Islamic Finance & Markets

Contributing editors
Rafael A Morales and Bishr Shiblaq

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United States

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Overview

1 In general terms, what policy has your jurisdiction adopted towards Islamic finance? Are Islamic finance products regulated differently from conventional instruments?

There are no United States laws specifically addressing Islamic finance in the United States, and financial institutions offering Islamic finance products are governed by the same federal and state laws and regulations as those offering conventional instruments. Islamic finance in the US is market-driven; rather than promote Islamic financial products, federal and state regulators respond to applications and inquiries from Islamic financial institutions (IFIs) wishing to offer Islamic financial products on a case-by-case basis. The Federal Reserve has been extremely helpful in organising forums to discuss with prospective issuers and investment bankers alternative ways to advance and grow Islamic finance.

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

Retail Islamic finance has been well-established in the United States since 1997, when the Office of the Comptroller of the Currency (OCC) approved the *ijarah* structure for home lending because it is 'functionally equivalent' to conventional secured real estate lending. In 1999, the OCC approved the use of the *murabahah* 'cost plus profit' structure for home financial products because this structure was deemed to be 'functionally equivalent' to conventional real estate mortgage transactions or inventory or equipment lien agreements.

There are no US national Islamic financial institutions; rather, IFIs operate as state banking corporations. Conventional banking institutions have established Islamic 'windows', but more often use subsidiaries for Islamic finance transactions. The gross annual dollar value of retail Islamic financial transactions in the US is only approximately US$4 billion, and most Muslims continue to use conventional financing in their US banking transactions.

Sovereign wealth funds have acquired considerable amounts of US real estate and remain active in these markets, but typically use conventional financing for their acquisitions. While there have not been any listings of *sukuk* on US stock exchanges, publicly held and private Islamic funds are active and offer, buy and trade securities that are *shariah*-compliant. Investment in businesses dealing with *haram* goods and services may be made and held in the US, provided they are de minibus and appropriate 'purification' is expected with respect to excess *haram* income.

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

The US has not adopted any federal legislation specifically addressing Islamic financing. Islamic banking, capital markets and insurance are subject to the same federal and state law and are subject to the same tax treatment that applies to corresponding conventional instruments. Only two rulings have been issued by the OCC, approving an *ijarah* and a *murabahah* structure for home and other retail financial products. IFIs in the US are state-chartered entities subject to state laws regulating corporate governance and banking and insurance operations.

All deposit accounts offered by US banks are required to be insured by the Federal Deposit Insurance Corporation (FDIC), which is intended to assure the overall 'safety and stability' of financial institutions. Although no IFI offers interest on its Islamic deposit accounts, the FDIC has approved insuring such accounts on the basis that investment return does not have to be based on interest, but may be based on a profit and loss participation.

State banking agencies regulate IFIs in the US. Although IFIs may be qualified to do business in different states, the majority of an IFI's assets are located in the institution's home state and licensing and other conditions must be satisfied with respect to any state where the IFI wishes to be qualified as a bank or mortgage or loan finance provider. Illinois and a number of other states have enacted a 'wild card statute', which allows IFIs chartered in such states to do anything that is permitted by the OCC to be done by national banks.

Supervision

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

The principal federal regulatory authorities charged with the oversight of US banking are the OCC and the FDIC. State banking authorities govern state-organised financial institutions, including IFIs. State authorities are also responsible for the oversight of insurance companies, as there is no federal insurance regulator. The principal regulatory authorities charged with regulating US capital markets are the Securities and Exchange Commissions, the self-regulatory stock exchanges and state securities authorities.

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

The 1997 and 1999 rulings by the OCC approved the *ijarah* and *murabahah* structures for home finance and retail transactions. In addition, states such as New York and Illinois have enacted legislation intended to encourage Islamic finance transactions, such as the elimination of a double real estate transfer tax in an *ijarah* sale-leaseback transaction.

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?

The US has no central authority responsible for insuring that transactions or products are *shariah*-compliant. IFIs in the US are not required to maintain their own *shariah* supervisory boards, but may work with the *shariah* board of another IFI, the Shari'ah Board of America or other scholars.

