

Islamic Finance & Markets 2020

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Lexology Getting The Deal Through is delighted to publish the seventh edition of *Islamic Finance & Markets*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes chapters on Philippines and Switzerland.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

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Contents

France	3	Switzerland	25
Jean-Baptiste Santelli and Racha Wylde De Gaulle Fleurance & Associés		Samuel Ljubicic and Robert Bissig Meyerlustenberger Lachenal Ltd	
Japan	9	United Kingdom	30
Takashi Tsukioka Nagashima Ohno & Tsunematsu		John Dewar and Munib Hussain Milbank LLP	
Malaysia	14	United States	36
Fiona Sequerah, Chan Jia Yong, Ng Chen Lynn and Phang Jian-Jie Christopher & Lee Ong		John H Vogel Crowell & Moring	
Philippines	21	Uzbekistan	43
Rafael A Morales Morales & Justiniano		Atabek Sharipov and Nodir Yuldashev Grata International Law Firm	

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OVERVIEW

Policies

- 1 | In general terms, what policy has your jurisdiction adopted towards Islamic finance? Are Islamic finance products regulated differently from conventional instruments? What has been the legislative approach?

There are no Swiss laws specifically addressing Islamic finance in Switzerland. Thus, financial institutions offering Islamic finance products are subject to the same laws and regulations as those offering conventional instruments.

However, the Swiss legal system is, generally, *shariah*-friendly, given that Swiss contract law is based on two principles enabling tailor-made solutions: freedom of contract and freedom of form.

Inter alia, the Swiss concept of such freedom of contract – which is similar to the principle of permissibility under Islamic law (ie, something is presumed to be allowed, or *halal*, unless it can be argued as being *haram*) – includes the freedom to:

- determine the subject matter and terms of the contract;
- conclude a contract that cannot be subsumed (as a whole or in part) under a contract category contained in the Swiss Code of Obligations (CO);
- determine whether and to what extent a contract shall be binding among the parties; and
- determine the remedies for non-performance, default, etc, unless such contractual arrangements or certain provisions would conflict with mandatory Swiss law or the Swiss *ordre public*.

Accordingly, the rules set forth in the CO may, subject to (fairly limited) mandatory provisions, be modified by the contracting parties. Hence, there is no *numerus clausus* with regard to types of contracts in Switzerland and as a consequence, any contractual relationship that is not regulated by statutory law (ie, CO) would be qualified as a contract sui generis, which typically contains certain elements of different types of contracts such as insurance contracts, instalment-purchase contracts, leasing contracts, etc.

Freedom of form means that a contract, to be valid, only needs to meet particular formal requirements if expressly stated by the law or determined by the parties. Such limitations are mostly to be found in consumer protection constellations, where the idea of social protection (ie, protecting the structurally weaker party) is a guiding principle. Conversely, this means that with respect to international commercial contracts, mandatory social protection provisions are hardly relevant or only in exceptional cases. Given the freedom of form under Swiss law, it is possible to adapt to formal prerequisites, if so required by or desirable under Islamic law (eg, witnessing of contracts).

Market development

- 2 | How well established is Islamic finance in your jurisdiction?
Are Islamic windows permitted in your jurisdiction?

The Swiss financial market has recognised a growing demand for *shariah*-compliant financial products. Many domestic Swiss banks are offering *shariah*-compliant finance and investment products as well as wealth management services in connection with such products and major Swiss banks are currently further expanding their operations in the Middle East. Furthermore, there are certain reinsurance companies based in Switzerland that offer *retakaful* products through their branches in the Middle East. As for Islamic windows, the scope of services that are provided by a conventional financial institution but based on Islamic principles, and thus the types of Islamic finance transactions they can carry out, are regulated by the same sets of rules applicable to services offered by such institutions in general (see also question 3).

Legislation

- 3 | What is the main legislation relevant to Islamic banking, capital markets and insurance?

Switzerland has no legislation specifically addressing Islamic finance. Islamic banking, capital markets and insurance are subject to general finance laws and regulations in Switzerland and are intended to be subject to the same treatment that applies to their corresponding conventional instruments having a similar economic effect or rationale (see also question 4).

