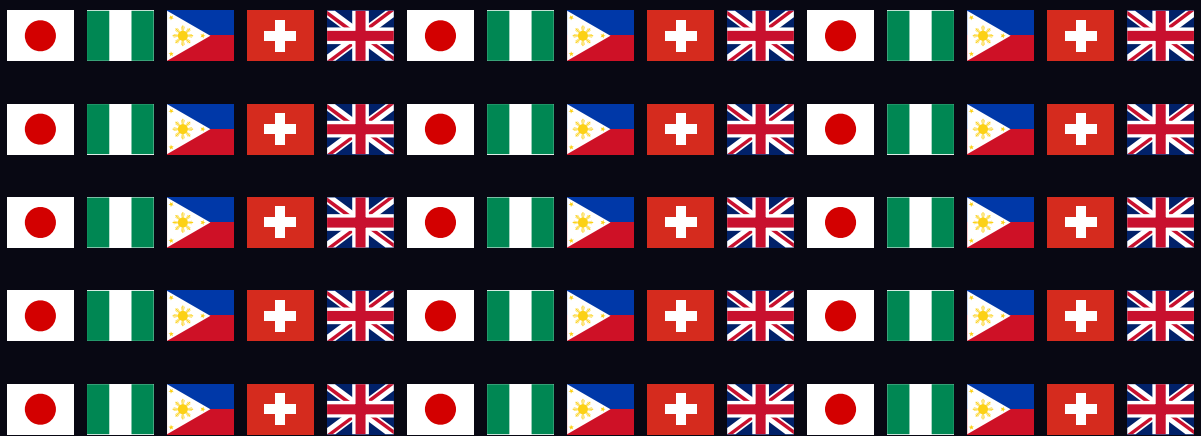


ISLAMIC FINANCE & MARKETS

United Kingdom



Islamic Finance & Markets

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Quick reference guide enabling side-by-side comparison of local insights, including into national policies, market development and legislation; supervision; sanctions, remedies and dispute resolution; contractual concepts (such as mudarabah, murabahah, musharakah, ijarah and wadiah); products and product considerations (such as Islamic securities, legal position of sukuk holders, and takaful – Islamic insurance); regulatory obstacles; Shariah law; takeovers of Islamic financial institutions; and recent trends.

Generated 30 June 2023

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OVERVIEW**Policies**

In general terms, what policy has your jurisdiction adopted towards Islamic finance? Are Islamic finance products regulated differently from conventional instruments? What has been the legislative approach?

Islamic finance has developed rapidly in the United Kingdom over the past decade, and the government has been very supportive towards its development and promotion. In 1982, the United Kingdom saw the launch of Al Baraka International Bank, making the country the first of the future European Union member states to host a stand-alone Islamic financial institution. Currently, the United Kingdom has the highest value of shariah-compliant assets of any non-Muslim country. The United Kingdom's strong and proud tradition of openness and flexibility, combined with London's position as a leading international financial centre and the country's significant Muslim population (just over 5 per cent of the UK population, according to the Office for National Statistics), provides a strong foundation for growth of Islamic finance. As a result of its standing, London has long been perceived as the Western hub for Islamic finance.

In 2013, the government established the United Kingdom's first Islamic Finance Task Force, and the task force's mandate has been to help to build upon London's status as the Western hub for Islamic finance by showcasing the United Kingdom as the preferred choice for the Muslim world to invest in and do business with. Its objectives include engaging with the UK Islamic Finance Secretariat and others to promote and raise the international profile of the industry and to use Islamic finance to facilitate inward investment and strengthen the United Kingdom's economy. In June 2014, the United Kingdom became the first Western country to issue a sukuk, attracting orders of more than £2 billion from global investors. London's maiden sukuk was structured as a sukuk al-ijarah and will pay out profits based on the rental income from three government-owned properties in lieu of interest (riba), which is forbidden by shariah. The £200 million sale was heavily oversubscribed by investors in the United Kingdom, the Middle East and Asia, attracting orders of £2.3 billion, 10 times higher than the amount sold. Then, in April 2015, the Secretary of State of Her Britannic Majesty's Government (acting by the Export Credits Guarantee Department and operating as UK Export Finance) guaranteed a sukuk issued by Khadrway Limited (where the proceeds of the issuance were used by the United Arab Emirates to finance the acquisition of four new Airbus A380-800 aircraft). This was the world's first sukuk supported by an export credit agency. More recently, in 2021, the UK government issued its second sovereign sukuk of £500 million, which was sold to institutional investors in the United Kingdom, Middle East and Asia.

