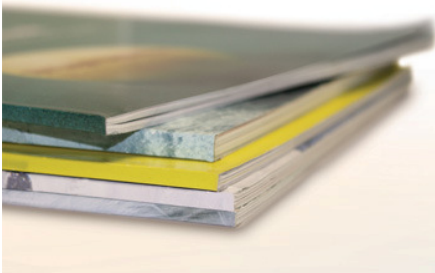


A Crescent Moon Over Guernsey: The Beginning of a Beautiful Friendship

As originally appeared in Finance – Offshore – Winter 2010/11



BY DAVID CLARK

Islamic finance is growing at an annual rate of 10-15%, which makes it one of the fastest-growing segments of the global financial system. There are more than 300 Islamic banking institutions, and over 250 Sharia compliant mutual funds in 51 countries, with an estimated US\$822 billion in Sharia compliant assets worldwide. Last year, even the Vatican remarked that the principles of Islamic finance may represent a possible cure for ailing markets!

In addition, Sharia compliant trusts have become increasingly popular, especially in the Middle East, for the purposes of asset protection and generational wealth preservation.

Given the well established reputation of Guernsey as a leading offshore centre for banking, funds and trusts, it is not surprising that Sharia compliant structures have become an increasingly important

feature in the Bailiwick.

Sharia Decoded

Sharia encourages investment and increasing wealth in accordance with the following principles:

- Charitable principles – i.e. a certain amount of wealth is passed to charity;
- Substantive principles – i.e. not investing in prohibited (Haram) investments (e.g. investments relating to alcohol, pork or gambling); and
- Procedural principles – i.e. not allowing for interest/excess (Riba), uncertainty (Gharar), speculation (Maysir) and not infringing certain specified rights of inheritance.

Islamic Banking

The main types of Islamic mortgages are the “*lease to own*” (Ijara), “*a shared ownership mortgage*” (Musharaka), and the Murabaha. Using the Murabaha as an example; instead of lending the purchaser money, the bank buys the property from the vendor and then re-sells it to the purchaser at a profit, while allowing the buyer to pay the bank in installments. However, the bank's profit cannot be made explicit and therefore there are no additional penalties for late payment. In order to protect itself against default, the bank asks for collateral and the property is registered in the name of the purchaser from the start of the transaction.

Bonds (Sukuks)

A Sukuk is the Islamic equivalent of a bond. The Sukuk constitutes partial ownership in an investment, achieving capital protection without creating a loan by including a binding promise by the issuer to repurchase the relevant assets. Meanwhile, “*rent*” (as opposed to interest) is paid to the investor which is often benchmarked against an interest rate like LIBOR, thereby replicating the cash flow of a conventional bond.

Sharia Funds

A key difference between establishment of a traditional fund and a Sharia fund is the necessity to appoint a Sharia board, which provides guidance to the directors of the fund and to the investment manager on matters of Sharia and in particular whether the proposed investments of the fund are Sharia compliant.

Guernsey is already home to a number of Sharia funds and feeder funds with several launching this year notwithstanding the difficult fund raising environment. Guernsey structures suited to Sharia funds include companies, protected cell companies (PCC's), limited partnerships and unit trusts.

PCC's were pioneered in Guernsey and are often used for multi-class funds. The PCC has a unique legal structure with separate and distinct cells within the same legal entity. A PCC may be useful for structuring a Sharia fund with different sub-funds employing different investment strategies and appointing separate investment advisers. Each cell can be created to offer exposure to a distinct underlying strategy and it is possible to create a single PCC structure offering a range of private equity, real estate and traditional investment options.

Sharia Trusts

Whilst the “*trust*” is an English law concept dating from medieval times, there is also an Islamic law concept known as the “*waqf*” which has many similarities to a trust dating back to at least the 10th century. In essence, the waqf was either a family or charitable endowment of property, created by a donor for use by designated beneficiaries and administered by trustees who in turn were under the supervision of a local judge.

In modern times, Sharia compliant trusts have seen a recent increase in popularity, evidenced by the creation of trust laws in both Dubai and Bahrain in 2007. However, offshore jurisdictions such as

Guernsey remain a popular choice for Sharia compliant trusts. In Guernsey's case, this is due to its well established reputation as a jurisdiction for the creation and administration of trusts, and its modern and flexible trusts law.

A Beautiful Friendship

With its versatile legal system, robust yet pragmatic regulation and strong corporate governance, Guernsey is well positioned to attract Sharia compliant structures from around the Islamic world.

Guernsey's service providers (lawyer's administrators, custodians, tax advisers and accountants) have a wealth of experience in working together with Sharia advisers to create bespoke structures combining the cutting edge expertise of Guernsey with the age old tenets of Sharia. In the immortal words of Humphrey Bogart at the end of Casablanca, "This could be the beginning of a beautiful friendship."

Author: DAVID CLARK
Group Partner – Guernsey
dclark@applebyglobal.com

This publication is intended only to provide a summary of the subject matter covered. It does not purport to be comprehensive or to provide legal advice. No person should act in reliance on any statement contained in this publication without first obtaining specific professional advice.

December 2010

© Appleby

Bahrain
Bermuda
British Virgin Islands

Cayman Islands
Guernsey
Hong Kong

Isle of Man
Jersey
London

Mauritius
Seychelles
Zurich