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BY EMAIL ONLY

Dear Ms Rosen

Response to Consultation on the legislative framework for the regulation of alternative finance investment bonds (*sukuk*)

This is the response of the Regulatory Law Committee of the City of London Law Society (**CLLS**) to the joint consultation paper (**CP**) of HM Treasury and the Financial Services Authority (**FSA**) (the **Authorities**) on the legislative framework for the regulation of alternative finance investment bonds (**AFIBs**), commonly known as '*sukuk*' or 'Islamic bonds'.

The City of London Law Society ("CLLS") represents approximately 13,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees. This response to the joint consultation has been prepared by the CLLS Regulatory Law Committee. Members of the Regulatory Law Committee advise a wide range of firms in the financial markets including banks, brokers, investment advisors, investment managers, custodians, private equity and other specialist fund managers, as well as market infrastructure providers such as the operators of trading, clearing and settlement systems. A number of firms whose partners are on the Regulatory Law Committee have been active in advising on *sukuk* issues and have had to address the issues raised in the CP, and other issues.

Executive summary

The Annex to this letter contains our full responses to the questions in the CP and other comments. These are summarised below:

- We welcome the Authorities' initiative to clarify the classification of *sukuk* under the UK's financial regulatory framework.
- Of the four options proposed in the CP we favour Option 1 (introducing a specific regulatory definition of AFIBs) or Option 3 (including AFIBs as an existing specified instrument under RAO¹ Articles 77 and 78):
 - *Option 2* is inappropriate to a regulatory provision (particularly one defining the perimeter of regulation) and dangerous;
 - *Option 3*: this is superficially attractive but we consider involves too high a risk of affecting interpretation of the existing provisions of Articles 77, which depends in particular on all instruments in that category being debts; and
 - *Option 4* we consider untenable.
- We consider the proposed definition unsatisfactory in various respects: it is important to amend this before introducing the AFIB provision, and to review its practical working in two or three years' time.

Please let us know if you wish us to clarify any of our responses, or suggest more specific proposals.

Yours faithfully

Margaret Chamberlain
Chair CLLS Regulatory Law Committee

Members of the CLLS Regulatory Law Committee

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¹ Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, as amended, commonly referred to as the Regulated Activities Order.

ANNEX

City of London Law Society Regulatory Law Committee Full Response to HMT's Consultation on the legislative framework for the regulation of alternative finance investment bonds (*sukuk*)

The response in this Annex is in three parts:

- Preliminary general remarks;
- Responses to the six specific questions posed in the CP; and
- Other comments on the four options.

1 Preliminary general remarks

- 1.1 We welcome the Authorities' initiative to clarify the classification of *sukuk* under the UK's financial regulatory framework. The regulatory treatment of *sukuk* has been subject of significant uncertainty and the potential treatment of these bonds as collective investment schemes (**CISs**) may well have inhibited the evolution of the market in the UK.
- 1.2 We would emphasise the need for flexibility in any definition of Alternative Finance Investment Bonds (AFIBs) to cater for future development of the market:
- (a) This would be consistent with the Government's objectives for the development of Islamic finance in the UK which are set out in the Introduction to the CP (at paragraph 1.3), namely:
 - (i) to enhance the UK's competitiveness in financial services by establishing the UK as a gateway for international Islamic finance; and
 - (ii) to ensure that everybody, irrespective of their religious beliefs, has access to competitively priced financial products.
 - (b) The market may develop from the models of *sukuk* seen hitherto, for example to include undated or privately placed instruments.
- 1.3 The regulatory and tax definitions have quite different objectives, contexts and effects:
- (a) For various reasons, the one should not be tied to the other; and
 - (b) it is important to remember that the regulatory definition is not simply about AFIB issues by UK corporates, but concerns the UK's role in international Islamic finance – the first of the Government's two objectives stated above.
- 1.4 Whichever option is chosen, it would be highly desirable for:
- (a) a revised draft of the proposed legislation to be circulated with adequate time for comment; and
 - (b) the FSA to include in its perimeter guidance (PERG) statements to the effect that AFIBs are transferable securities within the scope of MiFID, at least when negotiable on the capital market (assuming the definition ensures that they are transferable).

2 Responses to Questions posed in the CP

2.1 Regulation of AFIBs economically equivalent to conventional debt instruments

2.1.1 *Question 1:* Do you agree that AFIBs which have similar economic characteristics to conventional debt instruments should be regulated in the same way as those conventional debt instruments, where appropriate?