Islamic finance products in the United Kingdom are not regulated any differently from conventional instruments and existing legislation and regulations apply. The United Kingdom's approach has been to ensure a level playing field for Islamic finance products and conventional instruments, and so it has proactively monitored and responded to any unequal treatment between the two by introducing remedial legislation and regulations. For example, the government was quick to remedy the adverse tax treatment of sukuk to place them on a level playing field with conventional debt instruments. Another example is where the HM Treasury abolished the double stamp duty land tax charge on shariah-compliant mortgages. Most recently, in 2021 the Bank of England implemented an alternative liquidity facility (ALF) structured as a wakalah which allows UK Islamic banks to meet their capital requirements in a shariah-compliant manner. Before its introduction, UK Islamic banks (which are unable to make use of liquid gilts or interest-bearing reserve accounts at the Bank of England) had been reliant on holding high stocks of cash at zero return, or high yield and less liquid sukuk. These were both inefficient methods of meeting their capital requirements and subsequently hindered the development of UK-based IFIs. The Bank of England's ALF officially began taking deposits from participating UK-based Islamic banks for the first time in December 2021, which has further strengthened the UK's role as the leading international financial centre for Islamic finance outside Muslim-majority nations.

The government believes that the growth of Islamic finance in the United Kingdom is beneficial to all UK citizens and that Islamic finance should be available to everybody. On the retail side, all consumers gain from a wider choice of

retail financial services, in particular those consumers whose religious beliefs prevent them from accessing conventional finance. On the wholesale side, the entire country benefits from the UK financial services industry's success as the leading Western centre for Islamic finance.

Law stated - 19 August 2022

Market development

How well established is Islamic finance in your jurisdiction? Are Islamic windows permitted in your jurisdiction?

Islamic retail products first appeared in the United Kingdom in the 1990s, and in the past decade there has been significant growth of Islamic finance products in both the wholesale and the retail sectors. According to a report published by TheCityUK in 2020, the United Kingdom is ranked 18th out of 48 countries in the Islamic banking and finance industry (The Islamic Finance Country Index), with assets of UK-based institutions offering Islamic finance services amounting to a total of £4.7 billion in 2017.

Against the backdrop of global drivers of Islamic finance, the government, the Financial Services Authority (FSA) (replaced in large part by the Financial Conduct Authority (FCA)) and the Bank of England have actively supported the development of Islamic finance in the United Kingdom during the past decade. In 2000, the Bank of England recognised the potential for retail and wholesale Islamic finance in the United Kingdom and, together with HM Treasury, established a working group to investigate the obstacles facing the industry. This led to the first of many legislative measures introduced by HM Treasury to enable the development of Islamic finance in the United Kingdom. Since 2003, HM Treasury, HM Revenue and Customs (HMRC) and the FSA have introduced several changes to the tax and regulatory systems to enable UK companies to offer a range of Islamic financial products including asset finance, mortgages and ISAs. Since 2004, the FSA has authorised a number of Islamic financial firms and the United Kingdom was the first country in the European Union to authorise standalone IFIs to offer only shariah -compliant products. This has been achieved by applying the same authorisation criteria to Islamic and conventional financial institutions. Britain currently has over 20 financial institutions, including five fully shariah -compliant banks, offering Islamic finance products, more than any other Western country . The main financiers in the UK market include standalone Islamic financial institutions such as Al Rayan Bank (formerly the Islamic Bank of Britain), the Bank of London and the Middle East, which launched its own UK-licensed and shariah -compliant digital bank, Nomo, in July 2021, and certain conventional institutions that have set up Islamic windows. If a conventional institution establishes a separate branch or subsidiary to operate as an Islamic window, that branch or subsidiary would probably require a separate authorisation from the FCA.

