The Islamic Finance and Markets Law Review

Second Edition

Editors

John Dewar and Munib Hussain

The Law Reviews

© 2017 Law Business Research Ltd

THE ISLAMIC FINANCE AND MARKETS LAW REVIEW

SECOND EDITION

Reproduced with permission from Law Business Research Ltd
This article was first published in November 2017
For further information please contact Nick.Barette@thelawreviews.co.uk

Editors
John Dewar and Munib Hussain

THE LAWREVIEWS

© 2017 Law Business Research Ltd

PUBLISHER
Gideon Roberton

SENIOR BUSINESS DEVELOPMENT MANAGER
Nick Barette

BUSINESS DEVELOPMENT MANAGERS
Thomas Lee, Joel Woods

ACCOUNT MANAGERS
Pere Aspinall, Sophie Emberson,
Laura Lynas, Jack Bagnall

PRODUCT MARKETING EXECUTIVE
Rebecca Mogridge

RESEARCHER
Arthur Hunter

EDITORIAL COORDINATOR
Gavin Jordan

HEAD OF PRODUCTION
Adam Myers

PRODUCTION EDITOR
Harry Turner

SUBEDITOR
Robbie Kelly

CHIEF EXECUTIVE OFFICER
Paul Howarth

Published in the United Kingdom
by Law Business Research Ltd, London
87 Lancaster Road, London, W11 1QQ, UK
© 2017 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 is accurate as of October 2017, 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 – gideon.roberton@lbresearch.com