2.1.2 *Response:* Yes. And we consider that this is consistent with the Government's objectives set out in paragraph 1.4 of the CP. Some of our comments below are designed to go further than the draft proposed legislation in Annex B to the CP in ensuring economically equivalent regulation – for example in relation to instruments which may be undated or unlisted.

2.2 Amending the RAO and CIS Orders to give equivalent treatment

2.2.1 *Question 2:* Do you agree that including them as a specified investment under the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 and amending the Schedule to the Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001, affords these instruments a similar regulatory treatment to conventional debt instruments?

2.2.2 We agree that amending the RAO and CIS Orders could go a long way towards achieving a similar regulatory treatment for AFIBs and conventional bonds. However:

- (a) the draft proposed amendments to the CIS Order do not achieve similar regulatory treatment for AFIBs issued by persons listed in Article 78(1): such investments should be covered by amending Article 5(1)(c) of the CIS Order; and
- (b) if, as we recommend, AFIBs are not included in the RAO as Article 77 and 78 investments then there are likely to be more amendments required to other legislation, as well as to FSA rules and processes, to achieve similar regulatory treatment. Nevertheless, amending the RAO and CIS Orders will go a long way to resolving a key uncertainty which affected the *sukuk* market in the UK.

2.3 Sufficiency of the AFIB definition

2.3.1 *Question 3:* Do you believe the provisions above are sufficient for defining an AFIB for regulatory purposes?

2.3.2 *Response:* We believe that many of the features proposed are unnecessarily limiting as compared with the requirements for Article 77 instruments, and that the definition in the draft proposed legislation in Annex B reflects too closely the definition for tax purposes in Section 48A of the Finance Act 2005 (as set out in Annex C to the CP).

2.3.3 We also consider that the nature of the AFIB should be clearer, since in the draft proposed legislation Article 77(1) refers to "rights under an alternative finance investment bond" but there is no link to the concept of arrangements in 77A(2), nor does 77A(2) link to the concept of rights in 77A(1).

2.3.4 The investments we are concerned with are essentially trust certificates, under which holders are beneficiaries who have in particular:

- (a) a beneficial interest in trust assets held by the issuer as trustee; and
- (b) a right for the trustee to account to them for their respective shares of income from and proceeds of disposal of such assets.

Thus *sukuk* are certificates representing *pari passu* interests in a pool of trust assets. the purchase undertaking is granted by the originator to the *sukuk* issuer, and the *sukuk* issuer holds this on trust for the *sukuk* holders - it is a trust asset. the terms and conditions of a *sukuk* typically provide that capital amounts received by the *sukuk* issuer are used to redeem *sukuk*

in proportion to the face amount of the *sukuk*. In other words, the *sukuk* are redeemed, and there is no "repayment" of debt (and no undertaking to repay a debt). The primary credit risk to which a *sukuk*-holder is exposed is that of the originator.

2.3.5 In particular we would make the following points:

- (a) *Consideration* (paragraph (2)(a) of the draft proposed definition):
 - (i) this should reflect the fact that typically *one or more* persons (bondholders) will provide the consideration, and
 - (ii) if consideration in kind is not permitted, then AFIBs cannot be used in situations where commonly conventional debt securities are, for example as part (or alternative) consideration in a corporate acquisition;
- (b) *Maturity* (paragraph (2)(c) of the draft proposed definition):
 - (i) this is much less flexible than conventional debt instruments which can be perpetual or undated, which is important for example in funding capital for financial institutions – for example, banks' upper tier 2 subordinated debt must be undated² ;
 - (ii) in any event, the provision is potentially ambiguous because in some *sukuk* the arrangements with regard to the "bond assets" may continue even if the *sukuk* have been redeemed: in an *ijara sukuk*, the bond issuer usually requires the third party obligor (typically the underlying economic issuer or "originator") to purchase the property (that is subject to the *ijara* arrangements) on the scheduled redemption date, but in a *musharaka sukuk* the bond issuer usually requires the third party obligor to purchase the bond issuer's units in the *musharaka* on that date - the *musharaka* itself therefore may, or may not, cease to have effect as of that date; and
 - (iii) a fixed term or maturity date could prevent or limit "rolling" *sukuk* issuances where short term *sukuk* are backed by longer dated assets which are disposed of on the final redemption date.
- (c) *Redemption payment and additional payment* (paragraph (2)(d) of the draft proposed definition):
 - (i) use of the term "repayment" should be avoided in a regulatory context because it would probably be construed as implying the need for a debt claim that must be repaid: although debt obligations are not contrary to Islamic law (rather the paying of interest on them), the redemption payment on a *sukuk* is generally not in the nature of a debt obligation and (leaving aside additional payments) may not necessarily equal the original sum paid to the issuer;³
 - (ii) typically, the originator undertakes to the issuer (usually a special purpose vehicle (**SPV**)) to repurchase the bond assets and, although the SPV issuer holds this undertaking on trust for the benefit of *sukuk*-holders, the SPV separately undertakes to account to *sukuk*-holders by reference to the