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

There is no regulatory approval required for the appointment by an IFI of *shariah* supervisory board members. While the Shari'ah Board of America and other scholars serve in the US, it is a challenge to find competent *shariah* scholars able to balance knowledge of *shariah* law as well as knowledge of US banking and commercial law, the business and customer needs of the IFI and competency in the English language.

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

There is no nationally chartered Islamic bank in the US because of the difficulty in developing deposit products that are simultaneously *shariah*-compliant and eligible for FDIC protection, and that do not run afoul of securities regulations. While the OCC has been approached by entities interested in establishing a national Islamic bank, there have been no applications filed with or approved by the OCC.

The existing US Islamic banks, notably Devon Bank and University Islamic Finance Bank, are state-chartered, state-licensed banks, which have applied for and received FDIC insurance for depositors. The OCC and the banking authorities of New York, Illinois and a few other states have approved *shariah*-compliant structures on a limited basis to finance home and other retail purchases. These states have issued limited rulings eliminating double real estate transfer taxation in *shariah*-compliant home acquisition financings. The Board of Governors of the Federal Reserve allows US financial institutions to offer *shariah*-compliant products in foreign countries where they are mandatory or where they are necessary for the financial institution to be competitive.

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

Foreign financial institutions may offer in the US Islamic banking structures approved by the OCC, which include the *ijarah* and *murabahah* structures for home mortgages and retail financing. Foreign institutions are required to comply with all applicable federal and state law, including obtaining all requisite state banking and retail lending licences for the offering of approved products in those states where they operate.

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

In 2009, American International Group Inc became the first insurance company to offer Islamic homeowner *takaful* insurance in the US. *Takaful* is currently issued through AIG's underwriting subsidiaries, Risk Specialist Companies Inc and Lexington Insurance Company. The exclusive broker for the product, New York-based Islamic financial services firm Zayan Finance, is currently offering *takaful* in a number of states. AIG maintains a *shariah* board made up of Islamic scholars who have given legitimacy to the *takaful* alternative to conventional insurance in the US market.

Takaful operates to a large extent outside the reach of state insurance regulators. Lexington Insurance Company is a 'surplus lines' insurer, which means it is only lightly regulated by its headquarter state and is essentially free of review by the state insurance department. It is for this reason that the National Association of Insurance Commissioners has advised consumers to be wary before purchasing such policies. Life insurance through *takaful* is not permitted as it is not compliant with *shariah* law's proscriptions against *gharar* and *maisir*.

The 'establishment clause' of the First Amendment to the US Constitution presents a serious obstacle to the successful introduction of *takaful* and *retakaful* in the US, as this mandates separation of church and state and prohibits the favouring of one religion over another. In addition, the insurance regulatory regime in the United States poses a problem for the introduction of *takaful*, as each state determines its own licensing requirements for insurance companies. In order to obtain a licence, an insurance company must demonstrate that it has the experience and management capability to run the company, and that it is financially sound. Insurance companies are also required to justify their premium rates. In addition, insurance companies must meet or exceed the solvency requirements set by the state. Moreover, there are often limits on the types and concentrations of fixed-income investments that must be made with reserves held by insurance companies. Further exacerbating the situation, under *takaful*, in the case of potential insolvency, the shareholders' fund must provide an emergency loan to the *takaful* company to meet existing claim obligations. Capital requirements imposed on US insurance companies may not take into account the separation between policy holder and shareholder funds in *takaful* insurance. As a result, it is difficult for *takaful* and *retakaful* operators to operate effectively and extensively in the United States.

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?

Foreign *takaful* and *retakaful* operators face the same challenges in operating in the United States as domestic operators and would have to qualify their business and satisfy all applicable licensing requirements in any and each state that they wish to do business in.

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 laws.

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

In the event that Islamic-structured products have been falsely marketed in the US as *shariah*-compliant, there are no special legal sanctions or remedies available under federal or state law. Rather, there are three potential remedies available to an investor.

The first is a contractual remedy, which, depending on the terms on which the product was purchased, may enable the investor to call an event of default (arising from the misrepresentation by the IFI of a material term of the contract) and then accelerate amounts owed by the IFI to the investor.

The second remedy is to institute a civil claim for misrepresentation. For fraudulent and negligent misrepresentation, the claimant may claim rescission of the contract and damages. For innocent misrepresentation, the court has discretion to award damages in lieu of rescission or rescission; the court cannot award both.