Sovereign wealth funds from Islamic countries are active in the United Kingdom. The mandate of the Islamic Finance Task Force is to facilitate Islamic financial business, including investment in UK infrastructure by Islamic sovereign wealth funds. Islamic funds also operate from the United Kingdom and IFIs offer Islamic finance products in the United Kingdom.

In June 2021, UK-based Ethos Invest launched a fundraising vehicle with the aim of becoming the world's largest shariah -compliant tech-focussed private equity fund. However, the demand for these funds does not appear to be sufficiently high to make overcoming the clear 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 United Kingdom's private equity market.

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 United Kingdom has not seen a high number of shariah -compliant investment funds established. However, in December 2020, Schroders (a UK-headquartered asset manager) launched a shariah -

compliant fund that has also integrated the growing drift of funds towards multi-factor investing and environmental, social and corporate governance (ESG) principles. While many existing shariah -compliant funds have begun to integrate ESG principles, it is too early to tell whether Schroders' latest fund will be the first of many Islamic finance funds to launch in the United Kingdom. Nevertheless, in the past year we have seen Invesco start a shariah -compliant ETF, and, in July 2022, J O Hambro Capital Management launched a shariah -compliant fund in response to client demand. If these funds perform well, they could act as a catalyst for further growth in this area.

There are no explicit restrictions for investments in haram activities (ie, non-compliant investments), although investment might be limited to halal activities.

There have been many listings of sukuk on the London Stock Exchange. The issuers of these listings have principally been corporates and banks based in the Middle East. According to TheCityUK, 72 sukuk have been listed on the London Stock Exchange, including a total of three shariah -compliant exchange-traded funds (ETFs).

Law stated - 19 August 2022

Legislation

What is the main legislation relevant to Islamic banking, capital markets and insurance?

The United Kingdom has not enacted legislation specifically addressing Islamic finance. Islamic banking, capital markets and insurance are subject to general finance laws (in particular the Financial Services and Markets Act 2000 (FSMA)) and regulations in the United Kingdom, and they are intended to be subject to the same tax treatment that applies to their corresponding conventional instruments. However, certain amendments have been made to existing laws and regulations specific to facilitate Islamic finance transactions in the United Kingdom.

The most important changes have been to the tax laws (which broadly work on the basis of form over economic substance) to ensure the tax treatment of shariah -compliant structures follow the treatment of their conventional finance alternatives. For example, the rules have been amended to provide for certain shariah -compliant finance arrangements (including certain murabahah and musharakah arrangements) to be taxed in the same manner as conventional equivalents under the alternative finance arrangements regime (see Chapter 6 of Part 6, Corporation Tax Act 2009).

The alternative finance regime has now also been extended to sukuk, which hitherto have been treated differently from conventional bonds for tax purposes because payments on sukuk represent profit distributions, although such payments are economically similar to interest. Unlike interest, however, profit distributions are not usually tax-deductible and this would have made sukuk a more expensive way to raise finance, especially in comparison with conventional bonds.

To respond to this anomaly, the alternative finance regime (under which certain shariah -compliant finance structures are taxed in the same manner as their conventional equivalents) has been extended to provide that sukuk be taxed in a similar manner to conventional bonds. This has been achieved by providing that, where the arrangements meet certain conditions (including listing on a recognised stock exchange), amounts paid by issuers to sukuk holders (other than those representing the principal amount originally paid by the sukuk holder to the issuer) are generally deductible by the issuer under the loan relationships regime, and taxable in the hands of the holder as interest (if the holder is subject to income tax) or under the loan relationships regime (if the holder is subject to corporation tax).

In addition, the Finance Act 2009 provides relief from stamp duty land tax for sukuk (as alternative finance investment bonds), amends the law to classify sukuk as tax-exempt loan capital for stamp duty and stamp duty reserve tax purposes, and allows existing corporation tax and income tax rules on Islamic finance arrangements to be amended by regulation.

Law stated - 19 August 2022

SUPERVISION

Principal authorities

Which are the principal authorities charged with the oversight of banking, capital markets and insurance products?

