

AET Corporate Trust

April 2009

Sharia compliant lending in Australia

Role of the Trustee

Sharia compliant lending is a form of Islamic financing that complies with *Sharia* law. The main features of *Sharia* compliant lending are:

- the prohibition against *riba* – the paying or charging of interest
- the prohibition against investing in certain assets or industries – for example alcohol and gambling
- the prohibition of complex financial investments having elements of speculation or uncertainty – the underlying assets must be clearly identifiable.

Australian Executor Trustees Limited (AET) is a national statutory Trustee company, licensed to act as Trustee in all mainland states of Australia. AET has been in the trustee business for over 120 years and has been able to successfully grow its business through the relationships it has built with other companies who are expert in their field.

AET is a member of the Australian Wealth Management Group (AWM), which includes companies such as Bridges Financial Services, Spectrum Super, Ord Minnett and United Funds Management. The Australian Wealth Management Group is currently pursuing a merger with IOOF Limited which has recently purchased Skandia Funds Management Limited. Once completed, the merged entity will be one of the largest wealth management companies in Australia.

While *Sharia* law prohibits *riba* it does not prohibit profit from trading. Many *Sharia* compliant transactions take the form of a joint venture with the financier of a transaction sharing in the profit or loss of a particular project – *Musharaka*. *Ijara* and *Ijara-wa-Iqtina* are forms of *Sharia* compliant lending using sale and lease back financing technology which is similar to property warrant structures for which AET currently acts as Trustee. AET's understanding is that, while these structures may be used to roll out an over-the-counter *Sharia* compliant residential mortgage product, there is simply not the demand for such a product and, in any event, there are community groups who cater for the demand that currently does exist.

However, one interesting area of Islamic finance relevant to AET is the issue of '*sukuk*' or *Sharia* compliant bonds. *Sukuk* are typically issued by a special purpose vehicle (SPV) that could be a trust or a company. The *sukuk* could be used to finance the purchase of assets which are then subject to an *Ijara* arrangement (see above).

The first such international *sukuk* was issued by the Malaysian government in 2002. It is worth remembering that Malaysia is a common law country and thus recognises the concept of a trust and beneficial or equitable ownership of property and has a large Muslim population.



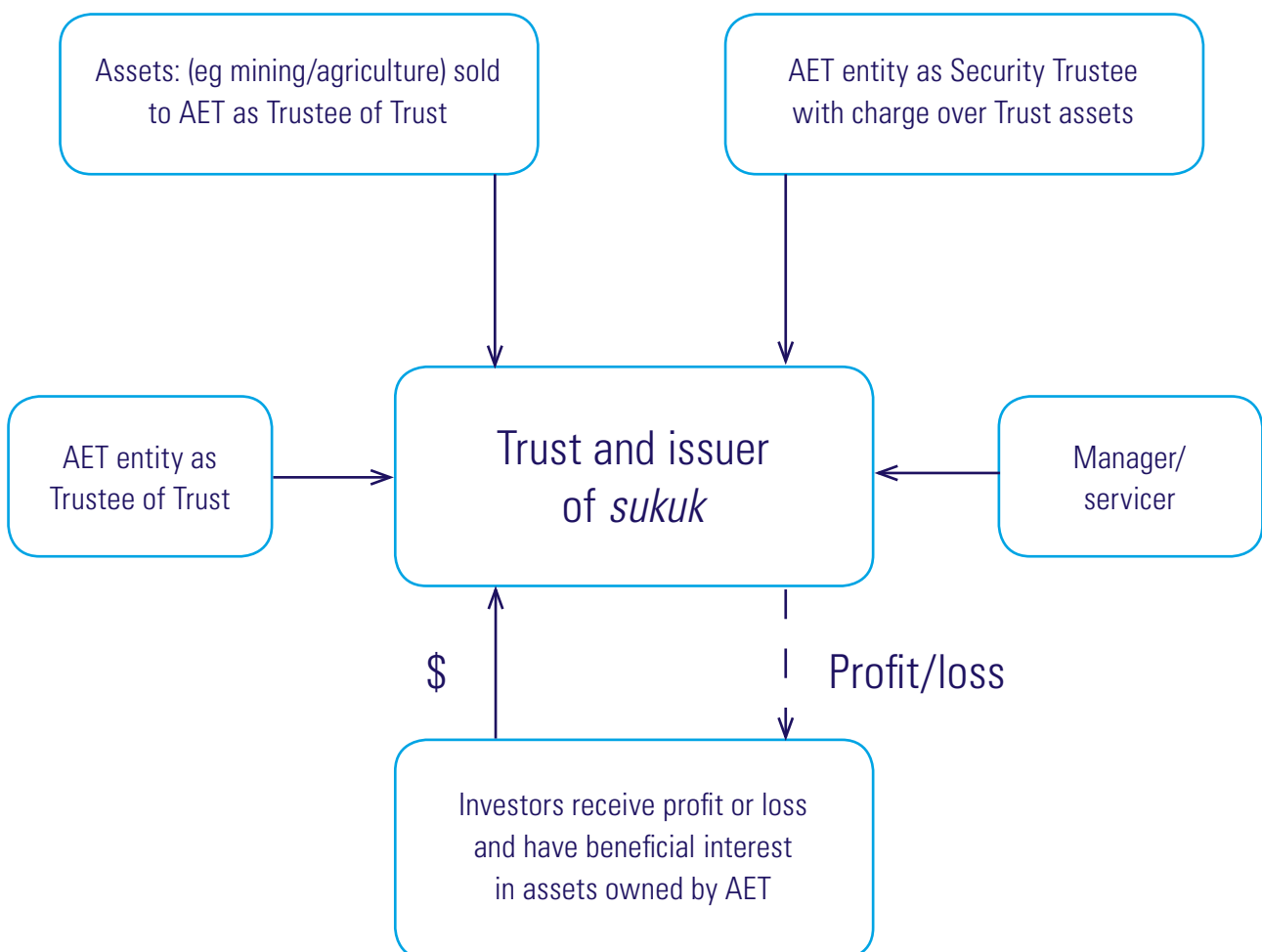
The UK government is currently being advised on the issue of its first *sukuk* and there have been numerous non-government *sukuk* issues in the UK.