The third remedy is only applicable if the relevant product is a securities offering that is made through a public or private offering and where a prospectus or private placement memorandum is issued that is untrue or misleading as to the *shariah*-compliance of the securities offered. In this circumstance, the person responsible for the prospectus may be liable for damages to a person who has acquired securities to which the prospectus applies and who has suffered loss as a result of any untrue, dishonest, or misleading statement in the prospectus or the omission from the prospectus of any matter required under applicable federal or state securities laws. Consequently, not only persons acquiring the *sukuk* directly upon issue but also those trading the *sukuk* on the secondary market would be entitled to bring a claim pursuant to these provisions.

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

There are no special courts, tribunals, arbitral or other bodies, which have jurisdiction to hear Islamic finance disputes. Rather, such disputes are subject to resolution before the applicable US federal and state courts in accordance with applicable rules of jurisdiction and venue, and may be subject to arbitral action if required by the terms of a contract between the parties to the dispute.

Contracting concepts

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

The *mudarabah* structure is a type of profit-and-loss sharing (PLS) partnership, which separates responsibility for capital investment and management. This is often compared with venture capitalism in the US, with the notable exception that in a *mudarabah* the manager (*mudarib*) does not share in any loss unless he or she is negligent, and any financial loss is suffered by the investor (*rab-al-mar*).

The *mudarabah* structure is also the basis for the deposit product developed by SHAPE and offered to US depositors by University Islamic Financial Bank. The depositors share in the profit of the bank but not any losses that might be incurred as a result of the bank's investment in a *shariah*-compliant portfolio. Profit shares are derived from the rental income paid by those obtaining home finance from the bank rather than coming from income on interest-based loans and mortgages. The deposits are structured on a *mudarabah* basis, with a proportionate share of the profit paid out to the depositors. Mandatory FDIC insurance is provided to all depositors.

16 *Murabahah* – cost plus profit agreement.

The *murabahah* structure is the most popular type of structure with respect to home financing in the US. The bank purchases the property and resells it to the client at a markup. Devon Bank and other IFIs providing Islamic products can design their products to avoid private mortgage insurance for those making relatively low down payments.

Murabahah financing for business, with a term up to seven years, is offered by Devon Bank, with the client making an initial payment to the bank followed by a series of monthly or quarterly payments until the total amount including the markup (representing Devon Bank's profit) is paid. The bank may take a mortgage on the property that has been thus financed, or require other collateral until the obligation has been fully repaid. Payments made by the customer to the bank to the extent that they constitute 'interest' are deductible from income tax and includible in the banks' taxable income. While the *murabahah* is only valid for a single transaction traditionally, Devon Bank has developed a *murabahah* 'guidance line' that can be used repeatedly for equipment or trade good purchases. In this case, the *murabahah* resembles a revolving line of credit. While a *murabahah* 'guidance line' is available for the purchase of building materials used in construction, it cannot be used to finance the labour component of construction. One of the advantages of *murabahah* is that since the bank, rather than the client, is paying the supplier directly, credit support may not be required, as the bank is less likely to default on its obligation than a small or medium-sized business.

The 1999 OCC interpretive letter permitted a bank to offer certain *murabahah*-based financing products to accommodate the acquisition and construction of Islamic schools, mosques, community centres and businesses. In these transactions, the client identifies the property, inventory or equipment to be purchased, negotiates the purchase rights with the seller, and applies to the bank for financing. If the ordinary credit underwriting critique is satisfied, the client and the bank simultaneously enter into a purchase agreement and a *murabahah* agreement, where the bank agrees to purchase the asset and immediately sell it to the client at cost plus mark up.

A *murabahah* transaction can also be used to refinance a conventional loan with the possibility, depending upon the advice of the relevant *shariah* scholars, that the borrower may be allowed to take cash out in the process, even to pay off interest-bearing obligations.

The nature of a *murabahah* transaction is such that the purchase price to be paid by the customer does not change if the customer is required to make early payments, for example, in a default situation, or if the customer seeks to prepay the purchase price voluntarily. This feature of a *murabahah* transaction may create problems under certain US federal and state laws that aim to protect consumers by limiting the interest and finance charges that may be imposed in a consumer transaction. Under US law, the profit element of a *murabahah* purchase price is treated as interest – taxable to the IFI and deductible by the customer.