With regard to banking, it should be noted that pure lending activities are generally – subject to providers of consumer credits and to anti-money laundering regulations – not regulated in Switzerland. Thus, Islamic finance providers (eg, sellers entering into reverse *murabaha* transactions) would not necessarily be required to obtain a banking licence. If a Switzerland-based entity combines financing activities with deposit taking from the public or refinances itself with a number of banks, such entity will generally qualify as a bank and thus be obliged to obtain a banking licence from the Swiss Financial Market Authority (FINMA) and be subject to the Federal Banking Act and encompassing regulations and ordinances.

With regard to capital markets, a distinction must be made between debt capital markets legislation and equity capital markets legislation.

Debt capital markets legislation

The applicable rules with respect to debt securities offerings (such as *sukuk*) depend primarily on whether the offering is public or private. Among public offerings, a further distinction must be made based on whether the securities are intended for listing on the Swiss Stock Exchange (SIX).

If the debt securities are publicly offered, in other words, submitted for public subscription or listed on a stock exchange in Switzerland, the

issuer must prepare and make available to investors a prospectus that complies with article 1156, paragraphs 1 and 2 of the CO and, by way of reference, article 652a of the CO. If the securities are to be listed on SIX, the detailed SIX listing requirements must be fulfilled in addition to the prospectus requirements pursuant to the CO.

With regard to private placements (ie, the offering of debt securities exclusively to a restricted circle of potential investors), no particular prospectus duty exists. In practice, however, a prospectus is often prepared on a voluntary basis. The content and style of the offering documentation in unlisted debt securities offerings are determined by the Swiss market standard.

On 15 June 2018, the Swiss Parliament adopted the Financial Services Act (FinSA). The FinSA contains the prerequisites for the provision of financial services and the requirements for the offering of financial instruments. With regard to the offering of debt instruments (and other financial instruments), the FinSA will, in particular, introduce a number of major changes to the Swiss prospectus rules and replace the provisions currently contained in the CO in its entirety. The FinSA will enter into force on 1 January 2020.

Equity capital markets legislation

Under the current Swiss legislation, the issuance and trade of equity securities are mainly governed by (i) the CO, (ii) the Federal Act on Stock Exchanges and Securities Trading and its implementing regulations, (iii) the Federal Act on Financial Market Infrastructures and Market Conduct in Securities and Derivatives Trading and (iv) the listing rules of Switzerland's main stock exchange, SIX.

In the future, the issuance and trading of equity securities will, in addition, be governed by (i) the FinSA and (ii) the Federal Act on Financial Institutions (the FinIA, such legislation will repeal the current Federal Act on Stock Exchanges and Securities Trading).

Insurance and reinsurance operations are regulated on a federal level. The Swiss Federal Financial Market Supervision Act, as amended, sets out supervision principles and instruments of the FINMA in respect of all financial markets. The Swiss Federal Insurance Supervision Act (ISA) and the Swiss Federal Insurance Supervision Ordinance contain the rules and regulations for insurance and reinsurance undertakings.

SUPERVISION

Principal authorities

- 4 | Which are the principal authorities charged with the oversight of banking, capital markets and insurance products?

The FINMA supervises insurance and reinsurance undertakings, insurance intermediaries and groups as well as other financial institutions such as banks, securities dealers and collective investment schemes. Banking and insurance activities may only be conducted in Switzerland if the relevant entity has been granted a licence by FINMA.

The various requirements to be complied with to obtain a licence are set out in the Federal Banking Act and the ISA. The requirements are equally applicable for Islamic banks and insurance providers to be authorised to carry out business in Switzerland. No specific requirements apply to Islamic banks or to *takaful* or *retakaful* operators.

Guidance

- 5 | Identify any notable guidance, policy statements or regulations issued by the regulators or other authorities specifically relevant to Islamic finance.

There is no guidance, policy statement or regulation issued by Swiss regulators or other authorities specifically addressing Islamic finance.

Central authority

- 6 | Is there a central authority responsible for ensuring that transactions or products are *shariah*-compliant? Are IFIs required to set up *shariah* supervisory boards? May third parties, related parties or fund sponsors provide supervisory board services or must the board be internal?

