in the US must be licensed by either the OCC or an applicable state banking authority and is supervised by the Federal Reserve and the FDIC. All deposit accounts offered by US banks are required to be insured by the FDIC, which is intended to ensure the overall 'safety and stability' of financial institutions.

US regulators have issued certain opinions applicable to the Islamic finance industry. Preliminarily, while the Federal Reserve approved *shariah*-compliant retail financing products in the US, the Federal Reserve focused on the substance of the products. The Federal Reserve subsequently influenced the OCC to issue opinions aimed at reconciling apparent conflicts between *shariah* and the federal and state laws, and their respective regulations. For example, the US National Bank Act of 1864 prohibits US financial institutions wishing to offer *shariah*-compliant lending services from purchasing, holding legal title to or possession of real estate to secure debts with terms over five years. The OCC issued two interpretive letters, which addressed the special concerns of clients who would otherwise be forced to choose either their religion or their home or business.

Although certain types of *murabahah* and *ijarah* financing are allowed under US laws, the OCC reconciled *musharakah* and *mudarabah*'s apparent violation of federal regulations that prohibited commercial banks from forming partnerships or holding common stock. The OCC allowed commercial banks to take 'as consideration for a loan a share in the profit, income or earnings from a business or enterprise of a borrower'.⁴ This interpretation created an opportunity for commercial banks to derive equity return from a loan deal without relying on interest, despite the still-intact prohibition against making true equity investment. US credit unions have also adopted a communal or partnership model that complies with *shariah*.

Savings associations can form joint ventures and own properties through a subsidiary servicing company. These institutions may easily obtain real estate financing through *murabahah* and *ijarah* structures as well as limited joint venture possibilities through *musharakah* and *mudarabah* transactions.

III COMMON STRUCTURES

i Home and other retail finance

Retail Islamic finance has been well established in the US since the OCC approved the *ijarah* structure for home lending in 1997 because it is 'functionally equivalent' to conventional secured real estate lending.⁵ Similarly in 1999, the OCC approved the use of the *murabahah* structure for home financial products as it was deemed to be functionally equivalent to conventional real estate mortgage transactions, or inventory or equipment lien agreements.⁶

5 OCC Interpretive Letter No. 806 (17 October 1997), [1997–1998 Transfer Binder] Fed. Banking L. Rep. (CCH) 81-253 (Islamic Home Finance Leases).

6 OCC Interpretive Letter No. 867 (1 June 1999), [1999–2000 Transfer Binder] Fed. Banking L. Rep. (CCH) 81-361 (Murabaha Financing Products).

The OCC opined that under such structures the bank's ownership of the property is only for 'a moment in time' because of the simultaneous nature of purchase and sale transactions. Therefore, the Islamic contracts, the OCC concluded, avoid the type of risk that existing restrictions aimed to limit. In terms of accounting, the bank records the loan as an asset on its balance sheet. The borrower is required to maintain the property and pay all expenses. If the borrower defaults, the bank may sell the underlying property to recover the amount owed, as in a mortgage transaction.

Musharakah is also used for home financing in the US. It is a 'rent-to-own' financed sale of property, where the bank first purchases the property and the customer pays the bank over time the full price plus a cost. With each rent payment, the customer earns a portion of the property's ownership. Under this equity-based structure (also called 'diminishing *musharakah*'), when the customer sells or disposes of the property, losses are shared between the customer and the bank as co-owners based on their percentages of ownership. The bank's return is taxable income to the bank and deductible by the borrower.

ii Insurance

Deposit insurance, which banks use for stability, is inconsistent with *shariah* because a bank having insurance alters the risk-sharing structure required under *shariah*. Therefore, *takaful*, a cooperative form of reimbursement that comes from a fund to which entities contribute regularly, does not work in the US. Reinsurance is necessary in the US because of high minimum capital requirements, but there are not many *retakaful* services. Although structuring a product around this impediment in the US is technically possible, it has been a strong enough practical impediment to prevent further growth of the Islamic insurance market. Another serious obstacle to the successful introduction of *takaful* and *retakaful* in the US is the Establishment Clause of the First Amendment to the US Constitution. Establishment Clause challenges are analysed under a three-part test, to establish that (1) there is a secular purpose, (2) religion is neither advanced nor inhibited, and (3) it does not foster excessive government intervention.⁷

Each state has its own licensing requirements for insurance companies operating in the state, which generally prohibit the proliferation of *takaful*. To be licensed, an insurance company must prove its experience, management capability and sound finances. It must also justify its premium rates and meet or exceed the solvency requirements. Even after it becomes licensed, an insurance company is often limited in choosing the types and concentrations of fixed-income investments that it must make with its reserves. Moreover, if the insurer becomes insolvent, an emergency loan must be taken out of the shareholders' fund to help meet obligations arising out of the insolvency. This could be a problem in *takaful* insurance, because capital requirements imposed upon the insurance companies may not accurately reflect the separation between the fund for policyholders and that for shareholders. Nonetheless, some *takaful* are subject to a lesser degree of oversight from the state insurance regulators.