Prior to 1 April 2013, the Financial Services Authority (FSA) was the principal authority charged with the oversight of banking, capital markets and insurance products in the United Kingdom. From 1 April 2013, the FSA was abolished and the majority of its functions transferred to two new regulators: the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA). The FCA inherited the majority of the FSA's roles and functions and also adopted the legal corporate identity of the FSA. The FCA is responsible for the conduct of business regulation of all firms, including those regulated for prudential matters by the PRA, is responsible for the prudential regulation of firms not regulated by the PRA, and inherited the FSA's market conduct regulatory functions, with the exception of responsibility for systemically important infrastructure, which was transferred to the Bank of England.

The FCA and the PRA, therefore, now regulate IFIs to the extent they perform 'regulated activities' for the purpose of FSMA. Their approach to the regulation of IFIs is expected to be the same as the FSA, which 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 IFI. The FCA's approach is to treat IFIs as it would treat conventional firms, so an IFI would require authorisation to carry on regulated activities and obtain the necessary permissions from the FCA. IFIs may need to provide additional information to the FCA in certain circumstances, such as the role, if any, that the IFI's shariah board performs in relation to operational and financial matters. Further, any financial institution already authorised by the FSA wishing to offer shariah -compliant products under its existing FCA permissions must, in practice, notify the FSA of its intention to expand its activities to include Islamic financial business.

Financial transactions entered into with an individual and not otherwise subject to regulation under Financial Services and Markets Act 2000 (FSMA) may be subject to regulation under the Consumer Credit Act 1974, unless that agreement is entered into wholly or predominantly for business purposes, or one of the other exemptions under the Consumer Credit Act 2006 applies.

Before its replacement by the FCA on 1 April 2013, the FSA stated that it intended to work with international industry bodies, such as the International Organization of Securities Commissions, which have their own Islamic finance initiatives. The FSA also supported moves to develop common shariah standards by organisations such as the Islamic Financial Services Board (IFSB) and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). While the FSA did not implement either the IFSB's or AAOIFI's standards (which, therefore, do not have any binding legal effect), these standards are certainly useful in identifying best practice for IFIs and examples of the application of regulatory rules to IFIs.

Law stated - 19 August 2022

Guidance

Identify any notable guidance, policy statements or regulations issued by the regulators or other authorities specifically relevant to Islamic finance.

The FSA issued a discussion paper in November 2007, 'Islamic Finance in the UK: Regulation and Challenges', which outlined the regulatory framework for Islamic finance in the United Kingdom and considered the risks and challenges that Islamic firms in the United Kingdom face in the retail and wholesale markets.

The FSA and HM Treasury released a joint consultation paper on sukuk in December 2008, 'Legislative Framework for the Regulation of Alternative Finance Investment Bonds (Sukuk)'. This paper suggested further legislative reforms to align the regulatory treatment of sukuk with conventional debt securities; in particular, the creation of a new specified instrument for sukuk under the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, to exempt such instruments from the definition of collective investment schemes under FSMA. HM Treasury also published a paper in December 2008, 'Development of Islamic Finance in the UK', on the government's approach to promoting and facilitating the development of Islamic finance in the United Kingdom.

In 2019, HM Land Registry published Practice guide 69: Islamic financing. This guide focuses on the three forms of contract found in Islamic finance: Ijarah wa-iqtina , diminishing musharakah, and murabahah. The guide also examines the emergence of the sukuk market .

Law stated - 19 August 2022

Central authority

Is there a central authority responsible for ensuring that transactions or products are shariah-compliant? Are IFIs required to set up shariah supervisory boards? May third parties, related parties or fund sponsors provide supervisory board services or must the board be internal?

The United Kingdom has no central authority responsible for ensuring that transactions or products are shariah - compliant. The United Kingdom does not impose a legal requirement requiring an IFI to have a shariah supervisory board. Although, by complying with the relevant AAOIFI guideline for shariah supervisory boards, an IFI could arguably demonstrate that it complied with its duties under the FCA's Principles for Businesses to take reasonable care to organise and control its affairs responsibly and with adequate risk management systems. Further, while there is no statutory requirement for IFIs to have shariah supervisory boards, most IFIs do, as a matter of course, have shariah supervisory boards that sit alongside their boards of directors or employ third parties to act as an external shariah supervisory board (either because their constitutive documents so require or because this provides investors, stakeholders and customers with an assurance that the IFI will operate in accordance with shariah principles).