² FSA Rules in GENPRU 2.2.177R(1) state that upper tier two capital must have no fixed maturity date.

³ Return of capital on a *sukuk* is achieved through purchase undertakings by the originator in favour of the issuer. Following a statement in February 2008 by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), it seems that in *musharaka*, *mudaraba* and *wakala sukuk*, the purchase price may need to be market value in most circumstances. However, the matter remains the subject of significant debate and in any event draft proposed paragraphs (2)(d)(ii) and 3e) to (g) address both the making of additional payments by reference to the value of (as well as the income generated by) bond assets and a fall in the value of those assets (or the income generated by them), and some deal structures address this issue too. Accordingly, we do not believe that further changes to the text of the draft proposed legislation are necessary to accommodate this.

payments it receives: however, that commitment of the issuer represents a trustee's obligation to account to beneficiaries rather than a debt obligation and accordingly a term such as "return of capital" would be more appropriate.

- (d) Reasonable rate of return (paragraph (2)(e) of the draft proposed definition):
 - (i) this criterion is important in distinguishing debt-like and equity-like securities for tax purposes. However, including it in the regulatory definition would discriminate against complex structures which are economically equivalent to conventional debt securities – for example *sukuk* which seek to give investors a return linked to an underlying index or equity ;
 - (ii) in addition, returns on debt securities can depart significantly from returns on a loan of the same amount to the same borrower: in a regulatory context, this criterion introduces unnecessary uncertainty which could be affected by day-to-day changes in market conditions.

- (e) Listing on a recognised investment exchange (paragraph (2)(f) of the draft proposed definition)
 - (i) whilst we recognise that tax laws distinguish listed securities for certain purposes, we do believe it is inappropriate to impose a listing criterion in determining the essential regulatory classification of a financial instrument, particularly where that classification relates to determination of the regulatory perimeter and the scope of authorised firms' FSA permissions;
 - (ii) even if it were appropriate to require AFIBs to be listed, it would not be appropriate to require such listing to be on the limited range of exchanges which are recognised investment exchanges:
 - (aa) although particular concerns and uncertainty have arisen in the issuance of *sukuk*, especially as to the potential need for issuers or others to have FSA permission to establish or operate CISs, the similarity in regulatory treatment of AFIBs should extend across the range of activities which are conducted in respect of debt securities;
 - (bb) thus, UK banks and investment firms are involved not only in underwriting and arrangements in relation to the issuance of *sukuk*, but also in dealings in *sukuk* (for themselves or for clients, including managed portfolios) and advising on *sukuk*: this is international business as well as having domestic impact. A UK broker, for example, with permission to deal for clients in Article 77 and 78 investments should be able to deal also in AFIBs without having permissions related to CISs, even if they were privately placed or not listed in the UK, Europe, or anywhere else, and subject only to restrictions and requirements which apply generally to unlisted securities.

- (f) *Security transferability*: the draft proposed definition does not specify that AFIBs be transferable, but the suggestion is made in describing key features of an AFIB in chapter 3 of the CP (page 15), and it is of course a criterion in tax legislation. Although transferability is not an inherent feature of an Article 77 investment, we believe that a bond-holders' right of transfer could be a helpful addition to the definition:
 - (i) a right of transfer is one feature which might help distinguish AFIBs from many CISs;
 - (ii) it is unlikely to limit significantly flexibility to develop the *sukuk* market;