Despite the difficulties associated with *takaful*, American International Group Inc (AIG) first started to offer Islamic homeowner *takaful* insurance in the US in 2008. Currently, AIG's underwriting subsidiaries, Risk Specialist Companies Inc and Lexington Insurance Company, issue *takaful*. Zayan Finance, a New York-based Islamic financial services firm,

7 Known as the 'Lemon Test': *Lemon v. Kurtzman*, 403 U.S. 602 (1970).

is the exclusive broker that offers *takaful* in many states. AIG also maintains a *shariah* board made up of Islamic scholars who have given legitimacy to the *takaful* alternative to conventional insurance in the US market.

iii Real estate investment

Islamic finance has widely used real estate as a basis for *shariah*-compliant financial structures. Prime or trophy assets (e.g., hotels or large office headquarter buildings) have been its focus. Thanks to rental guarantees, stable demand and rising rental payments, dorms and other student accommodation have also effectively attracted Islamic funds. Further developments may be achieved by expansion of the scope of social infrastructure to include education, healthcare and social housing sectors. Since 2010, however, Islamic funds and banks that offer mezzanine finance have proliferated. Here, a conventional senior bank provides a loan with interest, the investors provide the equity and the mezzanine financing is placed in a *shariah*-compliant way. The senior conventional bank and the *shariah*-compliant mezzanine lender enter into an intercreditor agreement governing the way in which each of their loans is treated while conforming to the mezzanine lender's Islamic sensibilities.

Murabahah is the most popular type of structure used for real estate investment in the US. A typical *murabahah* structure contains an unconditional contract of sale with a cost price, markup and payment date predefined. The profit from the marked-up sales price is paid in instalments. One of the largest examples of recent real estate investments done under *murabahah* is the US\$219 million syndicated construction loan for 45 Park Place, a luxury condominium tower in Manhattan, New York.⁸ It was led by Malaysia's Maybank and Kuwait's Warba Bank; Italy's Intesa Sanpaolo and MASIC, the investment arm of Saudi Arabia's Al Subeaei family, also participated.⁹

One advantage of *murabahah* is that it may not require credit support. Here, the bank pays the seller for the property for immediate sale to the buyer for the cost plus a profit pursuant to a *murabahah* agreement. A *murabahah* transaction has also been used to refinance a conventional loan to allow the borrower to withdraw cash to pay off interest-bearing obligations, subject to the advice of the *shariah* scholars. For US tax purposes, the profit piece of the purchase price in a *murabahah* transaction is deemed to be interest, such that it is taxable to the IFI and deductible by the customer.

An *ijarah* is a lease structure used in acquiring real estate as well as in other acquisition finance contexts (e.g., aircraft, ship or project finance). Under *ijarah*, a bank purchases a property and places the ownership over the property in a holding subsidiary and then leases it to the buyer for its use pursuant to the *ijarah* lease. Typically, title to the property is only transferred to the borrower after full payment of the cost of the property. The customer pays rent to the bank, which consists of, among other things, the purchase price and the profit. Unlike in a conventional finance lease transaction, the bank, acting as an owner and a lessor, has obligations to insure and undertake major maintenance of the leased asset. These obligations may, however, be contracted out to the borrower, who acts as a lessee. The lessee is responsible only for payment of the rent while the lessee continues to use the asset, so the *ijarah* structure cannot become effective before completion of the leased facility construction. Unlike in conventional leases, under an *ijarah*, if there is a total destruction or condemnation

8 Anna Nicolaou, 'Manhattan tower secures \$219m in *sharia*-compliant financing', Financial Times (19 May 2016), <https://www.ft.com/content/cf6c3a88-1c4d-11e6-b286-cddde55ca122>.

9 id.

such that the property cannot be used for its intended purpose, the rent payment will cease. The lease-to-purchase model (i.e., *ijarah wa iqtina*) is also frequently used in real estate investment in the US. Under the laws of most states, the transaction can be simplified by having the client immediately take title to the property at the initial purchase.

iv Investment funds

A *mudarabah* agreement is formed between two partners, with one contributing capital to invest in some form of commercial enterprise, while the other provides the expertise and management experience. The capital contributor is known as the *rab-al-mal* and the managing partner is known as the *mudarib*. This type of structure is typically used for funded participating arrangements and establishment of an investment fund. The *rab-al-mal* and the *mudarib* share the profit generated from the investment in accordance with pre-agreed profit sharing ratios. However, any loss of capital is assumed by the *rab-al-mal*.

v Other areas

There have been two major *sukuk* issuances in the US – the East Cameron Gas *sukuk*, the first *sukuk al-musharakah* in the US, which was backed by oil and gas assets, and the General Electric *sukuk al-ijarah*, which was backed by aircraft leases. The East Cameron *sukuk* has gone into bankruptcy, but the General Electric *sukuk* is performing well. Both Illinois and New York have begun their efforts to enact legislation to recognise *sukuk*.

For commodity trading, *tawarruq* is used, which essentially is a reverse *murabahah*. Under this structure, a bank buys freely tradable commodities such as platinum and copper (other than gold and silver since they are considered currency) at market value for spot delivery and spot payment, and then immediately sells them, at an agreed price that contains the profit, to the customer on a spot delivery and deferred payment basis. The customer immediately sells the commodities at market value to a third party for spot delivery and spot payment. The end result is that the customer has received a cash amount and has a deferred payment obligation for the purchase price to the bank. Under the *tawarruq* structure, the profit piece of the purchase price also takes into account the bank's commodity risk and third-party supplier risk, in addition to the creditworthiness risk of the customer.

vi Combining conventional and *shariah*-compliant financing capital stack

A *shariah*-compliant lender may participate in a capital stack structure in a transaction that uses both *shariah* and conventional financing, by delineating the assets and the cash flows in the transaction.

In certain circumstances, *shariah*-compliant and conventional lenders may enter into a formal intercreditor agreement that sets out the priority of payments and the ranking of security. This is most likely to occur when the structural subordination is not possible and the borrower under both the conventional and *shariah*-compliant finance is the same entity. The intercreditor agreement between *shariah*-compliant and conventional lenders is likely to address many similar matters covered in such an agreement between solely conventional lenders. Matters that could be addressed may include (1) allocation of the borrower's operating income; (2) allocation of proceeds following acceleration on default; (3) disputes and governing law; and (4) what the different lenders can and cannot do in respect of their facilities.