Law stated - 19 August 2022

Board approval

Do members of an institution's shariah supervisory board require regulatory approval? Are there any other requirements for supervisory board members?

There is no express requirement for regulatory approval of a shariah supervisory board; however, in an application to the FCA or PRA to become authorised, the IFI would need to indicate whether the members of the shariah supervisory board would perform an executive or an advisory role. To the extent an advisory role is to be performed, the IFI would not need to apply for each member to be an approved person. The competence of the members of the shariah supervisory board would still be relevant to determine whether the IFI is fit and proper to be authorised. To the extent that the shariah supervisory board would perform an executive role, then the IFI would need to apply and meet the requirements of the FCA for each member to be an approved person, including the requirement as to competence and capability.

Law stated - 19 August 2022

Authorisation

What are the requirements for Islamic banks to be authorised to carry out business in your jurisdiction?

The primary statute governing banking in the United Kingdom is FSMA. Under FSMA, it is an offence for a person to engage in 'regulated activities' unless he or she is authorised or exempt from the authorisation requirement.

As with conventional banks, Islamic banks are dual-regulated by the FCA with respect to how they conduct business and by the PRA for prudential requirements (such as capital and liquidity). To become an authorised bank, an application must be made to the PRA, the lead regulator for banks. This is assessed through a collaborative process. The final decision will be made and communicated by the PRA. To authorise the firm, the PRA must have received the FCA's consent.

Law stated - 19 August 2022

Foreign involvement

May foreign institutions offer Islamic banking and capital markets services in your jurisdiction? Under what conditions?

Foreign institutions may offer Islamic banking and finance products in the United Kingdom, provided that they comply with the applicable United Kingdom laws (including FSMA).

Law stated - 19 August 2022

Takaful and retakaful operators

What are the requirements for takaful and retakaful operators to gain admission to do business in your jurisdiction?

FSMA governs the regulatory regime in the United Kingdom. The FSMA provides that carrying on a regulated activity, or purporting to do so, in respect of a specified investment by way of business in the United Kingdom, requires authorisation from the FSA, unless the person carrying on such activity is exempt. Effecting or carrying out contracts of insurance (which includes takaful and retakaful) is a regulated activity. Therefore, a similar authorisation procedure to that applying to banks would also apply to takaful and retakaful operators.

Law stated - 19 August 2022

Foreign operators

How can foreign takaful operators become admitted? Can foreign takaful or retakaful operators carry out business in your jurisdiction as non-admitted insurers? Is fronting a possibility?

Foreign takaful operators may become admitted in the United Kingdom to offer takaful and retakaful products, by complying with the applicable UK laws (including FSMA).

Law stated - 19 August 2022

Disclosure and reporting

Are there any specific disclosure or reporting requirements for takaful, sukuk and Islamic funds?

There are no specific disclosure or reporting requirements for either takaful, sukuk or Islamic funds that differ from conventional products.

Law stated - 19 August 2022

Sanctions and remedies

What are the sanctions and remedies available when products have been falsely marketed as shariah-compliant?

If financial products are falsely marketed as shariah-compliant, there are three potential remedies available to an investor.

The first is a contractual remedy, which, depending on the terms on which the product was purchased, may enable the investor to call an event of default (arising from the misrepresentation by the IFI of a material term of the contract) and then accelerate amounts owed by the IFI to the investor.

The second remedy is to institute a civil claim for misrepresentation. For fraudulent and negligent misrepresentation, the claimant may claim rescission of the contract and damages. For innocent misrepresentation, the court has the discretion to award damages in lieu of rescission or rescission (if the right to rescind exists), but it cannot award both. If that is lost, damages under section 2(2) of the Misrepresentation Act 1967 are unavailable.

The third remedy is only applicable if the relevant product is a securities offering that is made through a public offering and where a prospectus is issued that is untrue or misleading as to the shariah compliance of the securities offered. In this circumstance, section 90 of FSMA establishes that the person responsible for the prospectus is liable for damages to a person who has acquired securities to which the particulars apply and has suffered loss as a result of any untrue or misleading statement in the particulars, or the omission from the particulars of any matter required under section 80 or section 81 of FSMA. Additionally, section 90A of FSMA extends the issuer's liability to include liability to persons that have suffered loss as a result of a misleading statement or dishonest omission in the prospectus or a dishonest delay in publishing the information. Consequently, not only persons acquiring the sukuk direct upon issue but also those trading the sukuk on the secondary market would be entitled to bring a claim pursuant to these provisions.