- (iii) it is relatively easy to determine if there is such a right: the criterion is likely generally to be objective and clear in its application; and
 - (iv) it would enable AFIBs negotiated on the capital market to be treated as “transferable securities” for the purposes of MiFID and various other EC directives and regulations.
- (g) Exchangeable and convertible AFIBs: the draft proposed legislation would not put AFIBs on an similar footing to conventional debt securities in respect of exchangeability and convertibility:
- (i) Although Article 77A(3)(h) appears to provide for this, Article 3 of the draft proposed Order would not go far enough in amending Article 5 of the CIS Order because:
 - (aa) that Article expressly excludes convertibles and exchangeables from the safe harbour in Article 5(1)(a), and
 - (bb) the safe harbour for convertibles and exchangeables in Article 5(1)(b) is limited to shares and, indeed, only to shares issued by the same issuer.
 - (ii) Because of the structure and nature of *sukuk* it is unlikely that any shares issued in exchange for or upon conversion of *sukuk* would be issued by the same issuer.
 - (iii) In any event, because many tradable debt securities do not come within the primary definition of CIS set out in section 235 of FSMA, they may not need to rely on Article 5 of the CIS Order to escape treatment as a CIS, even when they are exchangeable or convertible into shares or other securities. This may contrast with certain other debt instruments within (or potentially within) the scope of Article 77 (for example, some types of syndicated loans) which do rely on Article 77.
 - (iv) We would suggest that the non-convertible/non-exchangeable limitation on the application of Article 5(1)(a) of the CIS Order be disapplied in respect of *sukuk* and other AFIBs which are “transferable securities”.

2.3.6 Clarificatory provisions in paragraph (3) of the draft proposed definition: we have no additions or other changes to suggest to this paragraph.

2.4 Additional provisions for the AFIB regulatory definition:

2.4.1 *Question 4:* Do you believe there are any additional provisions that should be included for the regulatory definition of an AFIB?

2.4.2 *Response:* No, other than:

- (a) the transferability criterion referred to above in 2.3.3 (f); and
- (b) changes to paragraph (1) of the draft proposed Article 77 to address the issues raised in paragraph 2.3.3 above and the nature of the investment as describe in 2.3.4 and 2.3.5(c) – for example, it is not necessary for the AFIB label to be used except in the title of the article, and Article 77(1) could read as follows: “rights under an instrument issued under arrangements falling within this article”⁴

⁴ This would be consistent with the drafting approach of the RAO, and address the nature of the rights concerned – as already explained, the rights of the holder of a *sukuk* are (typically) rights of a beneficiary of a trust, including the right for the trustee to account for certain income earned from the bond-assets and proceeds of their disposal,

Continued.../

2.5 Mandatory listing

2.5.1 *Question 5:* Do you believe that the mandatory listing requirement is relevant for the reasons stated above?

2.5.2 *Response:* No, as we have explained above, why we think a mandatory listing requirement is inappropriate. In addition we see flaws in the reasons given in chapter 3 of the CP (on page 15) for this proposed criterion:

- (a) There seems to be an assumption that the only *sukuk* affected by the proposed regulatory changes are those which also seek to benefit from the UK tax regime for AFIBs, and that the changes affect issuers and others involved in the issue itself (including trustees). However, as explained above, the changes will affect firms' permissions in relation to secondary market activities: there is no reason for the RAO or the CIS Order to distinguish AFIBs listed on an RIE from those on, say, Luxembourg Stock Exchange or NASDAQ Dubai (or indeed an EEA multi-lateral trading facility (**MTF**), once MTF primary listings are permitted or where there is an appropriate primary listing).
- (b) We believe that the risk from regulatory arbitrage is low:
 - (i) the various criteria in the draft proposed definition (even once amended to reflect our comments) would allow little scope for truly collective investments to be sold as AFIBs; and
 - (ii) the CP's regulatory impact assessment acknowledges the low risk of regulatory arbitrage but implies that consumers would be unprotected: however, the financial promotion and authorisation regimes, and FSA conduct of business rules, place significant restrictions on the marketing of unlisted securities, and FSA Principles for Businesses and conduct of business rules apply substantial requirements on business especially with retail customers: we believe that through its rules, guidance and supervision, the FSA can address any issues which arise; and
 - (iii) including a transferability criterion would further mitigate the risk, as mentioned in 2.3.3(f) above.
- (c) The CP mentions "recognised stock exchange" (a UK tax concept) whereas the draft legislation refers to an RIE (an overlapping regulatory concept). The use of either would be extremely limiting; if HM Treasury determine that a mandatory listing is to be a criterion, then we recommend that a much broader list be used, including markets in key Islamic jurisdictions not merely exchanges vetted and monitored by the FSA.
- (d) We recommend that HM Treasury adopt a more open approach to listing, preferably by imposing no mandatory requirement, and certainly not limiting listing to RIEs or EEA "regulated markets", but should review this issue alongside the rest of the changes in two or three years' time.