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

Musharakah financing in the US is a 'rent to own' financed sale of property by an IFI to its customer. The customer identifies the home he or she would like the bank to purchase on his or her behalf, the customer negotiates the price and all aspects of the purchase and the customer makes any initial payment of earnest money required to reserve the home. The bank purchases the property and the customer agrees to purchase the property from the bank over time, at cost. A portion of the property's ownership is transferred to the customer with each payment he or she makes. Because he or she is using a property he or she does not own, the customer also pays rent on the bank's portion of the property. As an equity-based project financing, the customer and the bank are co-owners and, thus, share in any loss realised upon the customer's sale of the property, based on the bank's and the customer's respective percentage of ownership.

Other than a home financing, an IFI and investors may provide *musharakah* joint venture financing for a project in agreed proportions in the form of cash contributions or contributions in kind. The party providing the management or technical expertise may charge a fee. Many consider *musharakah* to be the most authentic form of an Islamic contract, as it is based on the PLS system where two or more persons combine their capital or labour, or both, and share in the profit and loss of the venture. A *musharakah* does not envisage a fixed return, but rather the return is based on the actual profit earned by the venture. Typically, each partner is both the agent and guarantor of the other, although more limited investment partnerships are available. This type of partnership can occur when two or more parties contribute to a capital fund, either with money, contributions in kind or labour. There are no regulations regarding the fair and equal treatment of partners, except *shariah* principles, which require that such treatment be provided by each partner to each other. The joint venture is typically structured so that the financing party receives its initial investment plus a return that is usually calculated by reference to a floating benchmark such as LIBOR, plus a margin. Losses, however, are shared in accordance with the parties' initial investment.

There are essentially three types of *musharakah* currently available in the United States:

- permanent *musharakah* – both parties' interests remain unchanged and each is entitled to receive its share of the profits as long as the joint venture continues its existence. This formulation is used for an ongoing equity investment. Here, the partnership is transparent for tax purposes and the partners are taxed on any profits;
- diminishing *musharakah* – sometimes used in residential mortgages, the financing party's interest in the joint venture is reduced over time because the borrower buys out the bank's shares. The bank's return is taxable income to the bank and deductible by the borrower; and
- temporary *musharakah* – this is used to provide working capital; the financing party is a partner for a specified period and receives its share of the profits and the rest of its principal contribution at the end of the agreement period.

Musharakah is similar to *mudarabah*, except that in a *mudarabah* only the financing party bears the losses associated with the joint venture.

18 *Ijarah* – lease to own agreement.

An *ijarah* is like a hybrid between a conventional operational lease and a finance lease. In this type of transaction, the bank purchases a property and places ownership in a holding subsidiary. Traditionally, title to the property is transferred to the borrower after he or she has paid the full cost of the property over time. The customer pays rent to the bank, which reflects an agreed profit element for the bank, as well as comparable rentals on conventional leases (where interest considerations would be relevant). Unlike a conventional finance lease, the obligations to insure and undertake major maintenance on the leased asset remains with the bank (owner and lessor), although these obligations may be shifted to the borrower (lessee) pursuant to a separate contract to provide services with respect to the leased assets. Further, the lessee is only responsible for the payment of rent while his or her use of the asset continues, and an *ijarah* cannot begin before construction of the leased facility; if the lessee is no longer able to use a leased asset (eg, total destruction), rental payments must cease. The lease-to-purchase model is known as *ijarah wa iqtina*.

Under the laws of most states, the transaction is simplified if the client takes immediate title to the property at the time of the initial purchase. For example, in California a client would give a financial institution like LARIBA an undertaking that he or she will repurchase the property in the event of a default, in which event LARIBA authorises the registration of title in the client's name at the time of LARIBA's initial purchase of the property.

Vehicles are financed by LARIBA, for typically three to five years, through the *ijarah* structure with a vehicle financing company; the client has title to the car from the start, and LARIBA holds a first lien on the car. The financing actually involves two agreements: a loan agreement, in which the original capital is to be returned without interest and a lease agreement, which is the source of LARIBA's profit. A promissory note is also drawn up by which the customer guarantees payment. State law requires the monthly payment stream to be calculated on a traditional amortisation basis, so clients can compare the percentage rate they pay with those offered in conventional financings.