Law stated - 19 August 2022

Jurisdiction in disputes

Which courts, tribunals or other bodies have jurisdiction to hear Islamic finance disputes?

There are no specific courts or tribunals in the United Kingdom that hear Islamic financing disputes. The matter would be dealt with by the competent court in the United Kingdom, which, at first instance and depending on the complexity and final value of the dispute, is likely to be either the county court or the High Court of Justice.

Law stated - 19 August 2022

CONTRACTING CONCEPTS

Accommodation of concepts

Mudarabah – profit sharing partnership separating responsibility for capital investment and management.

The entry into a mudarabah arrangement is acceptable for a UK entity or person as it would be treated as akin to a partnership arrangement wherein the investor (rab-al-mal) contributes the capital and the recipient (mudarib) provides professional or managerial expertise to carry out the venture to earn a profit that is shared between the rab-al-mal and the mudarib in accordance with an agreed ratio.

Where a mudarabah is used for deposits with a bank, care must be taken to ensure any deposit complies with the definition of 'deposit' in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (as amended) (RAO). While a traditional mudarabah requires that the rab-al-mal bears the risk of any loss on the deposit, the RAO requires that to be classified as a deposit under article 5(2) of the RAO, the depositor must be entitled to the right to repayment, whether on-demand or in accordance with terms agreed. The Financial Conduct Authority's (FCA) solution to this and to ensure that Islamic deposits are categorised as protected deposits under FCA rules (and therefore that customers who deposit funds with IFIs receive equivalent deposit protection to conventional depositors under the Financial Services Compensation Scheme) was that depositors under a mudarabah would be entitled to full payment of the amount deposited (thereby satisfying the RAO requirement). As this could be construed as a guarantee of the deposit by the mudarib and depart from the principle that the rab-al-mal bears the risk of any loss on the deposit, the rab-al-mal would, however, have the right to opt out of the deposit protection subsequently on religious grounds and choose to be repaid under the risk-sharing methodology reflecting a traditional mudarabah . In 2017, Dana Gas (an issuer based in the United Arab Emirates) attempted 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 appears to be a guarantee from the mudarib of the face amount of the sukuk contrary to the risk-sharing methodology reflecting a traditional mudarabah . While 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 Gas had 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 . On 17 November 2017, the English High Court ruled against Dana Gas on all grounds.

Law stated - 19 August 2022

Murabahah – cost plus profit agreement.

Murabahah transactions can generally be implemented under English law. As in economic terms the murabahah is akin to a loan, the transactions would be classified as loans for International Financial Reporting Standards (IFRS) purposes.

With respect to the taxation of a murabahah transaction, prior to the introduction of section 57 of the Finance Act 2005 (replaced by section 564C of the Income Tax Act 2007 and sections 503 and 511 of the Corporation Tax Act 2009), the profit paid by the customer to the bank would not have been tax-deductible by the customer. However, since the new legislation came into effect, subject to satisfying the applicable preconditions, such profit would now be treated as interest payable during the period of the loan and hence qualify for a tax deduction.

Where the assets acquired by the bank under the murabahah transaction include real property, while stamp duty land tax (SDLT) would otherwise have been levied on both the purchase of property by the bank and the subsequent sale to the customer, since the introduction of section 73 of the Finance Act 2003, provided certain conditions are met, no

SDLT is payable on the subsequent sale of the property by the bank.

For VAT purposes, HMRC treats the sale of the asset by the vendor and the onward sale by the bank to the customer in accordance with the normal VAT rules, which will be dependent on the nature and location of the asset.

Law stated - 19 August 2022

Musharakah – profit sharing joint venture partnership agreement.

It is permissible for a UK entity or person to enter into a musharakah arrangement as it is akin to a joint venture or partnership arrangement. However, care should be taken to determine whether the musharakah arrangement could fall within the broad definition of 'collective investment scheme' in FSMA. To the extent the musharakah arrangement is considered a collective investment scheme, the IFI may need to apply for permission under FSMA.