IV TAXATION

Islamic finance raises many US taxation issues, including strong tax incentives for debt over equity, the tax treatment of sales and additional layers of transactions in certain instruments. In addition, differences in the tax treatment of Islamic and conventional finance could cause cross-border spillovers and encourage international tax arbitrage. For instance, the Internal Revenue Service has yet to issue official guidance on tax deductibility of the payments made under *ijarah* and *mudarabah* structures and on partial treatment of such payments as interest. Real estate transfer taxes and mechanic's liens present another challenge because the *shariah*-compliant financing structures often require multiple transfers of the property with heavy fees incurred by parties with each transfer (e.g., property being purchased by the bank first and then transferred to the borrower). The State of New York has abolished these fees for transactions executed under *ijarah* and *mudarabah* structures, but many other states do still charge.

V OUTLOOK

Globally, Islamic finance has grown in terms of asset size by more than 20 per cent annually since the 2007–2008 financial crisis. Islamic banks are not outperforming other banks as a rule, since what they gain in safety, largely as a result of restrictions placed by *shariah* principles, they may lose in efficiency. It is during crises that the differences appear to have a material effect on performance. Two independent studies by the International Monetary Fund and the Islamic Financial Services Board found that Islamic banks demonstrated superior performance following the 2007–2008 crisis.

Nonetheless, while slow for the past two years and despite geopolitical pressures, for a variety of political and financial reasons, it is estimated that Islamic finance is on the rise in other countries, including the US. Just 20 years ago, there were few Islamic financial products being offered in the US. The opportunity cost for the US dollar, especially in light of Brexit, is quite large in not participating in this global market and opportunity at this moment in time. It is recommended that the US takes steps to introduce the rules and regulations required to engage in worldwide Islamic finance, *sukuk* and *takaful* business. Interest-free financing modes may enhance the system currently in use in the US and offer a chance for Americans to diversify their portfolios, attract global investors, enhance liquidity and compete in the global village.

ABOUT THE AUTHORS

SALMAN AHMED

Towers & Hamlins

Salman Ahmed has worked and lived in Dubai, Karachi, London, Manama and Riyadh.

Salman is regarded as one of the world's foremost experts in the field of Islamic finance and has been ranked in the highest tier by, among others, Islamic Finance News (IFN), *The Legal 500* (as a leading individual for Islamic finance, for London and Bahrain) from 2014 onwards, *IFLR1000* (Highly Regarded) from 2018 onwards, *Chambers Global* (Up-and-Coming) from 2017 onwards, and *Expert Guides: Banking* and *Expert Guides: Finance and Transactional* from 2017 onwards.

He also has a wealth of experience in capital markets transactions, including numerous award-winning and landmark transactions, such as Tilal Sukuk, Ominvest's perpetual capital securities debut, Bank Muscat's debut *sukuk* programme and Golden Group's debut *sukuk* programme, among others. He represents issuers and underwriters on the full spectrum of debt, equity and hybrid security offerings.

MURNI ZUYATI ZULKIFLI AZIZ

Adnan Sundra & Low

Murni Zuyati Zulkifli Aziz's main areas of practice are corporate banking and finance and debt capital markets. She has advised on the issuances of conventional and *shariah*-compliant additional Tier 1 and Tier 2 capital by several financial institutions (including banks and insurance companies) in Malaysia. She has also advised on the issuance of *sukuk* for the financing of power plants (both gas and coal fired) and toll-road concessions in Malaysia. Murni has also acted in respect of the acquisition of several expressway concession companies in Malaysia.

She was admitted to the Malaysian Bar in 1999. She graduated from King's College, London (LLB Hons). Murni is recognised as a leading lawyer in Malaysia by *IFLR1000*.

HUSSEIN AZMY

Al Busaidy, Mansoor Jamal & Co

Hussein is an associate in the commercial department of Al Busaidy, Mansoor Jamal & Co (AMJ) and has broad experience in the field of Islamic finance product development and structuring. Prior to joining AMJ, Hussein practised at an international law firm in Egypt, where he advised high-profile financial institutions in Egypt and the GCC on their Islamic

finance products; this included advising Abu Dhabi Islamic Bank (as IMLA) in Egypt on the structuring of a first-of-its-kind *shariah*-compliant *ijarah* debt-refinancing and revolving *mudarabah* facilities, and advising Arab National Bank on the structuring and licensing of *shariah*-compliant *tahawuut* instruments in Saudi Arabia. Hussein also participated in the review of the bill of the now abrogated Egyptian *sukuk* law. Hussein regularly advises Omani financial institutions such as Alizz Islamic Bank, Meethaq and Muzn Islamic Banking on the drafting and structuring of *shariah*-compliant corporate financing transactions and *sukuk* programmes; among those transactions was the offering by Meethaq Islamic Banking of a 50 million Omani rial diminishing *musharakah*-structured financing for the development of a fully integrated large-scale poultry project.

MAHMOUD BASSIOUNY

Matouk Bassiouny & Hennaawy

Mahmoud Bassiouny is a partner at Matouk Bassiouny & Hennaawy and heads its finance and projects practice. His experience in infrastructure projects, trade and project finance (for both conventional and Islamic structures) and in the oil and gas industry has earned him the trust of international consulting firms, commercial banks, export credit agencies and major players in the energy industry. He is a member of the following professional associations: the Egyptian Bar Association, the Egyptian Business Lawyers Association, the Association of International Petroleum Negotiators, the American Chamber of Commerce and the Canadian Chamber of Commerce.