Switzerland has no central authority responsible for ensuring that transactions or products are *shariah*-compliant. Furthermore, Switzerland has no specific regulation in place regarding *shariah*-compliant products. To ensure that contractual documentations or products adhering to *shariah* principles governed by Swiss law are *shariah*-compliant, the relevant financial institutions will often seek approval through obtaining an Islamic ruling or legal opinion (*fatwa*) by an expert in Islamic law (*mufti*). In addition, for contractual documentations governed by Swiss law adhering to *shariah* principles (eg, master *murabaha* agreements), it is common that the customer represents and warrants that the customer has examined the transaction documents and sought independent advice from advisers and is convinced that the documentation does not contravene *shariah* principles, and that the customer waives any objection as to matters of *shariah* compliance.

Board approval

- 7 | Do members of an institution's *shariah* supervisory board require regulatory approval? Are there any other requirements for supervisory board members?

There are no specific provisions for *shariah* boards under Swiss law. See also question 6.

Authorisation

- 8 | What are the requirements for Islamic banks to be authorised to carry out business in your jurisdiction?

As there is no regulatory framework specifically applicable to Islamic banks in Switzerland, in order for an Islamic bank to carry out its business as a bank in Switzerland, it must be licensed as a bank under the respective Swiss banking regulations (see question 4) and, equivalent to conventional Swiss banks, it will be subject to supervision through FINMA.

It should be noted that (subject to regulations applying to consumer credits) pure lending or financing activities do not require a banking licence in Switzerland, provided that the financing provider does not accept deposits from the public or refinances itself via a number of other banks. If a Switzerland-based financing provider combines such activities with deposit taking from the public or refinances itself with a number of banks, such entity will qualify as a bank and thus be obliged to obtain a banking licence from FINMA.

The granting of credits to individuals for purposes other than business or commercial activities (consumer credit) is regulated by the Swiss Consumer Credit Act (SCCA). Financial service providers contemplating consumer credit activities falling under the SCCA have to register with the canton in which they are established and to obtain a licence from such canton upon fulfilment of certain prerequisites. Exemptions from this registration requirement are, however, available for Swiss banks licensed by FINMA and for certain lending services that are ancillary to the commercial banking activities of a provider.

Foreign involvement

- 9 | May foreign institutions offer Islamic banking and capital markets services in your jurisdiction? Under what conditions?

Islamic banking and capital market services are not governed by a specific set of rules. Hence, foreign institutions may offer Islamic

banking and finance products in Switzerland, provided that they comply with the applicable Swiss law provisions, including obtaining all requisite licences required to conduct their business or to distribute the products in question.

The Swiss regime for cross-border provision of financial services, including credit facilities, to Swiss based individuals or companies has been rather liberal: to date, foreign regulated financial service providers operating on a cross-border basis do not need to be authorised by FINMA, unless they maintain a physical presence in Switzerland (eg, due to employees working in Switzerland) on a permanent basis. This rather liberal approach will, however, change with the introduction of the FinSA and the FinIA (see question 3). These laws will, inter alia, impose an obligation on foreign financial service providers to obtain an authorisation or register in Switzerland before providing financial services to Swiss based customers.

Takaful and retakaful operators

10 | What are the requirements for *takaful* and *retakaful* operators to gain admission to do business in your jurisdiction?

Takaful and *retakaful* operations fall within the definition of insurance business under Swiss law regulations and are therefore subject to the licensing requirements as set out in question 4. Hence, such operators must fulfil the respective requirements of the ISA, and comply with the constraints imposed on any insurance or reinsurance provider.

Any *takaful* or *retakaful* operator having its domicile in Switzerland must therefore obtain a licence from FINMA before engaging in *takaful* or *retakaful* activities. It must submit to FINMA an application that consists, inter alia, of a formalised business plan and ancillary documentation on (i) financial aspects, (ii) management aspects, (iii) organisational aspects, and (iv) business rationale, material shareholders, insurance classes and products. For regulatory purposes, the company must have the legal form of a corporation or cooperative, whereby the predominant legal form is the corporation.

Foreign operators

11 | How can foreign *takaful* operators become admitted? Can foreign *takaful* or *retakaful* operators carry out business in your jurisdiction as non-admitted insurers? Is fronting a possibility?

