

THE NEW UAE BANKING LAW AND ITS IMPACT ON ISLAMIC FINANCING IN THE UAE

INTRODUCTION

On 23 September 2018, the President of the United Arab Emirates promulgated Federal Law No. 14 of 2018 on the Central Bank and Organisation of Financial Institutions and Activities (the **New UAE Banking Law**). The New UAE Banking Law came into force on 30 September 2018 on the day of its publication in the Official Gazette.

The New UAE Banking Law will have impact on the regulatory landscape in the UAE for both fully fledged Islamic financial institutions and also conventional financial institutions operating through an Islamic finance window (**Islamic Financial Institutions** or **IFIs**).

One of the key features of the New UAE Banking Law is the establishment of the Higher Shari'a Authority (the **Authority**) which operates under the umbrella of the UAE Central Bank and which will oversee the implementation of Shari'a compliance in the UAE. The establishment of the Authority had been anticipated since 2016 and will assist in pushing forward the UAE's economic vision of becoming the global leader in Islamic finance, setting a roadmap for conformity as to Shari'a compliance at a federal level and fostering greater transparency to market participants.

KEY FEATURES

Repeal of existing banking laws

The Federal Law No. 6 of 1985, which had separately legislated for Islamic banking activities, has been repealed by the New UAE Banking Law. Similarly, Federal Law No. 10 of 1980 on conventional banking activities has also been repealed to unify federal-level banking legislation under one framework.

Key issues

- Repeal of existing banking laws
- Scope
- Implementing regulations
- Internal Shari'a supervision committees

Scope

The New UAE Banking Law applies to those IFIs regulated by the Central Bank and does not apply to the financial free zones (the **FFZs**) and the financial institutions that operate within them (which remain separately regulated by the financial services regulators within those free zones).

Implementing regulations

IFIs may carry on licensed business activities and the Board of Directors of the Central Bank shall issue regulations specifying the activities, conditions, rules and operating procedures for IFIs. We await the publication of such regulations to provide further guidance of how these matters will evolve.

Internal Shari'a supervision committees

Each IFI must establish an independent internal Shari'a supervision committee (a **Committee**). The Committee must establish procedures for the IFI to follow and to supervise the IFI to ensure it complies with the principles of Shari'a in accordance with the rules and principles set out by the Authority.

IFIs that operate in both onshore UAE and in an FFZ jurisdiction and which currently have their Shari'a committees as part of their business in the FFZ(s) would need to constitute a Committee in the onshore UAE jurisdiction under the Authority and Central Bank framework.

OTHER DEVELOPMENTS

In addition, the New UAE Banking Law provides:

- that the identity of the members of the Committee must be approved by the Authority prior to presentation of the potential appointment of such member to the general meeting of the IFI
- that internal Shari'a audit processes will need to be established to monitor compliance with Shari'a
- the requirement to submit an annual report (**Annual Report**) (in the form specified by the Authority) within two months of the end of the financial year (and in respect of which the Authority shall express its opinion prior to the annual general meeting of the IFI) prepared by the Committee to be presented to the annual general meeting of the IFI and which will need to demonstrate the extent of compliance with the provisions of Shari'a in its activities, business, offered products, contracts and documentation. The report must contain the following:
 - a statement of the extent of independence of the Committee
 - a statement of compliance of policies with Shari'a
 - a statement of compliance on the distribution of profits, losses etc. in accordance with the fatwa and opinion of the Committee
 - a statement of breaches of Shari'a provisions and any controls established by the Authority.

CONSEQUENCES FOR FAILURE TO COMPLY

Where an IFI has not conducted its business in compliance with Shari'a, in accordance with the fatwas or opinions of the Authority or the Committee, the Central Bank shall inform the IFI and after consulting with the Authority, ask the IFI to remedy the breach within 30 working days.

It is not clear what kind of corrective measures or actions the Central Bank may take in order to reconcile a breach of Shari'a compliance, including whether this can result in a variation of the contractual terms of any transaction documentation previously entered into by the concerned parties.

