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ACKNOWLEDGEMENTS

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

ADNAN SUNDRA & LOW
AFRIDI & ANGELL
DE BRAUW BLACKSTONE WESTBROEK
K&L GATES LLP
KING & SPALDING
MATOUK BASSIOUNY
OGIER
PAKSOY
TROWERS & HAMLINS
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EDITORS’ PREFACE

We are honoured to present the inaugural 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.

### Principles of Islamic finance

Islamic, or *shariah*-compliant, finance refers to practices employed by individuals and institutions that wish to invest in compliance with *shariah*, or Islamic law. Islamic finance emphasises productive economic activity over pure speculation, and encourages transaction counterparties to share profits and losses in order 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*, practices instituted or approved by the Islamic prophet Muhammad; (3) the *Hadith*, oral traditions regarding the words and deeds of the Prophet Muhammad; (4) the *ijma*, or consensus, of Muslim scholars; and (5) *qiya*, reasoned determinations based on analogy to established principles.

In connection with its focus on fair and equitable dealing, *shariah*-compliant finance prohibits certain practices that are viewed as unethical or contrary to Islamic tenets. Prohibited practices include:

1. **Riba** (translated literally, excess). Although *shariah* scholars debate *riba*’s precise definition, *riba* essentially represents unearned excess or profit charged in connection with a transaction. This is generally thought to include a prohibition against charging interest in connection with the use of money.
2. **Maysir.** *Maysir* 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.
3. **Gharar.** *Gharar* 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.

Islamic finance differs among market participants. In practice, Islamic financial institutions and investors typically engage shariah scholars to establish investment guidelines and parameters for investment activity. 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.

**Basic Islamic finance structures**

Although structures differ across national boundaries, the basic structures outlined below tend to be widely used by market participants.

**Ijarah (lease)**

An ijarah resembles a conventional asset lease, although ijarah provisions regarding risk and responsibility differ from many conventional leases. In an ijarah transaction, one party leases an asset to its counterparty in return for the payment of agreed rent. If the lessee also has an option to purchase the leased property, then the structure is referred to as an ijarah wa iqtina. Ijarah may be utilised to finance real estate and corporate acquisitions, as well as the purchase of assets.

**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. 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 upon 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.
**Editors' Preface**

*Mudarabah*

A *mudarabah* is a quasi-partnership arrangement, under which one party (the *rab al maal*) 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 profits of the enterprise according to agreed percentages. However, only the *rab al maal* bears the risk of losing money. The *mudarib*'s risk is 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 the *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*, 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 profit-and-loss sharing.

*Sukuk*

*Sukuk* are certificates that represent an interest in identified *shariah*-compliant assets. 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 certificate holders with a claim to the subject assets, and asset-based *sukuk*, which derive cash from such assets, but do not grant certificate holders direct rights in the assets. *Sukuk* are often referred to as Islamic bonds because they resemble bonds in some superficial aspects and have the ability to finance some of the transactions traditionally financed by conventional bonds.

Combinations of the above structures can be used in complicated transactions. For example, an asset manufactured under an *istisnah* can later be made the subject of an *ijarah*. A *mudarabah* or *musharakah* could be used to invest in the overall project.

**Conclusion**

Islamic finance has grown rapidly over the past 20 years, in market participants, structuring expertise and transaction types. Though still a relatively small industry compared with the overall financial market, Islamic finance is vibrant. 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.

**Andrew M Metcalf and Michael Rainey**

King & Spalding LLP

New York and Dubai

October 2016
Chapter 8

UNITED KINGDOM

Barry Cosgrave 1

I LEGISLATIVE AND REGULATORY FRAMEWORK

i Legislative and regulatory regime

The United Kingdom has taken a leading role in legislating for Islamic finance for over a decade. As early as 2003, the UK government introduced special exemptions to stamp duty land tax (a tax levied on property sales in the UK) to relieve an unintended double taxation charge that arose as a result of the structures used in Islamic mortgages in the UK. However, before considering some of the specifics of Islamic finance legislation in the UK, it is worth considering the broader approach that the UK has taken to the legislation of Islamic finance.

The UK’s approach has been to adapt pre-existing legislation governing finance transactions in the UK to incorporate Islamic finance transactions through certain amendments that cater for the structures commonly used in Islamic finance. In so doing, the approach in the UK has been to treat Islamic finance as a subset of conventional structured finance. The UK has not sought to introduce legislation that regulates the application of Islamic principles under English law. The application of Islamic principles has been left as a matter of conscience for the parties concerned and reflects both the fact that there is no 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 below in more detail, the English courts have taken an approach consistent with this in considering only English law (as 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 seeks to fold Islamic finance instruments into the conventional legislative environment. The approach taken by the legislation is relatively straightforward. For example, anything described in an Islamic

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finance instrument as ‘profit’ will be treated in the same manner as the provisions of previous Finance Acts that deal with ‘interest’, which is particularly important when considering the tax treatment of Islamic finance instruments. However, 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)) and was intended to pave the way for the inaugural sukuk issuance by the UK government, which took place in 2014 and which is discussed in more detail below.