Takaful operators whose domicile is abroad must obtain a licence from FINMA in respect of insurance activities conducted in or from Switzerland. If one of the policyholders or insured persons or the insured risk is located in Switzerland, an insurance activity is deemed to be conducted in Switzerland. A FINMA licence is not required for mere reinsurance or *retakaful* activities conducted in Switzerland by operators domiciled abroad. Furthermore, certain exemptions apply in respect of specific insurance products or risks (eg, marine, air transportation, international transport and war risks).

When obtaining the relevant licence in Switzerland, foreign *takaful* providers in particular must set up a branch in Switzerland, demonstrate that they are duly licensed and adequately capitalised in their home jurisdiction, have an adequate organisational fund in Switzerland and deposit collateral with the Swiss National bank.

Disclosure and reporting

12 | Are there any specific disclosure or reporting requirements for *takaful*, *sukuk* and Islamic funds?

There are no specific disclosure or reporting requirements for *takaful*, *sukuk* or Islamic funds that differ from conventional products under

applicable federal or state banking, insurance and securities law. Therefore, they only need to comply with the regulations applicable to any operator in the relevant sector.

Sanctions and remedies

13 | What are the sanctions and remedies available when products have been falsely marketed as *shariah*-compliant?

If financial products (in general) have been falsely marketed as *shariah*-compliant, investors would, in theory, be able to seek damages arising from such misstatements.

By the same token, if a securities offering is made through a public offering involving statutory disclosure documents (such as a prospectus, see question 3), and those disclosure documents describe the products in question as *shariah*-compliant, and this constitutes a material misstatement, it might be possible that the issuer, its directors, underwriters and certain other parties could be held liable by investors who acquired the products at the offering.

However, in any event, the amount of damages would be calculated based on the economic loss incurred by the relevant investor, which might be difficult to establish or link to a misstatement pertaining to *shariah* compliance.

Jurisdiction in disputes

14 | Which courts, tribunals or other bodies have jurisdiction to hear Islamic finance disputes?

There is only one court system in Switzerland, consisting of, among others, the Supreme Court of Switzerland, (cantonal) high courts and commercial courts and (cantonal) district courts. These courts have jurisdiction to hear Islamic finance disputes as well as conventional (financial) disputes. It must be considered that a Swiss court will generally not examine whether any contractual relationships in dispute are *shariah*-compliant or not (see also questions 6 and 13). Alternatively, the contracting parties may opt to settle their disputes by arbitration.

CONTRACTING CONCEPTS

Accommodation of concepts

15 | *Mudarabah* – profit sharing partnership separating responsibility for capital investment and management.

The main characteristics of *mudarabah* – being a form of profit partnership, in which one partner, the *Rabb al-mal*, provides funds or capital and the other partner, the *Mudarib*, manages the financier's investment for an economic activity – could be mirrored economically with different legal concepts or partnership forms under Swiss law.

For instance, the basic economic effects of *mudarabah* can be achieved by the *Rabb al-mal* and the *Mudarib* entering into a 'simple partnership' or a silent partnership agreement. In a simple partnership, by default, both partners shall have management rights, but the partners may defer from such default rule and assign the management responsibility to one of the partners. In a silent partnership, the partnership does not act externally as such: the silent partner will not be visible to the outside, but only his or her partners.

The internal relationship of the simple partnership is primarily determined by the contract between the partners. Subsidiarily, the rules of article 530 et seq CO apply.

In a simple partnership, title to the capital contributions provided by the partners will generally speaking belong jointly to the partners. In the case of a silent partnership, the silent partner customarily participates in the business activities of the other partner by making a contribution transferred to the latter's assets – in return for a profit

claim – and in which the principal shareholder acts solely externally and appears as the sole beneficiary and obligor of the business activity. Hence, in contrast to the *mudarahabah* structure, where the *Rabb al-mal* remains the owner of the assets, legal title to the funds or capital provided will usually be held jointly by the partners (simple partnership) or even transfer from the silent partner to the other partners (silent partnership).

From a formalistic point of view, *mudarahabah* agreements (with title to the assets will remain with the *Rabb al-mal*) in the form of simple partnerships are technically only feasible under Swiss law where the capital to the undertaking is not provided in money but in other assets, and where only the use of such assets (eg, the usufruct of a property), and not ownership of the assets itself, is supplied or contributed by the *Rabb al-mal*.

