Structuring Shari'a compliant investment funds in Ireland

Ireland has earned a reputation globally as a leading jurisdiction in which to establish investment funds. Promoters are attracted by the variety of fund vehicles which may be authorised under the Irish legal and regulatory system. Growth in Irish regulated funds can also be attributed to the domicile's flexibility, product innovation and the willingness of the Irish Financial Services Regulatory Authority (the "Financial Regulator") to adapt and develop its regulations to keep pace with developments in the global funds industry. The Financial Regulator has achieved this while maintaining a robust oversight of the promoters seeking to do business in Ireland.

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Recent years have witnessed an increased worldwide interest in Shari'a compliant funds and Ireland has participated in this growth. Dublin-based law firm Dillon Eustace has significant expertise in Shari'a compliant funds. It has recently advised funds promoted by asset managers from the Middle East, and various Muslim countries, and has also advised on the authorisation of Shari'a compliant funds.

Fund Structure

Funds may be established in Ireland as corporate, trust, contractual or partnership type structures under a wide range of regulatory authorisations, including both non-UCITS (retail, professional investor or qualifying investor) and UCITS type schemes. It is the UCITS structure which has proven the most popular for the Shari'a compliant funds.

UCITS are pan-European collective investment schemes, based on European Union ("EU") directives, transposed into law in each Member State of the EU by local regulations. A UCITS can be marketed across the EU on the basis of its European 'passport'. UCITS have become well recognised on a global basis, with dominant positions in Asia and South America. There is also potential for growth of the UCITS brand among promoters of Shari'a compliant funds as the UCITS framework is well suited for Shari'a compliant funds and offers significant distribution advantages.

UCITS offer a unique fund regime in terms of the structuring of the product, delegation of functions, and supervision of parties, all intended to ensure a high level of protection for investors. Such protection is ensured not only by the level of supervision of the UCITS but also due to the transparency of the UCITS structure through the information provided to investors both in the offering documentation, and on an ongoing basis.

UCITS must also ensure a certain level of diversification of their assets, maintain an appropriate risk management process, and only invest in certain types of assets (transferable securities, money market instruments, shares / units of other collective investment schemes and derivative instruments). Such investments must comply with the UCITS requirements in terms of liquidity, valuation and pricing principles. These rules ensure that UCITS remain reliable and reputable products and make them suitable for adaptation to Shari'a compliance.

Appointment of a Shari'a advisory committee

Irish Shari'a compliant funds will typically appoint a discretionary asset manager to manage the investment of the assets of the fund. However, a distinguishing feature of Shari'a compliant funds is the appointment of a Shari'a committee which provides guidance to the fund, and to the discretionary asset manager, on matters of Shari'a law and, in particular, whether the proposed investments of the fund are Shari'a compliant.

Shari'a Compliant Investments

A fundamental principle of a Shari'a compliant fund is that it must ensure that the underlying businesses in which it holds investments is Shari'a or Halal compliant. The fund's offering document will spell out the Islamic-based investment restrictions on its investment universe and in particular will normally set out that the fund may not invest in businesses which, among other things:

- **manufacture, sell or offer alcohol or pork;**
- **invest in gambling establishments;**
- **provide interest based financial services;**
- **invest in nightclubs or are involved in pornography or adult orientated material.**

In addition, a Shari'a compliant fund may not invest in interest–bearing instruments, may not sell short and may not engage in speculative transactions. These restrictions have in the past been deemed to rule out Shari'a compliant hedge funds or even funds which invest in derivatives but there have been recent developments to broaden the range of permissible investments for Shari'a compliant funds.

Income Purification

Another key feature of Shari'a compliant funds is "income purification". As it is often unavoidable that some of the income generated by the underlying companies in which a Shari'a compliant fund invests will include some form of interest, it will be necessary to purify that income which can be addressed in a number of different ways including segregation and donations to charity.

Irish Legal and Regulatory Considerations

The Financial Regulator is proactive in fostering relationships with regulators in MENA and the leading administrators and custodians in Ireland have garnered significant experience and have developed systems to facilitate the servicing of Shari'a compliant funds. The Irish Stock Exchange has also significant expertise dealing with Shari'a compliant products. The Financial Regulator has recently established a dedicated unit within its funds authorisation team to deal specifically with the authorisation of Shari'a compliant funds and any specific or special issues which might arise in relation to same, such as the following:

Shari'a Advisory Committee: One area that the Financial Regulator will look at is the role of the Shari'a Advisory Committee and the capacity in which it acts, and will require confirmation that the committee is acting in an advisory capacity only with no discretionary powers over the assets of the fund. If acting in an advisory capacity only, the Financial Regulator will not seek to regulate or approve the Shari'a Advisory Committee.

Shari'a Investment Restrictions: Another relevant area to consider is whether the Financial Regulator will impose any conditions or requirements on the Shari'a element of the fund. In our experience, the Financial Regulator will not seek to impose any oversight of the Shari'a element as this is essentially an embodiment of a set of guiding principles, investment philosophies or investment guidelines. From a regulatory prospective, the Shari'a element is viewed very much as an overlay, comparable to a fund established with a "socially responsible" investment ethos.

Monitoring of Compliance: Another issue to consider in the context of a Shari'a compliant fund is the monitoring of compliance with Shari'a principles and how and by whom the monitoring functions will be carried out. To a large part, this will depend on how the legal documents are drafted. The monitoring role for compliance with Shari'a principals would usually be provided by the Shari'a Advisory Committee and / or the discretionary asset manager.

Conclusion

There are now over 500 Shari'a compliant funds in existence worldwide and Ireland continues to be one of the favoured jurisdictions for the establishment of Shari'a compliant funds, particularly those established as UCITS seeking to capitalise on the distribution opportunities of the UCITS.