

# Islamic Financing and the relevant laws of the UAE

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Islamic financing has made a major breakthrough in the financial world and over the past few years and has now proven to be a major contender to conventional financing in the UAE.

Still in its infancy compared to the established conventional banking system, stumbling blocks on structuring Islamic financing products such that they are competitive with their conventional counterparts, are slowly being overcome. One of these is the interplay between the laws of the UAE and Shari'a concepts.

The Shari'a is an abstract form of law derived from Islamic principles and is capable of adaptation, development and further interpretation. It is not a codified law in the UAE. The Shari'a does not prescribe general principles of law, but rather, purports to deal with and cover specific cases or transactions and sets out rules that govern them.

Among the most important teachings of Islam for establishing justice and eliminating exploitation in business transactions, is the prohibition of all sources of unjustified enrichment and the prohibition of dealing in transactions that contain excessive risk or speculation. Accordingly, Islamic scholars have deduced from the Shari'a three principles that form the benchmark of Islamic economics and which distinguish Islamic finance from its conventional counterpart. Briefly, these are:

- (a) The prohibition of interest
- (b) The sharing of profits and losses
- (c) The prohibition against uncertainty and excessive speculation (being speculation over and above that which is necessary and unavoidable in a normal business transaction)

The UAE is governed by a civil law system, which means that all relevant underlying commercial and banking laws are, to a large extent codified. There is no separate legislation within the UAE which codifies Shari'a law for commercial transactions. There are also no separate Shari'a courts to hear disputes arising out of Shari'a financing transactions.

However, as many aspects of Shari'a rulings have been incorporated into the civil law, it can be said that large portions of the UAE commercial laws are underpinned by Shari'a elements and are therefore compatible with Shari'a principles. The courts are also permitted to refer to the Shari'a in the absence of clear legislation and established customary business practices. This is reflected in the approach taken by the UAE Federal Law No. 5 of 1985 Concerning Civil Transactions (the 'Civil Code'), which, together with the Federal Law No. 18 of 1993 concerning the Commercial Transaction Law (the 'Commercial Code'), sets out the main provisions for civil and commercial transactions in the UAE.

## **Applicability of Shari'a principles in the UAE**

The main challenge in structuring and offering Islamic compliant products in the UAE is to bridge the occasional mismatch between the laws of the UAE and the principles of Shari'a.

In many instances, the provisions of the UAE law are reflective of Shari'a principles, such as the pre-requisites relating to capacity to contract, the requirement for clarity of contractual terms, the absence of duress and the specific conditions governing sale and purchase transactions. In these instances, such transactions are fully compliant with both Shari'a elements and UAE law from the outset.

In other cases, the provisions of the UAE laws are inconsistent with Shari'a principles. For example, the charging of interest is generally permitted under UAE law as long as it is not unduly excessive (this being reflected by the flourishing conventional banking system in the UAE). However, interest is strictly prohibited under Shari'a, no matter how nominal the amount. Similarly, while it is not illegal under UAE law to deal with certain items such as pork products and the entertainment industry, these are prohibited under Shari'a. In such cases, it is best that these restrictions and prohibitions are eliminated from the financing structure and, where applicable, removed from the relevant agreements in order to ensure Shari'a compliance.

Less clear are transactions falling within grey areas, where UAE laws are silent and customary practice offers little guidance. An example is the legally untested area of derivatives transactions. From a Shari'a perspective, there are concerns that the speculative and uncertain nature of derivatives may breach Shari'a provisions. However, UAE laws are silent on this issue, and market practice has not developed to such an extent as to provide conclusive guidance. As the courts are permitted to refer to the Shari'a in the absence of clear legislation and established customary business practices, it is likely that courts will rely on the Shari'a criteria in analyzing the legality of a derivatives transaction.

### **The role of Shari'a pronouncements**

It is standard practice for each Shari'a product to be structured and certified as Shari'a compliant by Shari'a scholars or experts (who are usually appointed by the Islamic financial institutions).

Once a product is offered to the public by a licensed financial institution in the UAE, it would be reasonable to assume that such product has undergone legal and Shari'a analyses before approval was granted for such product to be made available to the public.

However, while such pronouncements formalizes the approval from the Shari'a perspective, they have no binding effect. The UAE courts are not compelled to take the Shari'a pronouncements into consideration when determining a case, and will most likely simply rely on the terms of the contract.

### **Disputes under Shari'a financial transactions**

Should a dispute be brought to a UAE court, the court is unlikely to apply a different treatment to the dispute solely on account of the transaction being Shari'a compliant. The dispute will be subject to the same processes and procedures as a conventional financing counterpart.

The courts will also apply the laws of the UAE in determining the case. Notably, if a document purports to be governed by Shari'a law, courts will likely disregard such choice of law, and will instead apply the applicable UAE laws.

To maintain the legal enforceability of an agreement, it is prudent that all the elements necessary for Shari'a compliance purposes are contractually provided for within the body of the agreement itself. Notably, under the Civil Code, where the intention of the parties is clear from the language of the contract, the courts will not imply any further meaning or additional terms to the contrary. Save in the cases where the contract was unclear and the provisions of the law and customary practice are silent on an issue, the UAE courts are unlikely to examine the Shari'a aspects of a document.

### **Shari'a products offered in the UAE**

The Islamic financial institutions within the UAE offer many mainstream products that one would expect to find, such as ijarah, murabaha, mudaraba and istisna. These are both from the loan and deposit aspects, and are fully supported by the normal ancillary services such as the provision of chequebooks, internet banking and Shari'a compliant credit cards.

It is a Shari'a requirement that all Shari'a structures must comply with the laws of the jurisdiction in which

it is made available. For that reason, due to legal limitations, certain products such as those which involve trust arrangements or beneficial ownership over land, are not offered in the UAE, as their structures are incompatible with UAE land laws.

### **Security arrangements for Shari'a financing**

Security arrangements for Shari'a compliant products are similar to their conventional counterparts, with modifications to remove elements of interest. One can therefore expect to find the standard security documents such as mortgages, assignments over assets, pledges and guarantees. While the suitability of such security arrangements depends on the underlying Shari'a structure, such security documents will be enforced by the UAE courts provided that they have been duly perfected under UAE law.

As a general overview, the UAE Civil Code has a strong Shari'a foundation which supports the proper regulation of Islamic financial mechanisms. Due to economic realities, certain mismatches between UAE laws and Shari'a principles exist, however, such incompatibilities are minimal compared to other major financial jurisdictions.