19 *Wadiah* – safekeeping agreement.

Wadiah agreements are not commonly used in the US, but they are not proscribed and should be possible provided that all applicable federal and state regulatory requirements are met.

Products

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?

The US has seen two major *sukuk* issuances – the East Cameron Gas *sukuk*, which was the first *sukuk al-musharakah* in America (backed by oil and gas assets) and the General Electric *sukuk al-ijarah* (backed by aircraft leases). Although the East Cameron *sukuk* experienced technical difficulties and went into bankruptcy for reasons unrelated to its Islamic structure, the General Electric *sukuk* is performing well. Both New York and Illinois have initiated legislation to enable *sukuk* transactions. NYSE Euronext has made available the machinery and process for listing *sukuk* in the US, although there are no *sukuk* currently listed. A number of *shariah*-compliant stock indices are available in the US, including the Dow Jones Islamic Index and mutual funds made available by the Amana Group, the Azzad Funds and others.

A controversial plan by Goldman Sachs in 2012 to issue a US$2 billion *sukuk al-murabahah* ignited a wide debate on whether conventional banks in the West should be allowed to engage in Islamic finance. Some scholars argued that investment banks, such as Goldman Sachs, should be prohibited from issuing *sukuk*, because the funds raised thereby could help finance other parts of their business that do not comply with *shariah*, particularly with respect to conventional interest. They also noted that such a *sukuk* might violate *shariah* law's ban against pure monetary speculation if it traded on a stock exchange at levels other than par value. Goldman Sachs succesfully floated the *sukuk* at a later date.

While over US$100 billion dollars have been raised through *sukuk* listed on exchanges in Dubai, Ireland, Luxembourg, Malaysia and the United Kingdom, there are no listings of *sukuk* on US security exchanges.

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?

Following the filing by East Cameron for bankruptcy in Louisiana, the issuer sought to argue that the *sukuk* should be characterised as a 'secured loan' and not as a true 'asset sale'. The court ruled, however, that, pursuant to the purchase agreement, title over all leases to the gas and oil properties belonged in the *sukuk* holders. East Cameron was an 'asset backed' *sukuk,* while most of the *sukuk* issued are 'asset based'. The East Cameron decision was the first in Islamic finance jurisprudence that declared that an asset-backed structure can indeed protect investors following a default: the *sukuk* holders were able to take title to the underlying property interests and sell them to recoup in part their losses. Thus, although *sukuk* instruments are generally considered hybrids of equity and debt, in a case where the *sukuk* is asset-backed, such as East Cameron, it is likely in light of this precedent that the *sukuk* holders will be deemed to own or have possessory rights in and to the underlying assets. In other cases, particularly sovereign *sukuk*, which are asset-based rather than asset-backed, it is questionable whether *sukuk* holders would be deemed to own the underlying assets. While asset-based transactions give their holders ownership of cash flows, the holders do not own the assets themselves and they do not have a claim on the assets in the event of a default.

The bankruptcy and restructuring of Arcapita, a private equity and investment company based in Bahrain and active in the US, is instructive as the first court-mandated Islamic finance restructuring. The bankruptcy plan approved by the US District Court in New York was considerably more transparent and workable than many of those hashed out directly between companies and creditors in other parts of the world. This case provided a clear, court-approved restructuring plan, which, for the first time, recognised the validity and enforceability of *shariah* principles in Islamic finance documents governed by US law.

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

Although conventional cooperative or mutual insurance vehicles operating in the US might be adapted to be *shariah*-compliant, this would require compliance with applicable state law (see questions 10 to 12).

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?

In the US, the only type of insurance currently offered as *takaful* is commercial and residential property insurance. Where *takaful* is the subject of reinsurance, that coverage is typically extended by conventional reinsurance companies. *Retakaful* is not generally available in the US.