ELEANOR CLOT

Trowers & Hamblins

Eleanor Clot is a trainee solicitor in Trowers & Hamblins' international corporate practice in Bahrain.

Prior to joining Trowers & Hamblins, Eleanor spent seven years in the drone industry advising on drone regulation and she is the lead co-author of the book *A Practical Guide to Drone Law*, which navigates the rapidly developing legal and regulatory landscape governing both commercial and recreational drone use.

MONA E DAJANI

Pillsbury Winthrop Shaw & Pittman LLP

Based in both New York and London, Ms Mona E Dajani has for over 20 years been counsel to many of the world's most prominent development and investment companies in connection with hundreds of successful infrastructure, real estate and energy transactions, and projects in conventional and Islamic equity and debt transactions. She represents sovereign wealth funds, private equity funds, export credit agencies, investment funds, governments, banks, developers, institutional investors, lenders, pension fund advisers, contractors and asset management companies with respect to a wide range of *shariah*-compliant finance and investment transactions across the core practice areas of banking, project finance, capital markets, restructuring, M&A, investment funds and dispute resolution. She has expertise in structuring, documenting and negotiating complex transactions and developing innovative *shariah*-compliant techniques, including finance, regulation, project and asset finance, hedging and swap transactions, funds and other structures, including *sukuk* issues.

Ms Dajani has repeatedly been recognised as a leading lawyer by *The Legal 500*, *IFLR1000*, *The Best Lawyers in America* (2013–2016) and other publications, and as a Rising Star by Law360. She was elected to the board of directors for the American Council on Renewable Energy in 2015.

Ms Dajani is a regular contributor and commentator for CNN radio, POLITICO, Bloomberg New Energy Finance, Fox News, *The New York Times*, *The Washington Post*, National Public Radio (NPR) and *USA Today*, among others.

RAHAT DAR

Afridi & Angell

Rahat Dar is a senior associate practising in banking and financial services, Islamic finance, mergers and acquisitions, capital markets, infrastructure and project finance, and corporate and commercial law. He has extensive experience in working with *shariah* and *fatwa* supervisory boards and independent *shariah* scholars in structuring a variety of Islamic financing transactions (including *istisnah*, *ijarah*, *murabahah*, *musharakah*, *mudarabah* and *sukuk*). Mr Dar is a member of the Law Society of England and Wales and co-author of the UAE chapter of the *Chambers Global Practice Guide: Banking & Finance 2019*.

RODNEY GERARD D'CRUZ

Adnan Sundra & Low

Rodney Gerard D'Cruz is primarily involved in capital market financing, banking, securitisation, corporate finance and corporate advisory work relating to debt and financing. He has been involved in a number of notable transactions, including advising on the issuance of private debt securities and *sukuk* by various Malaysian corporations. He has also acted as Malaysian legal counsel in relation to initial public offerings and listings on Bursa Malaysia and advised on the financing of several significant infrastructure and energy projects in Malaysia. Rodney has also advised in respect of the acquisition of motorway concession companies in Malaysia, in terms of financing and concession extensions, and on the privatisation of water supply services.

He was admitted to the Bar of England and Wales in 1994 and the Malaysian Bar in 1995. He graduated from the University of Nottingham (LLB Hons).

JOHN DEWAR

Milbank LLP

John Dewar is a partner in the London office of Milbank LLP. He is a member of the firm's global projects, energy and infrastructure finance group and leads the firm's Islamic finance practice. John is widely recognised as a leading individual in his field by a number of Islamic finance lawyer journals, among them: *Chambers UK* (which designated him among the first tier in the UK), *Chambers Global*, *The Legal 500*, *Who's Who Legal: Project Finance* and *Euromoney's Expert Guides* (which ranks him among the top 30 lawyers in the world in its *Best of the Best* guide for Islamic finance). He has built an extremely broad practice and outstanding reputation for advising on the most innovative and significant 'market-first' transactions around the world, and has particular expertise in multi-sourced financings,

including those involving Islamic institutions and multilateral and export credit agencies. John is also editor of *International Project Finance Law and Practice* published by Oxford University Press and co-author of that publication's Islamic finance chapter.

CHRISTOPHER DORTSCHY

Allen & Overy SCS (Luxembourg)

Christopher Dortschy is a counsel in the investment funds and regulatory department of Allen & Overy SCS (Luxembourg), specialising in collective investment schemes. He advises international fund initiators and promoters on establishing, administering and winding up all types of Luxembourg regulated investment vehicles, such as UCITS, Part II Funds, SIFs and SICARs, as well as unregulated alternative investment funds, such as limited partnerships and RAIFs. Mr Dortschy joined Allen & Overy in 2010 then left the firm at the beginning of 2013 to work for another international law firm in Luxembourg, before subsequently rejoining Allen & Overy in January 2016.

Mr Dortschy is a German-qualified lawyer who practises in Luxembourg under his German professional title (*Rechtsanwalt*). He is a member of the Frankfurt Bar and the Luxembourg Bar. Christopher regularly holds conferences and seminars on fund-related topics and is a member of various working groups of the Association of the Luxembourg Fund Industry (ALFI).

MUNIB HUSSAIN

Milbank LLP

Munib Hussain is a senior associate in the London office of Milbank LLP. He is a member of the firm's global projects, energy and infrastructure finance group and is a member of the firm's Islamic finance practice. Munib has significant expertise in advising lenders, sponsors and sovereigns on 'first-of-a-kind' international projects, energy and infrastructure financings in the oil and gas, power and mining sectors, and in particular specialises in multi-sourced financings involving Islamic banks and institutions, export credit agencies, multilaterals and commercial banks. Munib is also recognised as an expert in Islamic finance in *Who's Who Legal 100*.