2.6 Cross-reference to tax definition

2.6.1 *Question 6:* Do you agree that, although the regulatory definition of an AFIB should generally be the same as the definition of AFIBs for tax purposes and as set out in section 48A of the Finance Act 2005, it is not appropriate simply to cross-refer to section 48A?

2.6.2 **Response:** There are two issues here:

so the issuer's obligation includes the corresponding obligation to account as trustee to holders as beneficiaries. Note the term "instrument" is defined in Article 3 of the RAO.

- (a) An assumption that the regulatory definition should generally be the same as the definition of AFIBs for tax purposes; and
- (b) Whether the RAO should simply cross-refer to this definition (as proposed in Option 2).

2.6.3 We do not believe that the regulatory definition of AFIBs should generally be the same as the tax definition:

- (a) The objectives, context and effects of the definitions in the regulatory and tax regimes are different:
 - (i) the tax regime seeks to allow AFIBs treatment similar to that for certain types of bonds, but by no means all bonds, and failure to satisfy the criteria in the definition results merely in that treatment being unavailable;
 - (ii) the regulatory definition changes the regulatory classification of many types of instrument as part of a series of statutory instruments which together with the FSMA define the perimeter of financial regulation. Breach of that perimeter is a criminal offence with civil consequences including unenforceability of agreements, restitution and compensation; and
 - (iii) the FSMA and FSA Rules also contain various provisions in relation to CISs, breach of which expose authorised persons to disciplinary and other enforcement action and to civil liability;
 - (iv) accordingly each regime needs to be independently flexible and adaptable.
- (b) Whilst certainty is highly desirable in both regimes, the need is greater where a criminal offence is being defined.
- (c) Tying a regulatory definition to a tax-based definition could effectively transfer some regulatory responsibility from the FSA to HMRC in terms of scope of the regulatory regime, and:
 - (i) in respect of the regulatory regime detract from the FSA's roles in interpretative approach and proposing change of the definition; and
 - (ii) potentially restrict flexibility to change the tax regime if the Authorities wished to consult on impact on the regulatory regime of any proposed changes to the s48A definition; and
 - (iii) potentially result in the financial community and other stakeholders not being consulted when changes are proposed.
- (d) The tax definition inevitably includes factors which are irrelevant or inappropriate in determining regulatory classification: we think there are very good reasons to support each omission from the draft proposed definition for the RAO of an element of the definition in section 48A(1) of the Finance Act 2005 - for example the criteria requiring disposal of bond assets at maturity in (d)(i), arrangements by the bond issuer to manage bond assets in (f), and treatment under international accounting standards in (i) – and we could explain these reasons if this would be helpful.
- (e) The objectives for the changes (as set out in paragraph 1.4 of the CP) are wider than merely changing the regulatory classification of certain instruments which have a particular tax treatment.
- (f) There is no regulatory reason to reclassify only some of the established forms of *sukuk* investment and not others.

- 2.6.4 Accordingly, we do agree strongly that it would not be appropriate for the RAO definition of AFIBs simply to cross-refer to the definition for tax purposes in section 48A, and there are additional reasons for this:
- (a) cross-referencing would limit flexibility for HM Treasury and the FSA to address shortcomings which arise from a regulatory perspective;
 - (b) a clear distinction between the two definitions makes it easier for interpretations to develop driven by regulatory considerations;
 - (c) cross-referencing would mean the regulatory definition changed if a change were made to the tax definition, even though the latter were driven purely by tax considerations – for example a change in the qualifying corporate bonds regime.
- 2.6.5 However distinct the regulatory and tax definitions become, we believe that the term used for the regulatory concept should be different from the tax concept unless, contrary to our strong recommendation, the RAO merely cross-refers to the tax definition. For example the term "alternative investment bonds", "alternative finance bonds" or simply "alternative bonds" could be used.

3 Comments on the options proposed

3.1 *Option 1:* Introducing a specific regulatory definition of AFIBs.