Another possible structure of *madurahabah* under Swiss law could be based on a mandate under which the *Rabb al-mal* takes the role of principal and the *Mudarib* as an agent.

16 | *Murabahah* – cost plus profit agreement.

Murabaha transactions can be generally implemented under Swiss law and there are several banks offering this kind of transactions in the Swiss market (using documentation that is usually governed by English or Swiss law).

Generally, in *murabaha* transactions, a bank will act as funder for the purpose of purchasing certain goods (eg *shariah*-compliant commodities such as Palladium, Platin, etc) and the customer will act as the purchaser of those goods. The parties must determine the quantity, quality, cost and specifications of the goods. The bank may finance all or part of the cost of the goods and must provide the funds required for the purchase. The margin between the cost of the goods and their sale price for the sale to the bank's client and the (deferred) payment terms are agreed between the bank and the customer.

Thus, *murabaha* transactions encompass elements of several contractual relationships. Under Swiss law, *murabaha* is treated as a contract *sui generis* (see question 1) with elements of a purchase contract and a credit transaction. Furthermore, certain provisions of the CO pertaining to agency agreements will apply if the customer appoints the bank as its agent to on-sell the purchased goods (in particular in connection with master *murabaha* agreements pertaining to commodities).

17 | *Musharakah* – profit sharing joint venture partnership agreement.

In Islamic finance *musharakah* is a joint venture or a partnership arrangement in which profits and losses are shared. The term 'joint venture' covers a variety of short or long-term cooperation arrangements between two or more parties for a common project or enterprise. With simple partnership agreements under Swiss law (article 530 CO) profits and losses are also shared and compensated and, in principle, compliant with the prerequisites of Islamic finance.

Similar to *mudarahabah* structures, the main economic effect of *musharakah* can, in principle, be achieved by different forms of partnerships (in particular simple partnerships (see question 15) or limited partnerships in accordance with article 594-619 CO according to Swiss company law).

Just as *musharakah*, simple partnerships and limited partnerships involve a combination of entrepreneurship and capital, where the partners contribute their knowledge and their assets to achieve a common goal and profits are shared amongst the partners. However, depending on the chosen partnership structure under Swiss law, certain differences to the classic *musharakah* concept will appear with regard to the

recognition of the undertaking as a legal entity or in terms of the liability of the individual partners towards third parties, etc.

18 | *Ijarah* – lease to own agreement.

Ijarah can be implemented under Swiss law in the form of a rental agreement (operating lease) or in the form of a lease with transfer of ownership at the end of the period (financial lease), the latter being usually referred to as 'leasing' under Swiss law.

A financing lease involves pure innominate contracts, while an operating lease can include elements of rental agreement or usufructuary lease.

To date, there are no laws in Switzerland that specifically regulate the (financial) leasing industry, as leasing agreements usually contain and combine aspects of different types of contracts (instalment-purchase contracts, loan contracts, rental contracts, etc).

Given the principle of freedom of contract and form (see question 1), *shariah*-compliant *Ijarah* transactions governed by Swiss law are possible without there being significant obstacles to be observed.

19 | *Wadiah* – safekeeping agreement.

In Switzerland, *wadiah* agreements could, in principle, be used for safekeeping agreements. Contrary to customary safekeeping agreements, the bank should not guarantee any incentive, performance, reward or bonus to the customer and the bank would have to guarantee the return of the deposited funds and allow the customer to collect the funds at any time (subject to any restrictions directly imposed by certain investment vehicles). However, the bank could, at its sole discretion, grant to the customer a gift (*hibah*) in lieu of interest. The bank could still charge the customer administration fees if they directly relate to the management of the deposited funds.

As set forth above (see question 8), deposit-taking is regulated in Switzerland and providers should thus adhere to the relevant licensing requirements.

PRODUCTS

Securities structuring

- 20 | *Sukuk* – Islamic securities. Have *sukuk* or other Islamic securities been structured and issued in your jurisdiction to comply with Islamic principles, such as the prohibition of interest?

At present, there are no *sukuk* listed on the Swiss Stock Exchange. Furthermore, we are not aware of any *sukuk* issuance publicly announced in Switzerland to date.