NAOYUKI KABATA

Anderson Mōri & Tomotsune

Naoyuki Kabata has been involved with an extensive range of financial transactions at Anderson Mōri & Tomotsune, including securitisation, asset management and investment funds, project finance, private finance initiatives and leveraged buyouts. He advised the lender financing the acquisition of real properties in Japan through a fund affiliated with an Islamic bank in Kuwait. The structure, which was co-developed by the lender and the fund asset manager, involved use of the sale and leaseback structure, to comply with *shariah* requirements, and is said to have been the first transaction using Islamic finance techniques in Japan.

SATOSHI KATO

Anderson Mōri & Tomotsune

Satoshi Kato is a former associate at Anderson Mōri & Tomotsune. He provided legal advice on financial transactions and financial regulation, including Islamic finance-related matters. During the year that he worked for a Malaysian subsidiary of a Japanese bank, he focused extensively on providing advice about Islamic finance.

AMJAD ALI KHAN

Afridi & Angell

Amjad Ali Khan is a senior consultant at Afridi & Angell. He represents foreign and local clients, including banks and leading multinationals, in banking, financial and corporate transactions in the UAE and abroad. He specialises in banking and financial services, including project finance, syndicated loans, treasury products and Islamic banking transactions. Mr Khan has considerable experience in undertaking conventional, Islamic and private banking transactions. He has been involved in several project finance transactions in the UAE. He is also a regular speaker at banking seminars.

MANSOOR J MALIK

Al Busaidy, Mansoor Jamal & Co

Mansoor J Malik is a founder and senior partner at Al Busaidy, Mansoor Jamal & Co (AMJ) and head of the corporate/commercial, capital markets, banking and finance, and natural resources and infrastructure teams.

Mansoor is a senior corporate/commercial, finance, energy and projects specialist with over 30 years' experience advising on innovative public–private partnerships, restructurings and privatisations of government entities across the full spectrum of industry sectors. Involved in most of Oman's high-value 'first-of-a-kind' transactions and projects, Mansoor is an expert on Oman's laws and regulatory frameworks and is consistently ranked as the country's star performer and leading legal practitioner. Regarded as a pioneer in the newly emergent field of Islamic finance, he heads AMJ's dedicated Islamic finance team.

Mansoor is also regarded as the foremost authority on Oman's privatisation and utilities sector law, by virtue of which he was engaged by the government of Oman to draft the first public–private partnership law, publication of which is imminent. His clients include most power and water companies, banks, state-owned enterprises and leading trading houses in Oman. He is the Omani counsel of choice for magic circle and silver circle international firms operating out of the UAE.

FRANK MAUSEN

Allen & Overy SCS (Luxembourg)

Frank Mausen is the managing partner at Allen & Overy SCS (Luxembourg) and a partner in the banking and international capital markets department, specialising in securities law and capital markets regulation, including stock exchange listings. His clients include banks as well as corporate, institutional, supranational and sovereign issuers, which he advises on debt and equity transactions, Islamic financing and structured finance transactions, including securitisation, structured products, covered bonds, IPOs, placements and buy-backs of

securities, exchange offers, listing applications and ongoing obligations deriving from such listings. He has 16 years' experience in these areas. Mr Mausen regularly holds conferences on securitisation and other capital markets topics in Luxembourg and abroad. Mr Mausen is a member of the securitisation working group of the Association of the Luxembourg Fund Industry (ALFI) and the securitisation working group and the financial markets committee of the Luxembourg Bankers' association (ABBL). Mr Mausen is also a member of the Islamic finance working group of Luxembourg for Finance (Luxembourg's agency for the development of the Luxembourg financial centre) and the securitisation working group set up by the Haut Comité de la Place Financière (HCPF).

RAFAEL A MORALES

Morales & Justiniano

Rafael A Morales is the managing partner at Morales & Justiniano. Prior to that he was the managing partner at SyCip Salazar Hernandez & Gatmaitan and the head of its banking, finance and securities department.

He is a professorial lecturer at the College of Law of the University of the Philippines, as well as the author of two books (*The Philippine General Banking Law (Annotated)* and *The Philippine Securities Regulation Code (Annotated)*) and numerous legal articles. Among the many accolades he has received, he was cited in Euromoney's *Expert Guides: Banking* and included in the *Asian Legal Business* list of 100 pre-eminent Asia-Pacific lawyers. He is a former president of the Inter-Pacific Bar Association.

Mr Morales finished his Bachelor of Arts studies in political science (*cum laude*, 1970) at the University of the Philippines, where he also took his Bachelor of Laws (*cum laude* and class valedictorian, 1974).

He holds a Master of Laws degree (1978) from the University of Michigan, where he was a DeWitt Fellow. While in the United States, he trained as a foreign attorney at Rosenman Colin Freund Lewis & Cohen in New York City. He later became a foreign attorney at Anderson Mōri & Rabinowitz in Tokyo.

ANTHONY OAKES

Ogier

Tony Oakes is the head of Ogier's finance practice in Asia and specialises in banking, capital markets, corporate and commercial transactions, structured finance and restructuring. He was named one of the top 10 offshore lawyers in Asia by *Asian Legal Business* in its Offshore Client Choice List 2016 and 2017.

Since joining Ogier, Tony has advised on a number of landmark transactions, including the Garuda Indonesia US\$500 million *sukuk*.

Tony started his career at a leading Australian firm in Sydney, where he gained broad experience in banking and corporate transactions. He then worked in-house at one of Australia's largest investment services groups, where he focused on funds establishment and capital markets and structured finance transactions.

Tony then moved to Hong Kong to join a magic circle law firm. There, he advised on capital markets transactions, private equity, structured finance and bank lending.

