

United Arab Emirates – Islamic Finance: A Legal and Regulatory Framework

By Bashir Ahmed – Afridi & Angell

There are several Islamic banks and finance companies established and operating in the United Arab Emirates (UAE). These are primarily regulated by the UAE Central Bank pursuant to UAE Law No. 10 of 1980 concerning the Central Bank, the Monetary System and the Organization of Banking (the Banking Law).

Islamic banks are licensed under the *Banking Law* as commercial banks and are generally subject to the same regulations. However, as Islamic banks operate by purchasing and selling goods as well as investing in projects, such banks would be unable to operate without exemption from some of the restrictions applicable to commercial banks under the Banking Law. UAE Law No. 6 of 1985 regarding Islamic banks, financial institutions and investment companies was therefore promulgated to allow such Islamic institutions to engage in commercial, trading, finance and investment activities which are otherwise prohibited to conventional commercial banks. Such Islamic banks, financial institutions and investment companies are required to provide, in their Memorandum and Articles of Association, for the formation of a *Shariah* Board or controlling authority. Such institutions are also subject to regulation by the Ministry of Justice, Islamic Affairs and Awqaf.

Islamic banks and finance companies incorporated in the UAE are required to be structured as public joint stock companies (an Islamic finance company need not be a public joint stock company if one of its founders is itself a public joint stock company). Under UAE Law No. 8 of 1984, as amended, concerning commercial companies (Companies Law), the founders of a public joint stock company are required to subscribe to between 20% to 45% of the capital of the company, with the balance subscribed by the general public.

REGULATORY AUTHORITY

Although Islamic financial institutions are subject to regulation both by the Ministry of Islamic Affairs and by the Central Bank, in practice, the Central Bank exercises regulatory authority as well as rights of supervision and inspection. In response to the growth in demand for Islamic compliant financing, and foreseeing an increase in the number of Islamic finance companies in the UAE, in 2004 the Central Bank promulgated the *Central Bank Board of Directors Resolution No. 165/6 of 2004 Concerning the Regulation of Finance Companies That Conduct Their Activity in Accordance with the Provisions of the Islamic Shariah* (the Resolution).

The resolution provides that an Islamic finance company must operate in accordance with the principles of Islamic *Shariah* and may:

- provide financing for personal and consumer purposes including personal financing, property financing and vehicle financing;
- undertake trade financing, issue guarantees and enter into foreign exchange contracts with corporate entities;
- participate in the capital of existing or future projects, subscribe to shares, bonds and/or certificates of deposits;
- accept deposits from and open accounts for corporate entities; and
- manage investment vehicles.

The financial resources of an Islamic finance company shall consist of:

- the paid up capital of the company;
- reserves available to the company;
- undistributed retained profits; and
- fees charged for issuing legal deeds and other instruments granting financing and certificates of deposits.

THE CENTRAL BANK'S ROLE

Islamic finance companies are prohibited from accepting deposits, from making loans to or opening any kinds of accounts for individuals. The prior approval of the Central Bank is required before an Islamic finance company may engage in any additional activities.

The name of an Islamic finance company may not contain the words "bank," "commercial or real estate company" or any other word that indicates activity other than Islamic finance.

The paid up capital of an Islamic finance company must be no less than UAE Dirhams 35,000,000 (approx. US\$ 9.5million), unless approval of the Central Bank has been obtained for a lesser paid up capital. An amount of at least UAE Dirhams 15,000,000 must be deposited with a bank in the UAE and a certificate from such bank confirming the deposit of this amount must be submitted at the time of application. Also required is an undertaking that the balance capital will be deposited immediately after obtaining the preliminary approval of the Central Bank for establishment of the Islamic finance company. At least 60% of its shares must be held by UAE nationals or companies wholly owned by UAE nationals.

A license to carry on Islamic financing activities will be granted by the Central Bank only if the following criteria are met:

- a majority of the board of directors of the company must be nationals of the UAE;
- the founding members must have the necessary personal and professional qualifications

which include the following:

- o must not have been previously sentenced for any crime;
- o must not have defaulted on his/its obligations to banks or other creditors, been declared bankrupt, entered into settlement with creditors, had assets attached;
- the manager and auditor of the Islamic finance company must have knowledge and experience in Islamic financing activities and operations;
- the founders must be at least six individuals and/or corporate entities;
- at least 60% of the members of the board of directors must be knowledgeable and familiar with Islamic financing activities and operations;

The license granted by the Central Bank to an Islamic finance company shall be for a period of five years, renewable for similar periods.

THE SHARIAH SUPERVISORY BOARD

Every Islamic finance company must have a *Shariah* Supervisory Board consisting of at least three members. The Memorandum and Articles of Association of the Islamic finance company must provide for the appointment of the *Shariah* Supervisory Board and its administration. The names of the members of the *Shariah* Supervisory Board must be submitted to the Higher *Shariah* Board of the UAE Ministry of Justice, Islamic Affairs and Awqaf for their approval before being appointed as members of the *Shariah* Supervisory Board of the Islamic finance company.

THE COMPANY'S OBLIGATIONS

An Islamic finance company is subject to a number of continuing obligations.

An Islamic finance company must not engage in currency exchange, the business of financial investment companies, or any other activity for which it is not licensed. No more than 7% of the capital of an Islamic finance company may be used to finance a single person or to deposit or invest in a single facility or group without the prior approval of the Central Bank. An Islamic finance company may not provide financing to any member of its board of directors or a company belonging to such member in excess of 5% of its capital, and in excess of 25% in respect of all members of its board of directors. An Islamic finance company may not provide certificate of deposits that exceed twice the capital and reserves of the company. An Islamic finance company must set aside 10% of its annual net profits towards accumulation of a legal reserve, until such legal reserve equals 50% of the company's paid capital. However, an Islamic finance company shall not be subject to the mandatory cash reserve requirements that are imposed on commercial banks involved in conventional financing.

The prior approval of the Central Bank is required for any change in the name, corporate form, capital or head office location of an Islamic finance company; for merger of an Islamic finance company with another entity; for opening a branch office; for charging its assets; for amendment of its Articles of Association; for any change in composition of the board of directors; for any

change of shareholding in excess of 5%; and for any change in governance.

An Islamic finance company is required to appoint auditors, to maintain regular records in accordance with the forms required by the Central Bank, to use official documents with all of its clients, and to issue all correspondence, documents and deeds under signature of duly authorized representatives. An Islamic finance company may not provide any financing or facilities to or open accounts for its external auditors.

months;

- the license issued to the Islamic finance company by the licensing authority of the Emirate where the company is headquartered is withdrawn.

In promulgating the said Resolution, the Central Bank has largely extended to Islamic finance companies many of the regulations and restriction that are already in place in respect of commercial banks, including Islamic banks.