Legal position

- 21 | What is the legal position of *sukuk* holders in an insolvency or a restructuring? Are *sukuk* instruments viewed as equity or debt instruments? Have there been any court decisions or legislation declaring whether *sukuk* holders are deemed to own the underlying assets?

Generally, holders of *sukuk* issued by a Swiss issuer should be treated the same way as conventional bondholders (ie, *sukuk* would most likely qualify as debt instruments).

However, there is no court decision concerning or clarifying the legal position of holders of *sukuk* in the event of the insolvency or restructuring of the issuer.

Insurance

- 22 | **Takaful – Islamic insurance. Are there any conventional cooperative or mutual insurance vehicles that are, or could be adapted to be, *shariah*-compliant?**

There is no definition of the term 'insurance contract' in the Insurance Supervisory Act or Insurance Supervisory Ordinance. The Swiss Federal Supreme Court has consistently defined the following vital elements of an insurance contract:

- the risk or the danger (the financial consequences of the possible risk or danger are transferred from the insured to the insurer);
- the premium (the duty of the insured to pay premiums to the insurer);
- the duty of the insurer (if the risk or danger is realised, the insured has the right to receive the contribution agreed from the insurer; in most cases, this will be a financial contribution);
- independence of the operation (the performance of the insurance has to be the core of the specific business operation; the insurance business operation should not be only a sideline business or a modality of a different business operation); and
- compensation of the risks based on the rules of statistics.

As opposed to certain more sophisticated insurance products (such as mixed life insurances combining elements of a mere risk insurance and capital investment plus interest accruing thereon), the mere risk insurance products (as per the definition above) could be adapted relatively easily to be *shariah*-compliant (for as long as the insured risks cannot be associated to gambling but rather can be seen as a form of shared risk in the sense of a cooperative insurance contract).

However, as regards the set-up of Swiss insurance companies, the way cooperative insurance vehicles (fairly limited in numbers) have been set up in Switzerland until now is not comparable with such Islamic insurance vehicles.

- 23 | **Which lines of insurance are currently covered in the *takaful* market? Is *takaful* typically ceded to conventional reinsurers or is *retakaful* common in practice?**

The *takaful* insurance market in Switzerland is in its infancy. However, some major Swiss reinsurance companies have recognised the increasing importance of Islamic reinsurance or *retakaful*. Thus, major Swiss reinsurance providers have built up certain expertise in this regard and offer *retakaful* to their clients (mainly through their Middle East branches).

MISCELLANEOUS

Regulatory obstacles

- 24 | **What are the principal regulatory obstacles facing the Islamic finance industry in your jurisdiction?**

Islamic finance is emerging in Switzerland and there are currently no regulatory obstacles in place that would adversely affect the further development (the Swiss legal system is – as set out in question 1 – in principle *shariah*-friendly). There are no legal restrictions to establish banks that solely operate in a *shariah*-compatible manner or for conventional banks to offer *shariah* windows.



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Shariah law

- 25 | **In what circumstances may *shariah* law become the governing law for a contract or a dispute? Have there been any recent notable cases on jurisdictional issues, the applicability of *shariah* or the conflict of *shariah* and local law relevant to the finance sector?**

There is currently no judgment by a Swiss court addressing whether *shariah* law would be the appropriate governing law for a contract made in Switzerland or a dispute arising in Switzerland.

In light of Swiss civil procedure, it seems unlikely that general *shariah* principles (as opposed to the substantive laws of any specific country or the specific substantive set of rules contained in certain conventions – eg, the United Nations Convention on Contracts for the International Sale of Goods) would be recognised as the governing law for a contract or a dispute under Swiss conflict-of-laws rules even if the parties to the relevant contract so designate.

Institutional takeover

- 26 | **Are there any special considerations for the takeover of an Islamic financial institution, outside the requirements of the general merger control regime?**

Besides the generally applicable provisions pertaining to mergers and takeovers applicable in Switzerland in general, the acquisition of control of an Islamic (financial) institution holding a banking, securities trading or insurance licence would be subject to prior authorisation by FINMA.

Other notable features

- 27 | **Are there any notable features of the Islamic finance regime and markets for Islamic finance products in your jurisdiction not covered above?**

Not applicable.

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