Miscellaneous

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

A principal challenge facing Islamic financial providers in the US is offering products that conform to both Islamic religious doctrine and state and federal banking regulations. The same stringent licensing and supervision standards that apply to conventional financial institutions apply to financial institutions offering Islamic banking and financial services. For example, the National Bank Act of 1864, which prohibits banks from the purchase, holding of legal title to or possession of real estate to secure debts due for a period exceeding five years, presents an obstacle to US financial institutions wishing to offer *shariah*-compliant lending services. This conflict was resolved in part by the OCC's two interpretive letters, in response to the special needs of clients who otherwise would be forced to choose between adhering to their religion and owning a home or business. Any organiser of a *shariah*-compliant bank in the US faces the challenge of introducing new business practices to regulators, regulatory requirements for significant capital and the requirement that the bank must reasonably be expected to achieve and maintain profitability. There are no meaningful conflicts between generally accepted accounting principles in the US and AAOIFI-promulgated *shariah*-compliant accounting standards. Ultimately, there is no reason why a well-managed, legally capitalised and profitable Islamic banking institution cannot be chartered nationally in the US to operate in a *shariah*-compliant matter.

Although certain types of *murabahah* and *ijarah* financing are permissible, *musharakah* and *mudarabah* would appear to violate federal regulations preventing commercial banks from engaging in partnerships or owning common stock. In response, the OCC has recognised that a commercial bank may take 'as consideration for a loan a share in the profit, income or earnings from a business or enterprise of a borrower'. This means that, even though commercial banks are restricted from making true equity investments, the opportunity exists to structure an equity return from a loan transaction while avoiding reliance on interest.

In addition to commercial banks, US credit unions follow a communal/partnership model consistent with Islamic financial theory. Moreover, savings associations are able to enter into joint ventures and own property through subsidiary servicing companies. These institutions not only have ready access to real estate financing through *murabahah* and *ijarah* financing, but limited joint venture possibilities are available to saving associations through the use of *musharakah* and *mudarabah* transactions.

Additional regulatory challenges remain. For example, deposits structured according to profit and loss sharing are not permitted in the US, although SHAPE Financial Corporation has developed a modified deposit product offered by University Bank so that principal is guaranteed and the deposit-holders share only in bank profits, not losses. The depositor who accepts full repayment in the case of a loss at the bank may not be in compliance with *shariah* law.

The restrictions placed on the range of permissible investments that commercial banks may hold constitute another regulatory challenge. Banks must limit their investments to fixed-income, interest-bearing securities, which are prohibited by *shariah*. In order to comply with consumer credit laws, commercial banks must make numerous disclosures in a manner that does not always fit within the principles of Islamic finance. For example, the Truth and Lending Act requires that banks make advance disclosure of annual percentage rates, which are inapplicable to Islamic financing by reason of the prohibition of interest. Moreover, a financial institution that wishes to finance the purchase of a car or home under a *murabahah* or *ijarah* structure may face additional hurdles if state laws require the institution to qualify as a licensed leasing company or auto lender.

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?

Shariah law may not be the governing law for any contract or dispute, as US law does not recognise *shariah* as a system of national law capable of governing a contract. The Convention on the Law Applicable to Contractual Obligations 1980 (the Rome Convention) requires that the governing law of an agreement must be that of a country (or, in the case of the US, a state.) In the US, court disputes will be dealt with by applying applicable state law (or foreign law, if the governing law of the contract is that of another country), and US courts will not comment on whether or not an agreement or contract complies with *shariah* law.

The restructuring plan approved by the court in the Arcapita case is the first time a US District Court approved a *shariah*-compliant restructuring plan pursuant to the US Bankruptcy Code. Although certain creditors argued the restructuring *murabahah* loan to Arcapita was not *shariah*-compliant, the court took cognisance of *Beximco Pharmaceuticals Ltd v Shamil Bank of Bahrain*, in which the court found similarly that a *murabahah* agreement was enforceable as a matter of applicable national contract law without regard to the question of whether or not the agreement was in fact *shariah*-compliant. The court in Arcapita recognised as applicable the principles of *shariah*, but did not find any conflict between *shariah* and applicable governing US bankruptcy and contract law.

If the parties stipulate in their agreement that any dispute is to be determined by enforceable arbitration, the relevant arbitral tribunal can be required by the terms of the agreement to decide disputes with reference to *shariah* principles.

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

There are no special rules governing the takeover of an IFI in the US, other than the requirements of state merger laws and applicable federal and state bank regulatory provisions governing the takeover of any financial institution.

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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