EVELINA PALGAN

Allen & Overy SCS (Luxembourg)

Evelina Palgan is a senior associate in the banking and international capital markets department of Allen & Overy SCS (Luxembourg), specialising in securitisations and fiduciary issuances, as well as listing and admission of securities to trading on the regulated market and the Euro MTF market of the Luxembourg Stock Exchange. She also advises on legal and regulatory aspects of Luxembourg legislation relating to prospectuses for securities, transparency obligations and market abuse. Ms Palgan has worked in law firms in both London and Luxembourg since 2007. She joined Allen & Overy in 2009.

ASAD QAYYUM

Al Busaidy, Mansoor Jamal & Co

Asad is a partner at Al Busaidy, Mansoor Jamal & Co (AMJ) and heads up the Islamic finance and natural resources (oil and gas, and mining) teams at the firm. He is a dual-qualified corporate/commercial lawyer with over 17 years' experience of practising law in the United Kingdom, Oman and Pakistan. As a solicitor of the Supreme Court of the United Kingdom, a barrister of England and Wales and an advocate of the Pakistani high courts, Asad combines cross-border expertise with an intimate knowledge of Omani law and practice gained over five years of legal practice with AMJ.

Asad regularly advises sovereigns, corporate entities and Islamic financial institutions in connection with their debt capital markets and corporate transactions, such as *sukuk* and bond issuances, cross-border acquisitions and disposals, investments, joint ventures and restructurings. Asad has advised a number of sponsors on the establishment of REITs in Oman, and he continues to advise Islamic finance institutions in Pakistan and Oman with respect to the development of their *shariah*-compliant products. Asad also has extensive experience of the projects side of private practice, with a particular focus on natural resources and agriculture projects in Africa, Europe and Kazakhstan. Asad has advised the government of Oman on all the Islamic debt capital market issuances it has undertaken to date, and he is a regular speaker at local and international Islamic finance seminars and forums.

OMAR SALAH

De Brauw Blackstone Westbroek

Omar Salah is a senior associate in the corporate practice group at De Brauw Blackstone Westbroek, specialising in finance, restructuring and insolvency. Some of his recent finance work includes advising on leveraged financing, asset-based financing, secured lending, syndicated loans and debt capital markets transactions. His restructuring practice covers international restructurings, cross-border insolvencies, trading in non-performing loans and distressed M&A. Before joining the corporate practice group, Omar was with the litigation practice group, where he focused on Dutch Supreme Court, bankruptcy and corporate litigation and insolvency-related matters.

He has significant experience with cross-border transactions, having practised law in Amsterdam, Singapore and London. From 2015 to 2018, Omar was based in the Singapore office of De Brauw, where he worked on M&A transactions, international investments,

multi-jurisdictional joint ventures, corporate restructurings and (Islamic) finance transactions. Previously, he was seconded to the London office of King & Spalding, where he advised on Islamic finance transactions.

Omar has noted expertise in Islamic finance and investments. He is a visiting professor of Islamic finance law at IE Business School in Madrid, Spain. He is also an expert member of the Sukuk Standardization Working Group of IIFM in Manama, Bahrain. Omar holds a PhD in *sukuk* (Islamic securities). He teaches and conducts research on Islamic finance law at various universities worldwide (among others, the University of Oxford, the University of Cambridge and the University of Melbourne) and is a frequent speaker at international conferences.

ZOFIA WHITE

Allen & Overy SCS (Luxembourg)

Zofia White is an associate in the tax department of Allen & Overy SCS (Luxembourg), specialising in national and international corporate tax matters. She is frequently involved in novel and high-profile transactions in the corporate and financial markets.

Appendix 2

CONTRIBUTORS' CONTACT DETAILS

ADNAN SUNDRA & LOW

Level 11, Menara Olympia
No. 8, Jalan Raja Chulan
50200 Kuala Lumpur
Malaysia
Tel: +60 3 2070 0466
Fax: +60 3 2078 3382
rodney.d'cruz@asl.com.my
murni.zulkifli@asl.com.my
www.asl.com.my

AFRIDI & ANGELL

Jumeirah Emirates Towers
Office Tower, Level 35
Sheikh Zayed Road
PO Box 9371
Dubai
United Arab Emirates
Tel: +971 4 330 3900
Fax: +971 4 330 3800
akhan@afриди-angell.com
rdar@afриди-angell.com
www.afриди-angell.com

AL BUSAIDY, MANSOOR JAMAL & CO

Muscat International Centre
Central Business District
Bait Al Falaj Street
PO Box 686, Ruwi
PC 112, Muscat
Oman
Tel: +968 2481 4466
Fax: +968 2481 2256
mj-co@omantel.net.om
www.amjoman.com

ALLEN & OVERY SCS (LUXEMBOURG)

33 avenue J F Kennedy
1855 Luxembourg
Tel: +352 44 44 55 1
Fax: +352 44 44 55 22 2
frank.mausen@allenoverly.com
christopher.dortschy@allenoverly.com
evelina.palgan@allenoverly.com
zofia.white@allenoverly.com
www.allenoverly.com

ANDERSON MÖRI & TOMOTSUNE

Otemachi Park Building
1-1-1 Otemachi
Chiyoda-ku
Tokyo 100-8136
Japan
Tel: +81 3 6775 1057
Fax: +81 3 6775 2057
naoyuki.kabata@amt-law.com
www.amt-law.com/en

**DE BRAUW BLACKSTONE
WESTBROEK**

Claude Debussylaan 80
1082 MD Amsterdam
The Netherlands
Tel: +31 20 577 1389 / +31 6 8363 1541
Fax: +31 20 577 1775
omar.salah@debrauw.com
www.debrauw.com