However, we note that Article 79(4) of the New UAE Banking Law envisages any disputes over matters of Shari'a compliance between members of a Committee (or between the Committee and an IFI's board of directors) would be referred to the Authority for resolution. This could be a potential avenue for an IFI to seek clarification on differences in views of Shari'a compliance prior to launching a line of business or financial product which may prevent a retrospective assessment of non-Shari'a compliance by the Central Bank or the Authority.

Further, it should be noted that the Central Bank has broad powers, including the ability to impose fines and general power to suspend, withdraw and revoke licenses, in the event of a breach of licensee obligations.

HIGHER SHARI'A AUTHORITY

The New UAE Banking Law now sets out parameters around the constitution, operation and powers of the Authority. The Authority shall determine the rules, standards and principles applicable to the licensed IFIs and the activities they conduct and the Authority has the key role of supervising the Committees of each IFI. It should be noted that fatwas and opinions of the Authority shall be binding on the Committees and the IFIs.

Whilst the New UAE Banking Law sets out the provisions on the establishment of the Authority, the Authority has in fact been in operation prior to the publication of the New UAE Banking Law. Press releases extracting certain minutes of the meetings of the Authority are available on the Central Bank website and indeed the Authority has been consulting with Committees and also publishing directives and instructions (**Resolutions**) to IFIs.

Resolutions that have been sent to IFIs include the following:

- IFIs must conduct their business from 1 September 2018 in accordance with the Shari'a Standards issued by the Accounting and Audited Organisation for Islamic Financial Institutions (**AAOIFI**). Whilst AAOIFI Shari'a Standards are well known in the market, this requirement will have an impact on IFIs conducting transactions in the UAE because, to date, each IFI has been making its own independent assessment as to Shari'a compliance and that has not necessarily been in compliance with AAOIFI principles
- New "financial products" have to be approved by the Authority prior to their use. New "financial products" are products that are intended to be based on standard terms and conditions and where there is no or little negotiation, e.g. retail products and bilateral facilities
- For existing standard financial products, IFIs have been given until 31 December 2020 to ensure they are compliant with AAOIFI Shari'a Standards. IFIs are required to submit a "gap" analysis on the variations between their current financial products and AAOIFI requirements before the end of 2018 with a revision plan. IFIs will therefore need to undertake a review of the existing retail and bilateral structures/documents in light of AAOIFI Shari'a Standards

- We understand that any product/deal which is negotiated (such as syndicated Islamic financings and sukuk transactions) does not need to be specifically approved by the Authority in advance. However, each IFI will need to ensure that the structure and documentation of any transaction is compliant with AAOIFI Shari'a Standards (and will need to confirm this to the Central Bank/Authority in the Annual Report). This principle of self-determination will need further consideration by each IFI as the AAOIFI Shari'a Standards are not prescriptive in nature but rather provide guidance and principles which should be followed. This is likely to have an impact on current transactions and on forthcoming transactions as IFIs will be required to revisit some of the traditional mechanical features of transactions. From a compliance perspective, we assume that the Authority will rely on the principle of self-determination in the Annual Report to ensure the IFI complied with AAOIFI Shari'a Standards. However, it is not clear whether the Authority would go beyond this and actually audit individual underlying transactions themselves.

CONCLUSION

The full impact of the New UAE Banking Law and also resolutions of the Authority issued to IFIs is yet to be seen. However, it is clear that IFIs should review their existing product offerings, governance requirements, standard documentation, current and forthcoming transactions and also their auditing and reporting procedures. Whilst this review may have an impact in the short to medium term, the long-term benefit for the UAE must not be underestimated. Provided that the Authority acts quickly when dealing with new ideas and structures from the market and allows the Islamic finance industry in the UAE to continue to be innovative, the establishment of the Authority can only improve the efficiency and cost savings within IFIs, the quality of the Islamic financial industry in the UAE more generally and provide greater certainty for those that operate within it.

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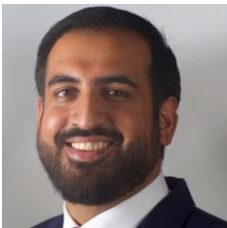
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