The *sukuk* structure, based on principle of *Musharaka*, is as follows. An SPV (either a trust or company) acquires assets, for example mining tenements. The SPV then declares a trust over the assets contained within it. The income or profit produced by the SPV's assets (for example, the rent) is distributed to *sukuk* holders. The *sukuk* holders share in the profit (or loss) of the SPV's assets and do not receive a fixed income which could be considered *riba*.

This structure could be used to finance resource projects or certain permitted or *halal* agricultural schemes and could be of great interest to offshore sovereign investors looking for *Sharia* compliant investment opportunities.

If the structure of the vehicle issuing the *sukuk* is a trust, an AET entity would act as Trustee, owning the assets in the trust and issuing the *sukuk* to investors. In addition, a related entity of the issuing trustee could act as security trustee and hold a charge over the assets of the trust on trust for creditors of the trust. The architecture of this structure is similar to a 'double' or 'back to back' trust commonly used in a standard Australian mortgage securitisation structure for which AET group entities have acted as Trustee/Security Trustee.

Double trust vehicle



Alternatively, if an independent trustee is not considered necessary as the *sukuk* issuing vehicle or, if the issuing vehicle is to be a company, AET could simply act as Security Trustee and hold a charge over the issuing vehicle's assets on trust for the creditors in the event of a default by the issuing vehicle.

AET is also able to offer corporate governance services to corporate SPVs through its SPV management function which includes accounting, company secretarial and directorship services for Australian companies.

AET sees no reason in principle why an issuing vehicle would need to be an Australian corporation, although AET would not be able to offer its SPV management services to overseas companies. Offshore SPV management could, however, be offered through AET's relationship with Deutsche Bank AG.

The structure of a corporate vehicle issuer would be as above with an SPV acting as issuer instead of AET as Trustee. The SPV would own the assets financed by the *sukuk*.

Subject to careful arrangement, taxation and jurisdictional issues, the issuer could be an offshore company owning assets in Australia over which AET could hold a charge. In the event of enforcement of the charge, it would be preferable for the documents to be subject to Australian law and courts but this is not breaking new ground in multi-jurisdictional financing transactions.

In view of the prohibition of *gharar* or uncertainty in contracts, it is uncertain if hedging agreements could be part of the structure and this in turn raises issues if, for example, there is a foreign currency element to a transaction. Note: hedging arrangements are permitted by certain schools of thought (ie *Shabie* and *Maliki*).

In conclusion, the area of *Sharia* compliant lending is in essence a form of financing which must comply with a body of sacred/religious law as well as local laws and regulatory requirements. AET feels that many of the existing structures used to secure finance could be adapted to raise finance by way of *sukuk* issuance.

AET could act either as both issuer/owner of the assets and Security Trustee or just simply Security Trustee; ultimately, as in securitisation transactions, the preferred structure will be driven by investors.

AET works closely with all service providers in the corporate finance sector and has built strong relationships with asset servicers, finance professionals and law firms, all of whom are able to assist in the arrangement of the first Australian *sukuk* issue.

AET would be happy to discuss any aspect of deal structuring with interested parties.

Further information:

James Connell, Legal Counsel Corporate Trust: +61 2 9208 5971

Philip Joseph, CEO Corporate Trust: +61 2 9028 1051

Level 22 207 Kent Street Sydney

Locked Bag 4004 QVB Post Office NSW 1230

Sydney is GMT + 10

