

Legal Perspective of Converting a conventional Business into an Islamic One

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This phrase fails to demystify the statement because a conventional view of life is not contrary to that of Islam. Rather in some instances a conventional model may be used to serve or further Islamic principles. Examples include the conversion of banks to Sharia compliant banking institutions, and the use of conventional banking services and products to provide Islamic wealth management. This article focuses on methods that a conventional business may apply in order to operate on an Islamic basis. However, it is important to note that, from a UAE legal perspective, there are no specific laws or regulations that govern corporate Shariah practices. Although there may be national laws that apply in some sectors, this article only provides general guidelines.

Although a conventional business and an Islamic business may be fairly similar, there will be a few key differences demanded by Sharia law. These include

- the structure of business arrangements (loan agreements, business-to-business contracts, etc.),
- the structure of investments and debts,
- business sectors in which the company is involved which may be banned under Sharia (alcohol, gambling, etc.),
- any licensing requirements,
- the appointment of a Sharia B/board or a consultant to assist with compliance, and
- Sharia-specific internal controls or constitutional documents.

Structuring business arrangements

First, the company should review and amend its business arrangements to ensure compliance with Sharia principles. Its liabilities must also comply with Sharia standards, which prohibit earning or paying interest. All the facility arrangements the company has undertaken with any financial institution must be Sharia compliant. For instance, conventional property financing will have a prevailing interest rate, a term, and non-payment penalties, while the company retains ownership of the property. Islamic financing for that property will commonly require an ijara model under which the property is owned by the bank and leased to the company. Business loans and arrangements also need to be assessed for Sharia compliance, and any conventional facilities converted. This review will not only include outstanding facility arrangements, third-party guarantees, and corporate credit cards, but business-to-business arrangements that impose penalties, fines or interest.

Compliant investments and debts

A company needs to ensure that its investments are in accordance with Sharia standards, which may be a fundamental change to its risk management. Many company assets (such as savings accounts, stocks, bonds, mutual funds, stock in trade, etc.) may have attributes inconsistent with Sharia principles. Investments and debts are not limited to the financial sector, but extend throughout the value chain. If a company owns grocery stores which sell alcohol or pork products, these products must be removed from the shelves and the entire stock discarded. Any profits or funds related to these products may not be accrued, and the funds may not be mingled with the company's receivables.

Reviewing business sectors

Taking a holistic approach, a company must ensure Sharia compliance within the various business sectors in which it operates or participates. Sharia prohibits engaging in any business that involves pork, alcohol,

gambling, pornography, among other activities. A practical example is a company or a subsidiary which owns a restaurant.. The restaurant may not serve, own, or distribute any alcohol or pork products. In the event that the company sells the restaurant's alcohol stock, then the company may not be considered Sharia compliant until the products are discarded. Any resulting funds may not be utilized as working capital or create a benefit to the company. This becomes more intricate and complex as companies engage in multiple activities and projects that have underlying profit centers (for example, airlines sell alcoholic beverages). This may also be a concern for entities with shareholdings in other companies that may engage in prohibited activities. Even if the shareholding is minimal, the business must be Sharia compliant. This extends to a company's marketing practices. As an example, raffles and other marketing plans may be considered gambling under Sharia law.

Licensing under Sharia

The company must be compliant with all licensing and regulatory requirements within the jurisdictions in which it operates. In the United Arab Emirates/UAE/Emirates, the UAE Commercial Companies Law, Federal Law No. 8 of 1984 (Companies Law), does not specifically regulate Sharia compliance. Rather, the same Companies Law applies to both conventional and Sharia-compliant corporations. This is contrary to the regulation of financial institutions licensed by the UAE Central Bank which has specific requirements for Islamic institutions. The company needs to incorporate any additional or varied regulatory requirements within the new Sharia-compliant model and provide the necessary training for employees to ensure proper and adequate compliance. However, beyond Islamic financial institutions, the option to adopt Sharia compliance will often be an individual choice.

A Sharia Board or consultant

A company should consider the appointment of a Sharia board or a Sharia consultant to aid in the transition and review of the company and its activities. Although not compulsory, it is in the company's interests since a Sharia board will identify even minor elements of its internal operations or asset management that require modification. Currently there are no global or regional standards governing Sharia-compliant companies.

Codes for compliance

The company may elect to indoctrinate the Sharia policies in its corporate structure. This may include the development of internal policies that are drafted according to Sharia standards, or imposing guidelines and restrictions within its Memorandum and Articles of Association. For instance, the Memorandum and Articles of Association may restrict borrowing practices to ensure that all lending (including shareholder loans, guarantees, acquisition of subsidiaries, etc.) will be undertaken in accordance with Sharia principles and standards.

Succession and wealth planning

Finally, a business owner has Islamic wealth management options, even if the business is in a jurisdiction that does not support the division of inheritance in accordance with Sharia law. There are various mechanisms that may be used to divest wealth in accordance with Sharia law, as described in Bank Sarasin's previous reports, Islamic Financial Planning and Estate and Succession Planning, respectively. There are options pertaining exclusively to a corporate structure that provide the greatest flexibility for the distribution of wealth while at the same time preserving the daily operations of the company.

Shares in the business may be distributed in accordance to any desired percentage, including in accordance with Sharia principles. The business owner may maintain control over the new corporate entity through various mechanisms including statutory reserves, controlled voting, sale of stock restrictions, voting restrictions, and guidelines for the management of the company in the Articles of Association. Using a corporate structure, the business owner has the flexibility to retain control over the assets during his lifetime. Further, the corporate structure will continue to exist after the business owner dies, ensuring that his beneficiaries retains their respective inheritance.

The conversion of a conventional entity to a Sharia compliant entity requires great attention to detail.

Business owners are advised to initiate the process with a Sharia consultant who is not only familiar with the business model, but with the relevant jurisdictions' laws and regulations. A Sharia consultant will assist in outlining specific procedures for the conversion and oversee the process, reducing risk.