A musharakah where each partner's share in the capital remains constant would be treated as a partnership and therefore be transparent for tax purposes, which means that the profits of the partners would be taxed.

In the case of a diminishing musharakah, following the enactment of section 47A of the Finance Act 2005 (replaced by section 564C of the Income Tax Act 2007 and sections 503 and 511 of the Corporation Tax Act 2009), and provided that the specified conditions are met, the return paid to the financier is now treated as if it were interest payable on a loan and is tax-deductible.

Law stated - 19 August 2022

Ijarah – lease to own agreement.

An ijarah will generally be classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership to the lessee. If, substantially, all the risks and rewards incidental to ownership are transferred to the lessee, such an ijarah is likely to be categorised as a finance lease. An ijarah munthahiyah bi-tamlik (lease to own) is akin to a conventional hire-purchase agreement and so would be accounted for in the same way as a finance lease.

Law stated - 19 August 2022

Wadiah – safekeeping agreement.

Wadiah agreements are not commonly used in the United Kingdom, but entering into such an agreement should be possible provided the applicable regulatory requirements are met.

Law stated - 19 August 2022

PRODUCTS

Securities structuring

Sukuk – Islamic securities. Have sukuk or other Islamic securities been structured and issued in your jurisdiction to comply with Islamic principles, such as the prohibition of interest?

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 that complies with Islamic principles. On its website, the London Stock Exchange (LSE) boasts that over US\$50 billion has

been raised through 68 sukuk issuances listed on the LSE, and such securities can be admitted on either the Main Market, which is a regulated market under the UK Markets in Financial Instruments Regulation, or the Professional Securities Market, which is a platform reserved for professional investors and is not a regulated market. Most of the listed sukuk have been structured as either sukuk al-mudarabah or sukuk al-ijarah . To take advantage of certain tax efficiencies, the vehicle that is most often adopted by issuers is a limited company incorporated in a tax-efficient jurisdiction. 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.

The requirements in relation to listings of sukuk on the Main Market are governed by the Financial Services and Markets Act 2000 (FSMA) and the UK Listing Authority's Prospectus Rules, the Listing Rules and the Disclosure and Transparency Rules. An application to list a sukuk on the Official List must be submitted to the Financial Conduct Authority together with listing particulars, which, in accordance with section 80(1) FSMA, should contain all such information as investors and their advisers would reasonably require, and reasonably expect to find there, for the purpose of making an informed assessment of the assets and liabilities, financial position, profits and losses, and prospects of the issuer of the securities, and the rights attaching to the securities.

Law stated - 19 August 2022

Legal position

What is the legal position of sukuk holders in an insolvency or a restructuring? Are sukuk instruments viewed as equity or debt instruments? Have there been any court decisions or legislation declaring whether sukuk holders are deemed to own the underlying assets?

There are various structures that can be adopted for a sukuk that may have an impact on 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.

On an insolvency involving the issuer, the legal position of sukuk holders should not be any different from that of conventional bondholders in that the sukuk holders would have a debt claim against the issuer for the outstanding face amount of their respective certificates.

Whether a sukuk is treated as an equity or 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 is 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 need 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.

There have been no English court decisions, nor has there been legislation declaring whether sukuk holders are deemed to own the underlying assets.

Law stated - 19 August 2022

Insurance

Takaful – Islamic insurance. Are there any conventional cooperative or mutual insurance vehicles that are, or could be adapted to be, shariah-compliant?

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 United Kingdom, the friendly society would need 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 to them) receives insurance or similar benefits from the society.

Law stated - 19 August 2022

Which lines of insurance are currently covered in the takaful market? Is takaful typically ceded to conventional reinsurers or is retakaful common in practice?

The UK takaful insurance market is in its infancy. Principle Insurance attempted to provide takaful motor insurance but suffered significant financial difficulties in 2009. Cobalt Underwriting launched a takaful structure in 2013 that allows syndication of the risks across a number of insurers, but it remains to be seen how successful this venture will be.

Law stated - 19 August 2022

MISCELLANEOUS

Regulatory obstacles

What are the principal regulatory obstacles facing the Islamic finance industry in your jurisdiction?