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 in order for such treatment to be given in the UK, an assessment would need 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 went on to introduce 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.

It is also worth noting that 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. Such 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 Financial Conduct Authority (FCA) is the conduct regulator with supervisory responsibility for Islamic finance in the United Kingdom and all Islamic banks in the UK are required to be authorised and licensed by the FCA. The Prudential Regulatory Authority (PRA) was created as part of the Bank of England by the Financial Services Act 2012 and
holds responsibility for the prudential regulation of banks, building societies, credit unions, insurers and major investment firms – this includes 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.

A recent example of this is the £1,384,950 fine handed down by the PRA to QIB (UK) Plc on 8 April 2016 for what it described as ‘significant failing in assessing, maintaining and reporting to the regulator on its financial resources’. The details of the case are not intended to be the subject of this chapter. Instead, this case is illustrative of the fact that the regulators in the UK do not distinguish between Islamic and conventional banks in the UK when supervising bank activities and are equally comfortable issuing fines against Islamic banks as they are against conventional banks.

II COMMON STRUCTURES

i Consumer finance

Shariah-complaint 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. The most prominent consumer finance bank in the UK is probably Gatehouse Bank, but other notable providers include the Bank of London and the Middle East as well as the branches of some well-known Middle Eastern banks such as Abu Dhabi Islamic Bank, Al Rayan Bank and QIB UK.

One of the most interesting recent developments in Islamic consumer financing has been the establishment of Beehive, a peer-to-peer financing platform which includes a shariah-compliant window, in the UK. Beehive’s shariah-compliant window uses commodity murabahah financing backed by the Dubai Multi Commodities Centre’s ‘DMCC 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 United Kingdom are ijarah and an ijarah with diminishing musharakah structure, which contain many of the features of

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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 of 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 of 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 of the bank’s interest in the *musharakah* (and registration of title in the name of the homeowner). This change in tax law is discussed further below.

**iii Insurace**

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 Dubai International Financial Centre in March 2015.

**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 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. 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 which is common in shariah structures. However, with established assets (especially those held by conventional landlords) late payment interest may be embedded in the contracts, with amending such contracts being 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 such 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 HM Treasury’s £200 million sukuk issuance in June 2014. The UK was not the first government to issue a sukuk – that award goes to the government of the state of Saxony-Anhalt in Germany in 2004 – but it was the first non-Islamic national government to do so. The sukuk used an ijarah structure identifying three pieces of UK government property as the ijarah assets. The UK government selected an ijarah structure as the simplest and most widely accepted Islamic finance structure, and the issuance was reportedly 10 times oversubscribed. 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 new Airbus A380 aircraft, which would become the ijarah assets. 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 a 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 were further supplemented by the Alternative Finance Investment Bonds (Stamp Duty Land Tax) (Prescribed Evidence) Regulations 2009, which prescribe the evidence that needs to be provided to HMRC 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

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 will treat any such situation. 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, the English courts have 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 question that arises is how English courts – being courts in a non-Muslim jurisdiction – will address matters that concern shariah compliance. In particular, will English courts consider matters of shariah law in reaching a judgment?

The Shamil Bank case3 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, in order 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 Potter stated that shariah is a non-national system of law and agreed with the view of Morrison J 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 sometimes openly contradictory. As such, it is not clear how the reference to ‘Subject to the principles of the Glorious Shari’a...’ should be interpreted by a judge. As noted by Morrison 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.’

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Lord Potter 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.*

Lord Potter 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 Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) in its ‘Shari’ah’ Standards’ should apply. AAOIFI’s ‘Shari’ah Standards’ represents 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, 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 which 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 a

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4 *Islamic Investment Company of the Gulf (Bahamas) Ltd v. Symphony Gems N.V. & Ors.*

Unreported, 13 February 2002.
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 which may, on its facts, be non-compliant with *shariah*.

The best-known case on this is the *Blom Bank* case.\(^5\) 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 which, on 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 that ‘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 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 added to its appeal in response to the *ultra vires* argument) was likely to succeed. Blom was awarded summary judgment for the principal amount it invested with the question of *ultra vires* and whether or not Blom 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 this 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.

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. London remains one of the world’s premier financial capitals 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 crowd funding 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.
Appendix 1

ABOUT THE AUTHORS

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Barry Cosgrave is a partner in the finance group of K&L Gates LLP in London. Mr Cosgrave's practice covers all areas of Islamic finance including sukuk, bilateral financing and complex, first-of-a-kind derivatives and structured investment products. Mr Cosgrave spent six years in the Middle East working on a variety of Islamic finance transactions which also included a secondment to the trading floor of an international investment bank in Dubai to assist in the development of its Islamic derivatives platform. Mr Cosgrave has worked on Islamic finance transactions across numerous jurisdictions in the US, Europe, the Middle East and South East Asia including the first issue of a sukuk by a corporate on mainland Europe and the first sukuk issuance in Oman. Mr Cosgrave has unique experience in the structuring and documentation of complex, cross-border Islamic finance products and works closely with all of the leading Islamic scholars.

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