3.1.1 We strongly support this option.

3.1.2 We agree that Option 1 is flexible, simple and creates legal certainty, as paragraph 3.4 of the CP suggests.

3.1.3 There are two aspects of Option 1 which might be argued to be disadvantages but which, for the reasons we explain, we believe are not:

- (a) Option 1 would require consequential amendments across the financial regulatory regime, both in statutory instruments and in FSA rules and guidance, to extend most existing direct or indirect references to Articles 77 and 78 investments to Article 77A investments also – for example, in the FSA Glossary definition of "debt securities", which is used in various other Glossary definitions and rules such as the definition of "equity stake".
 - (i) Option 3 might appear to avoid this, but that would be a mistake: it is important that each cross-reference to Articles 77 and 78 be considered, to decide whether it should or should not cover AFIBs;
 - (ii) For example, it may not be necessary to extend Article 9 of the RAO (which excludes from the definition of deposit "sums received in consideration for the issue of new securities").
- (b) Investors who wish to allow their investment managers to invest in AFIBs may need to change their investment parameters, policies and/or mandates (and possibly also their constitutions) to some extent and this hurdle may limit demand for AFIBs:
 - (i) if Option 3 were adopted then, those UK institutional and other investors which define those parameters, etc by reference to investment categories in the RAO, would be able to invest in Islamic finance securities which are economically equivalent to conventional debt securities, without seeking changes in their constitution or mandates;

- (ii) on the other hand, Option 1 offers a greater degree of investor protection to such investors because they won't become invested in AFIBs unless they make a conscious decision that AFIBs are an acceptable investment category.

3.1.4 We have commented above (in 2.3 in particular) on the key features of the proposed definition, which we understand proposed whichever option is adopted.

3.2 *Option 2: Using the tax definition of an AFIB for regulatory purposes*

We do not consider Option 2 appropriate, and have explained our reasoning in our response to question 6 above, and in paragraph 1.3 of this annex.

3.3 *Option 3: Similar to Option 1, but including AFIBs as an existing specified instrument*

3.3.1 We do not favour this option because we think it would prove too difficult to implement it without adverse implications for either AFIBs or for the types of investment currently within the scope of Article 77.

3.3.2 The advantage of Option 3 that is set out in paragraph 3.15 of the CP, namely that "it ensures that AFIBs are treated as debt instruments without having to create a unique regulatory category" is superficial, we believe, and in fact brings disadvantages that more than outweigh avoidance of the "need to upgrade the FSA's IF systems". In particular:

- (a) If AFIBs which are included within an existing RAO investment category of debt securities or government/public securities institutions and other investors whose constitutions, investment policies and/or mandates are defined at least in part by reference to RAE specified investment categories could find themselves invested into AFIBs by their managers without having made a conscious or deliberate decision to invest in securities which (in the case of *sukuk* at least) are technically not debt securities;
- (b) Investors and their managers/advisers may make decisions to invest in *sukuk* without realising that they are not debt obligations; and
- (c) Cross-references to Articles 77 and 78 from elsewhere in legislation and FSA Rules would include AFIBs even if that were not appropriate, unless there was an appropriate due diligence exercise to review each cross reference: at first sight one might think that Option 3 avoids the need for such a review, but that is not the case (see 3.1.3(a) (ii) above for an example of a potentially inappropriate cross-reference) and therefore removes one of the few potential advantages of Option 3.

3.3.3 Potential PR impact:

- (a) a significant disadvantage of Option 3 would be the potential characterisation by UK and foreign media (and possibly others) of AFIBs as having been classified by the Authorities as debt instruments (and possibly by implication interest-bearing);
- (b) this negative publicity might encourage doubts as to the Sharia-compliant credentials of products issued within the scope of Article 77;
- (c) this risk might not be mitigated to any significant degree by providing clarification (as we believe has been discussed) in the AFIBs definition to the effect that they are not debt securities and that they may not be interest-bearing.

3.4 *Option 4: Do nothing*

We consider this option untenable, in that:

- (a) it would continue a legal uncertainty which can be easily remedied, and is arguably inhibiting development of the *sukuk* market in the UK and the involvement of UK-based authorised firms in that market; and
- (b) it would be wholly inconsistent with the Government's stated objectives for supporting the development of Islamic finance in the UK (as set out in paragraph 1.4 of the CP).

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