MATOUK BASSIOUNY & HENNAWY

12 Mohamed Ali Genah Street
Garden City
11451 Cairo
Egypt
Tel: +20 2 2796 2042
Fax: +20 2 2795 4221
mahmoud.bassiouny@
matoukbassiouny.com
www.matoukbassiouny.com

MILBANK LLP

10 Gresham Street
London EC2V 7JD
United Kingdom
Tel: +44 20 7615 3004 / 3013
Fax: +44 20 7615 3100
jdewar@milbank.com
mhussain@milbank.com
www.milbank.com

MORALES & JUSTINIANO

7th Floor, RCI Building
105 Rada Street
Legaspi Village
Makati City 1229
Metro Manila
Philippines
Tel: +63 2 832 7198 / 833 8534
Fax: +63 2 834 2551
ramorales@primuslex.com
www.primuslex.com

OGIER

11th Floor Central Tower
28 Queen's Road Central
Central
Hong Kong
Tel: +852 3656 6065
Fax: +852 3656 6001
anthony.oakes@ogier.com
www.ogier.com

**PILLSBURY WINTHROP SHAW &
PITTMAN LLP**

31 West 52nd Street
New York
NY 10018
United States
Tel: +1 212 858 1000
Fax: +1 212 858 1500

Tower 42, Level 21
25 Old Broad Street
London EC2N 1HQ
United Kingdom
Tel: +44 20 7847 9500
Fax: +44 20 7847 9501

mona.dajani@pillsburylaw.com
www.pillsburylaw.com

TROWERS & HAMLINS

7th Floor, West Tower
Bahrain World Trade Center
PO Box 3012
Manama
Bahrain
Tel: +973 17 515 600
Fax: +973 17 131 003
sahmed@trowers.com
eclot@trowers.com
www.trowers.com

