

MAYER • BROWN

1st IIR Islamic Finance & Real Estate Forum

Legal issues in structuring Shariah compliant investments

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German Supervisory law vs Shariah board

- BaFin shall supervise the institution in accordance with the provision of the German Banking Act
- Observe organisational duties
- Minimum requirements for Risk Management (MaRisk)
 - Business strategy
 - Internal control system
 - Organisational study
 - Internal auditing
- Advisor to the Management

Distribution of Islamic funds in Germany (I)

- Generally, public distribution of investment fund units requires notification to German Federal Financial Supervisory Authority (BaFin)
- Funds which are not notified may only be distributed by private placement
- German Investment Act (“InVG”) also applies to public distribution of foreign investment funds within Germany
- Risk diversification required to fall in the InVG

Distribution of Islamic funds in Germany (II)

- If the public distribution has been notified and was not rejected by the BaFin, the fund units can be distributed to the public in Germany
- Public distribution
 - Public distribution means distribution by way of public offering, public advertisement etc.
 - number of people are pre-determined
 - investors are not individually known to the offeror

Distribution of Islamic funds in Germany (III)

- Private placement
 - fund units are sold to a restricted circle of persons
 - persons are known by the offeror prior to the offer
 - if they are addressed by him on the basis of a selected choice according to individual aspects

Distribution of Islamic funds in Germany (IV)

- Amendment to InVG
 - if offer of the fund units solely to professional investors in Germany (Ø private placement) (sample)
 - credit institution
 - financial service institution
 - insurance companies
 - pension funds
 - Advertisement of products as “Shariah compliant” in the light of the German Unfair Competition Act

Distribution of Islamic funds in Germany (V)

- Banking Licence
 - conduct banking business or financial services in Germany requires a licence from the BaFin
 - BaFin's note April 2005

Transformation of a bank into an Islamic finance institution (I)

- Set-up of a new bank
- Acquisition of a bank
 - Section 2c para. 1 German Banking Act: Any person or entity that has the intention to acquire a significant participation in German regulated institutes has to inform BaFin and Deutsche Bundesbank immediately
 - A significant participation is given, if through direct or indirect participations or through acting in context with the parties at least 10% of the equity or voting rights are held
 - Acquisition needs to be notified as mentioned above
 - BaFin can reject, acquisition is not possible

Transformation of a bank into an Islamic finance institution (II)

- Deposit participation fund
- Organisational duties
- Reorganisation with the requirements of Accounting and Auditing Organization for Islamic Financial Institutions (Shariah standards No. 6)

Jurisdiction clause vs Shariah law

- Decision London High Court, 1 August 2003, Shanil Bank of Bahrain vs Beximco Pharmaceuticals Ltd. and Others
- Article 27 of the Introductory Act of the German Civil Code
 - Choice of law requires a choice of a specific jurisdiction
 - Arbitration clause / non-specific jurisdiction law à possible (non-state principles)

Drafting of Shariah compliant contracts from a German law perspective (I)

- With the acquisition of property, the purchaser becomes liable for the premises (tax, legal, environmental liability etc)
- When using a German company as purchaser and only the assets of the purchase entity are available to satisfy the claims of the creditors under exceptional circumstances, the shareholders of the purchase may be held liable, in case of
 - substantial under-capitalisation;
 - mingling of assets;

Drafting of Shariah compliant contracts from a German law perspective (II)

- destructive intervention (*existenzgefährdender Eingriff*)
- abuse of legal form

Hence: Parties shall agree to different indemnifications and/or hold harmless clauses between the parties

Many thanks!

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