In view of the legislation designed to remedy the adverse treatment of Islamic products relative to corresponding conventional products, and the non-discriminatory regime of the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) towards ensuring the same authorisation and prudential requirements that apply to conventional firms also apply to IFIs, there appear to be no immediately apparent regulatory hurdles for the Islamic finance industry in the United Kingdom.

In HM Treasury's paper 'Development of Islamic Finance in the UK', issued in December 2008, the government identified a number of areas in which further progress was necessary to develop the Islamic finance industry. These included:

- the need to create a set of robust and accessible term sheets for the main Islamic products through collaboration between industry and international standard-setting bodies;
- the need to raise awareness of, and knowledge about, Islamic finance at the grassroots level; and
- the need to highlight the United Kingdom's strength as a provider of education, training and skills in Islamic finance.

Law stated - 19 August 2022

Shariah law

In what circumstances may shariah law become the governing law for a contract or a dispute? Have there been any recent notable cases on jurisdictional issues, the applicability of shariah or the conflict of shariah and local law relevant to the finance sector?

Shariah law is not applied in the United Kingdom 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.

The approach of the English courts, in the main, has been to distinguish between shariah and the contractual governing law of an Islamic finance agreement by ruling that shariah issues are not justiciable in the English courts. That element of the agreement is deemed as forming part of the commercial agreement (which English courts will rarely interfere with) and not the legal agreement. Instead, the dispute will be dealt with applying the ordinary principles of English law and an English court will avoid ruling or commenting on the compliance of the agreement with shariah (see *Shamil Bank of Bahrain v Beximco Pharmaceuticals Ltd* [2003] 2 All ER (Comm) 84). This approach was reaffirmed in a recent English High Court case, *Dana Gas PJSC v Dana Gas Sukuk Ltd & Ors* [2017] EWHC 2928, where Dana Gas (an issuer based in the United Arab Emirates) was attempting to render its mudarabah sukuk unenforceable on a number of grounds, one of which was that its sukuk was not shariah-compliant.

Parties may still elect to have a dispute in relation to a contract determined and resolved in accordance with shariah principles by submitting to arbitration. Under section 46 of the Arbitration Act 1996, arbitral tribunals are obliged to decide disputes with reference to either the national law chosen by the parties or any other agreed considerations (including shariah considerations).

Law stated - 19 August 2022

Institutional takeover

Are there any special considerations for the takeover of an Islamic financial institution, outside the requirements of the general merger control regime?

The United Kingdom has no special rules governing the takeover of an IFI.

Law stated - 19 August 2022

Other notable features

Are there any notable features of the Islamic finance regime and markets for Islamic finance products in your jurisdiction not covered above?

Not applicable.

Law stated - 19 August 2022

UPDATES AND TRENDS

Key developments of the past year

Are there any proposals for new legislation or regulation, or to revise existing legislation or regulation? If so, please give a reference to any written material, whether official or press reports. Are there any other current developments or trends that should be noted?

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 government has a track record of reacting to the demands of the market as they arise.

In terms of commercial and transactional developments, 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 and the latest shariah -compliant fintech in digital bank Nomo should be the first of a number of similar initiatives. Furthermore, in July 2022, the UK's first shariah -certified credit card, the Score Mastercard, was launched by DND Finance in a bid to service the estimated 100,000-plus Islamic finance retail customers in the UK.

The government has done its part to encourage Islamic finance through the issuance of two sukuk , which have paved the way for UK corporate issuers to follow suit. Organisations from the UK have also taken the lead on the global stage, with the Islamic Finance Council UK, Her Majesty's Treasury and London Stock Exchange Group all becoming founding members of a High Level Working Group on Green Sukuk (HLWG). The HLWG was launched in November 2021 to help global financial leaders meet their goal of unlocking over US\$30 billion of capital by way of green and sustainability-linked sukuk by 2025. 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.

Law stated - 19 August 2022

Jurisdictions

	Japan	Nagashima Ohno & Tsunematsu
	Nigeria	Bloomfield Law
	Philippines	Morales & Justiniano
	Switzerland	MLL Meyerlustenberger Lachenal Froriep Ltd
	United Kingdom	Milbank LLP