ISBN 978-1-910813-88-1

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

THE LAW REVIEWS

THE MERGERS AND ACQUISITIONS REVIEW

THE RESTRUCTURING REVIEW

THE PRIVATE COMPETITION ENFORCEMENT REVIEW

THE DISPUTE RESOLUTION REVIEW

THE EMPLOYMENT LAW REVIEW

THE PUBLIC COMPETITION ENFORCEMENT REVIEW

THE BANKING REGULATION REVIEW

THE INTERNATIONAL ARBITRATION REVIEW

THE MERGER CONTROL REVIEW

THE TECHNOLOGY, MEDIA AND TELECOMMUNICATIONS REVIEW

THE INWARD INVESTMENT AND INTERNATIONAL TAXATION REVIEW

THE CORPORATE GOVERNANCE REVIEW

THE CORPORATE IMMIGRATION REVIEW

THE INTERNATIONAL INVESTIGATIONS REVIEW

THE PROJECTS AND CONSTRUCTION REVIEW

THE INTERNATIONAL CAPITAL MARKETS REVIEW

THE REAL ESTATE LAW REVIEW

THE PRIVATE EQUITY REVIEW

THE ENERGY REGULATION AND MARKETS REVIEW

THE INTELLECTUAL PROPERTY REVIEW

THE ASSET MANAGEMENT REVIEW

THE PRIVATE WEALTH AND PRIVATE CLIENT REVIEW

THE MINING LAW REVIEW

THE EXECUTIVE REMUNERATION REVIEW

THE ANTI-BRIBERY AND ANTI-CORRUPTION REVIEW

THE CARTELS AND LENIENCY REVIEW

THE TAX DISPUTES AND LITIGATION REVIEW

THE LIFE SCIENCES LAW REVIEW

THE INSURANCE AND REINSURANCE LAW REVIEW

© 2017 Law Business Research Ltd

THE GOVERNMENT PROCUREMENT REVIEW

THE DOMINANCE AND MONOPOLIES REVIEW

THE AVIATION LAW REVIEW

THE FOREIGN INVESTMENT REGULATION REVIEW

THE ASSET TRACING AND RECOVERY REVIEW

THE INSOLVENCY REVIEW

THE OIL AND GAS LAW REVIEW

THE FRANCHISE LAW REVIEW

THE PRODUCT REGULATION AND LIABILITY REVIEW

THE SHIPPING LAW REVIEW

THE ACQUISITION AND LEVERAGED FINANCE REVIEW

THE PRIVACY, DATA PROTECTION AND CYBERSECURITY LAW REVIEW

THE PUBLIC–PRIVATE PARTNERSHIP LAW REVIEW

THE TRANSPORT FINANCE LAW REVIEW

THE SECURITIES LITIGATION REVIEW

THE LENDING AND SECURED FINANCE REVIEW

THE INTERNATIONAL TRADE LAW REVIEW

THE SPORTS LAW REVIEW

THE INVESTMENT TREATY ARBITRATION REVIEW

THE GAMBLING LAW REVIEW

THE INTELLECTUAL PROPERTY AND ANTITRUST REVIEW

THE REAL ESTATE M&A AND PRIVATE EQUITY REVIEW

THE SHAREHOLDER RIGHTS AND ACTIVISM REVIEW

THE ISLAMIC FINANCE AND MARKETS LAW REVIEW

THE ENVIRONMENT AND CLIMATE CHANGE LAW REVIEW

THE CONSUMER FINANCE LAW REVIEW

THE INITIAL PUBLIC OFFERINGS REVIEW

THE CLASS ACTIONS LAW REVIEW

THE TRANSFER PRICING LAW REVIEW

THE BANKING LITIGATION LAW REVIEW

THE HEALTHCARE LAW REVIEW

www.TheLawReviews.co.uk

© 2017 Law Business Research Ltd

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

ALLEN & OVERY SCS (LUXEMBOURG)

BAKER MCKENZIE LLP

DE BRAUW BLACKSTONE WESTBROEK

MATOUK BASSIOUNY

MILBANK, TWEED, HADLEY & MCCLOY LLP

MORALES & JUSTINIANO

OGIER

PAKSOY

TROWERS & HAMLINS

© 2017 Law Business Research Ltd

CONTENTS

PREFACE.. v
John Dewar and Munib Hussain

Chapter 1 BAHRAIN 1
Salman Ahmed, Brian Kelleher, Shah Malik and Sabah Shah

Chapter 2 CAYMAN ISLANDS 9
Anthony Oakes

Chapter 3 EGYPT 17
Mahmoud Bassiouny

Chapter 4 LUXEMBOURG.. 20
Frank Mausen, Christopher Dortschy, Evelina Palgan and Zofia White

Chapter 5 MALAYSIA 35
Rodney Gerard D'Cruz and Murni Zuyati Zulkifli Aziz

Chapter 6 NETHERLANDS 58
Omar Salah

Chapter 7 PHILIPPINES 65
Rafael A Morales

Chapter 8 TURKEY.. 73
Sera Somay and Özlem Barut

Chapter 9 UNITED ARAB EMIRATES 77
Amjad Ali Khan and Rahat Dar

Chapter 10 UNITED KINGDOM 91
John Dewar and Munib Hussain

© 2017 Law Business Research Ltd

Chapter 11 UNITED STATES 102
Mona E Dajani and Dong Whi (Tony) Noh

Appendix 1 ABOUT THE AUTHORS 109
Appendix 2 CONTRIBUTING LAW FIRMS' CONTACT DETAILS 117

© 2017 Law Business Research Ltd

PREFACE

We are honoured to present the second 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*, *Shaf'i* and *Hanbli*.

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 which rebuts that presumption by declaring it as

© 2017 Law Business Research Ltd

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 of 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

© 2017 Law Business Research Ltd

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.

Ijarah (lease)

The *ijarah* is a form of lease financing pursuant to which 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

© 2017 Law Business Research Ltd

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. At the time of publication, Dana Gas (an issuer based in the UAE) was attempting 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 muntahiya 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 profit-and-loss sharing.

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.

Combinations of the above 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 pursuant to an *ijarah*.

iv Conclusion

Islamic finance has grown rapidly during the past 20 years, in 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,

© 2017 Law Business Research Ltd

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, Tweed, Hadley & McCloy LLP
London
September 2017

© 2017 Law Business Research Ltd

Chapter 6

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

---

1 Omar Salah is a senior associate at De Brauw Blackstone Westbroek and a visiting professor at IE Business School.

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.