THE LAWREVIEWS

For more information, please contact info@thelawreviews.co.uk

THE ACQUISITION AND LEVERAGED FINANCE REVIEW

Marc Hanrahan

Milbank Tweed Hadley & McCloy LLP

THE ANTI-BRIBERY AND ANTI-CORRUPTION REVIEW

Mark F Mendelsohn

Paul, Weiss, Rifeind, Wharton & Garrison LLP

THE ASSET MANAGEMENT REVIEW

Paul Dickson

Slaughter and May

THE ASSET TRACING AND RECOVERY REVIEW

Robert Hunter

Edmonds Marshall McMahon Ltd

THE AVIATION LAW REVIEW

Sean Gates

Gates Aviation LLP

THE BANKING LITIGATION LAW REVIEW

Christa Band

Linklaters LLP

THE BANKING REGULATION REVIEW

Jan Putnis

Slaughter and May

THE CARTELS AND LENIENCY REVIEW

John Buretta and John Terzaken

Cravath Swaine & Moore LLP and Simpson Thacher & Bartlett LLP

THE CLASS ACTIONS LAW REVIEW

Camilla Sanger

Slaughter and May

THE COMPLEX COMMERCIAL LITIGATION LAW REVIEW

Steven M Bierman

Sidley Austin LLP

THE CONSUMER FINANCE LAW REVIEW

Rick Fischer, Obrea Poindexter and Jeremy Mandell

Morrison & Foerster

THE CORPORATE GOVERNANCE REVIEW

Willem J L Calkoen

NautaDutilh

THE CORPORATE IMMIGRATION REVIEW

Chris Magrath

Magrath LLP

THE CORPORATE TAX PLANNING LAW REVIEW

Jodi J Schwartz and Swift S O Edgar

Wachtell, Lipton, Rosen & Katz

THE DISPUTE RESOLUTION REVIEW

Damian Taylor

Slaughter and May

THE DOMINANCE AND MONOPOLIES REVIEW

Maurits J F M Dolmans and Henry Mostyn

Cleary Gottlieb Steen & Hamilton LLP

THE E-DISCOVERY AND INFORMATION GOVERNANCE LAW REVIEW

Tess Blair

Morgan, Lewis & Bockius LLP

THE EMPLOYMENT LAW REVIEW

Erika C Collins

Proskauer Rose LLP

THE ENERGY REGULATION AND MARKETS REVIEW

David L Schwartz

Latham & Watkins

THE ENVIRONMENT AND CLIMATE CHANGE LAW REVIEW

Theodore L Garrett

Covington & Burling LLP

THE EXECUTIVE REMUNERATION REVIEW

Arthur Kohn and Janet Cooper

Cleary Gottlieb Steen & Hamilton LLP and Tapestry Compliance

THE FINANCIAL TECHNOLOGY LAW REVIEW

Thomas A Frick

Niederer Kraft Frey

THE FOREIGN INVESTMENT REGULATION REVIEW

Calvin S Goldman QC and Michael Koch

Goodmans LLP

THE FRANCHISE LAW REVIEW

Mark Abell

Bird & Bird LLP

THE GAMBLING LAW REVIEW

Carl Rohsler
Memery Crystal

THE GLOBAL DAMAGES REVIEW

Errol Soriano
Duff & Phelps

THE GOVERNMENT PROCUREMENT REVIEW

Jonathan Davey and Amy Gatenby
Addleshaw Goddard LLP

THE HEALTHCARE LAW REVIEW

Sarah Ellson
Fieldfisher LLP

THE INITIAL PUBLIC OFFERINGS LAW REVIEW

David J Goldschmidt
Skadden, Arps, Slate, Meagher & Flom LLP

THE INSOLVENCY REVIEW

Donald S Bernstein
Davis Polk & Wardwell LLP

THE INSURANCE AND REINSURANCE LAW REVIEW

Peter Rogan
Ince & Co

THE INSURANCE DISPUTES LAW REVIEW

Joanna Page
Allen & Overy LLP

THE INTELLECTUAL PROPERTY AND ANTITRUST REVIEW

Thomas Vinje
Clifford Chance LLP

THE INTELLECTUAL PROPERTY REVIEW

Dominick A Conde
Fitzpatrick, Cella, Harper & Scinto

THE INTERNATIONAL ARBITRATION REVIEW

James H Carter
Wilmer Cutler Pickering Hale and Dorr

THE INTERNATIONAL CAPITAL MARKETS REVIEW

Jeffrey Golden
P.R.I.M.E. Finance Foundation

THE INTERNATIONAL INVESTIGATIONS REVIEW

Nicolas Bourtin
Sullivan & Cromwell LLP

THE INTERNATIONAL TRADE LAW REVIEW

Folkert Graafsma and Joris Cornelis
Vermulst Verhaeghe Graafsma & Bronckers (VVGB)

THE INVESTMENT TREATY ARBITRATION REVIEW

Barton Legum
Dentons

THE INWARD INVESTMENT AND INTERNATIONAL TAXATION REVIEW

Tim Sanders
Skadden, Arps, Slate, Meagher & Flom LLP

THE ISLAMIC FINANCE AND MARKETS LAW REVIEW

John Dewar and Munib Hussain
Milbank Tweed Hadley & McCloy LLP

THE LABOUR AND EMPLOYMENT DISPUTES REVIEW

Nicholas Robertson
Mayer Brown

THE LENDING AND SECURED FINANCE REVIEW

Azadeh Nassiri
Slaughter and May

THE LIFE SCIENCES LAW REVIEW

Richard Kingham
Covington & Burling LLP

THE MERGER CONTROL REVIEW

Ilene Knable Gotts
Wachtell, Lipton, Rosen & Katz

THE MERGERS AND ACQUISITIONS REVIEW

Mark Zerdin
Slaughter and May

THE MINING LAW REVIEW

Erik Richer La Flèche
Stikeman Elliott LLP

THE OIL AND GAS LAW REVIEW

Christopher B Strong
Vinson & Elkins LLP

THE PATENT LITIGATION LAW REVIEW

Trevor Cook
WilmerHale

THE PRIVACY, DATA PROTECTION AND CYBERSECURITY LAW REVIEW

Alan Charles Raul
Sidley Austin LLP

THE PRIVATE COMPETITION ENFORCEMENT REVIEW

Ilene Knable Gotts

Wachtell, Lipton, Rosen & Katz

THE PRIVATE EQUITY REVIEW

Stephen L Ritchie

Kirkland & Ellis LLP

THE PRIVATE WEALTH AND PRIVATE CLIENT REVIEW

John Riches

RMW Law LLP

THE PRODUCT REGULATION AND LIABILITY REVIEW

Chilton Davis Varner and Madison Kitchens

King & Spalding LLP

THE PROFESSIONAL NEGLIGENCE LAW REVIEW

Nicholas Bird

Reynolds Porter Chamberlain LLP

THE PROJECT FINANCE LAW REVIEW

David F Asmus

Sidley Austin LLP

THE PROJECTS AND CONSTRUCTION REVIEW

Júlio César Bueno

Pinheiro Neto Advogados

THE PUBLIC COMPETITION ENFORCEMENT REVIEW

Aidan Synnott

Paul, Weiss, Rifkind, Wharton & Garrison LLP

THE PUBLIC-PRIVATE PARTNERSHIP LAW REVIEW

Bruno Werneck and Mário Saadi

Mattos Filho, Veiga Filho, Marrey Jr e Quiroga Advogados

THE REAL ESTATE INVESTMENT STRUCTURE TAXATION REVIEW

Giuseppe Andrea Giannantonio and Tobias Steinmann

Chiomenti / EPRA

THE REAL ESTATE LAW REVIEW

John Nevin

Slaughter and May

THE REAL ESTATE M&A AND PRIVATE EQUITY REVIEW

Adam Emmerich and Robin Panovka

Wachtell, Lipton, Rosen & Katz

THE RENEWABLE ENERGY LAW REVIEW

Karen B Wong

Milbank

THE RESTRUCTURING REVIEW

Christopher Mallon

Skadden, Arps, Slate, Meagher & Flom LLP

THE SECURITIES LITIGATION REVIEW

William Savitt

Wachtell, Lipton, Rosen & Katz

THE SHAREHOLDER RIGHTS AND ACTIVISM REVIEW

Francis J Aquila

Sullivan & Cromwell LLP

THE SHIPPING LAW REVIEW

George Eddings, Andrew Chamberlain and Holly Colaço

HFW

THE SPORTS LAW REVIEW

András Gurovits

Niederer Kraft Frey

THE TAX DISPUTES AND LITIGATION REVIEW

Simon Whitehead

Joseph Hage Aaronson LLP

THE TECHNOLOGY, MEDIA AND TELECOMMUNICATIONS REVIEW

John P Janka

Latham & Watkins

THE THIRD PARTY LITIGATION FUNDING LAW REVIEW

Leslie Perrin

Calunius Capital LLP

THE TRADEMARKS LAW REVIEW

Jonathan Clegg

Cleveland Scott York

THE TRANSFER PRICING LAW REVIEW

Steve Edge and Dominic Robertson

Slaughter and May

THE TRANSPORT FINANCE LAW REVIEW

Harry Theochari

Norton Rose Fulbright

THE VIRTUAL CURRENCY REGULATION REVIEW

Michael S Sackheim and Nathan A Howell

Sidley Austin LLP

www.TheLawReviews.co.uk



ISBN 978-1-83862-066-0