© 2017 Law Business Research Ltd

may need amendments to specifically address Islamic finance products.[4] 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 need 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 thereof. A comparable regulatory regime applies to insurance companies (whether conventional or the Islamic *takaful*), which also need 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 on 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 need 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.[5] Furthermore, the Mortgage Credit Directive (2014/17/EU) was implemented in the Netherlands on 14 July 2016, resulting in the introduction of a new Chapter 2b to Book 7 DCC and amendments to the FMSA. These amendments relate to new rules on credit worthiness assessments, obligations to provide information to consumers, and customers having certain consumer protection rights in cases of early repayments, arrears and foreclosures. As of 1 January 2017, Chapters 2a and 2b of Book 7 DCC were further amended and a new Chapter 2c was introduced, with rules on consumer credit, asset financing and loans. These amendments mainly relate to the abolishment of Chapter 5a of Book 7A DCC and the Interim Hire Purchase Immovable Property Act (IHPIPA), and the transfer of a large part of their articles to the aforementioned parts of Book 7 DCC. Chapter 5a of Book 7A DCC and IHPIPA used to contain mandatory rules for leasing contracts such as the *ijarah* and the *ijarah wa iqtina*, but also for a purchase

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

5 As a result of the implementation of the Consumer Credit Directive (2008/48/EC) in the Netherlands, a new Chapter 2a was introduced to Book 7 DCC and the Act on Consumer Credit was amended (whereby a large number of articles were abolished and transferred to Chapter 2a of Book 7 DCC).

© 2017 Law Business Research Ltd

and sale of property in instalments such as the *murabaha* (as will be further discussed below). The most important change of their abolishment and the amendments to Book 7 DCC is that the provisions are no longer mandatory for professional parties, but they are only mandatory if the borrower or lessee is a consumer.

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 private company with limited liability (*besloten vennootschap* (BV)) or a public limited liability company (*naamloze vennootschap* (NV)).[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 7:84 (3) and 7:101 DCC. As mentioned above, as of 1 January 2017 no mandatory rules under Book 7 DCC that may conflict with Islamic law apply to the *murabaha*, *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 case of early repayment) need 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 thereof are more closely connected to the Netherlands, then under Article 13 of the Hague Trust Convention the

6 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.

© 2017 Law Business Research Ltd

Netherlands is not bound to recognise an English law trust. In such cases, 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 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 need to approve a prospectus for the issuance of *sukuk* in the Netherlands.

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, Ic 23 on Netherlands, in: J Putnis (ed), *The Banking Regulation Review*, Law Business Research 2017, pp. 340–356.

© 2017 Law Business Research Ltd

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.

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, which will acquire the real estate (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 documenation 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.

© 2017 Law Business Research Ltd

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.

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.

© 2017 Law Business Research Ltd

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.

VII OUTLOOK

Within the Netherlands, the major Dutch banks, such as Rabobank, ABN AMRO, ING and the Volksbank (formerly SNS Bank), have not yet shown much interest in entering, or developing, the Islamic finance market. There are no significant reasons to believe that this will change in the near future either. However, 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. To the extent that they will increase their interest and activities in Islamic finance, the author expects this will be mainly in Islamic jurisdictions.

Certain foreign Islamic banks have been looking with interest to the Dutch Islamic finance market for retail banking. The entrance of these foreign Islamic 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. 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 for providing 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 such transactions.

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.

© 2017 Law Business Research Ltd

ABOUT THE AUTHORS

OMAR SALAH
De Brauw Blackstone Westbroek

Omar Salah is a corporate and finance lawyer at De Brauw Blackstone Westbroek in Singapore. He has an Asia-based practice focusing on banking and finance, mergers and acquisitions, and international restructurings. Some of his recent work includes advising on (Islamic) finance transactions, multi-jurisdictional acquisitions and distressed debt trading. Omar regularly represents multinational companies, financial institutions and private equity firms. Before joining the corporate and finance practice group, Omar was with the corporate litigation and insolvency practice group where he gained experience in Dutch Supreme Court, corporate, and bankruptcy litigation at the Amsterdam offices of De Brauw.

Omar has noted expertise in Islamic finance. 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) and regularly publishes on Islamic finance law. He has been teaching, and conducting research on, Islamic finance law at various universities worldwide (among others University of Oxford, University of Cambridge, University of Melbourne, Leiden University and Tilburg University) and is a frequent speaker at international conferences. Omar was seconded to the global Islamic finance and investment practice group of King & Spalding, London in 2010.

DE BRAUW BLACKSTONE WESTBROEK
Marina Bay Financial Centre Tower 3
12 Marina Boulevard #17-01
Singapore 018982
Tel: +65 6809 5016 / 8354 1742
Fax: +65 6809 5276
omar.salah@debrauw.com
www.debrauw.com

© 2017 Law Business Research Ltd

Strategic Research Sponsor of the
ABA Section of International Law

ISBN 978-1-910813-88-1

© 2017 Law Business Research Ltd