LUXEMBOURG FOR FINANCE

ISLAMIC FINANCE

THE FINANCIAL CENTRE DEVELOPMENT AGENCY

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ISLAMIC FINANCE

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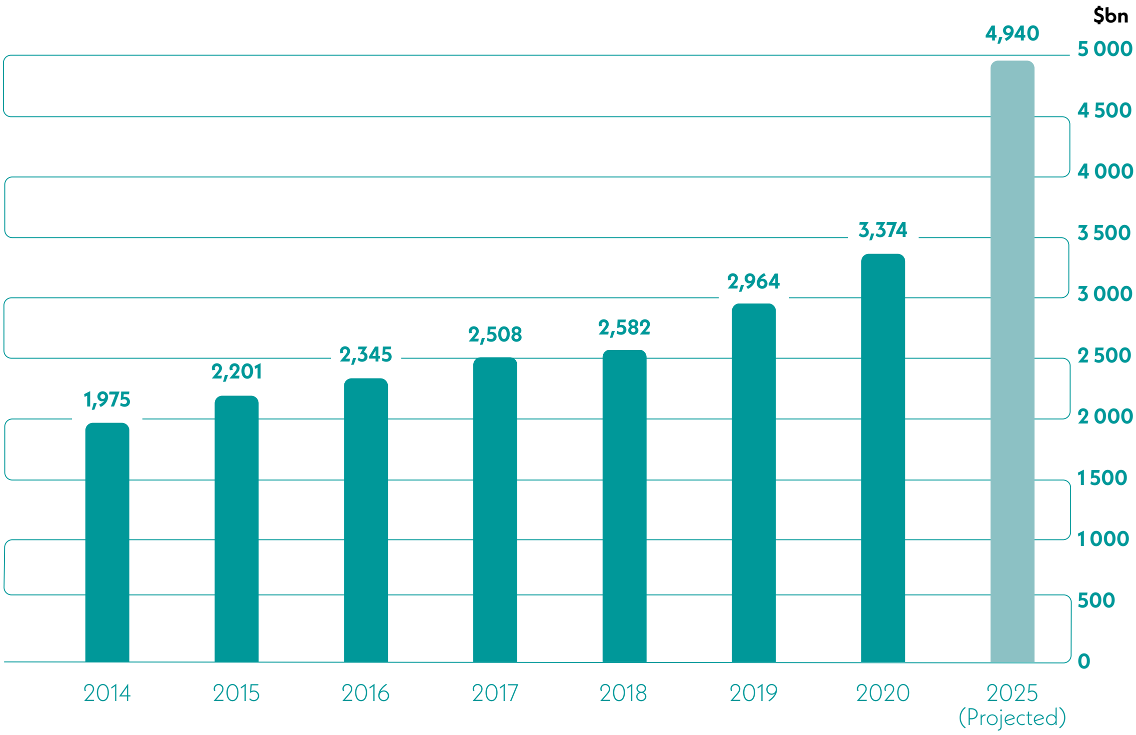
ISLAMIC FINANCE

In the space of three decades, Islamic finance has become a widely accepted integral part of the global financial services industry and one that is projected to grow even stronger in the future. Islamic finance has expanded outside of the Muslim world and the Global Islamic Finance Development Indicator (IFDI) forecasts the global Islamic finance industry to grow from $3.3tn in 2020 to $4.9tn in 2025, an average growth of 8% throughout 5 years. Its clear synergies with sustainable finance have only strengthened growth opportunities for Shariah-compliant finance and made it possible for Islamic finance to develop in new ways and more broadly to touch on new markets.

Islamic Finance Assets Growth (2014-2025)



Source: Islamic Finance Development Report 2021

MAIN PRINCIPLES OF ISLAMIC FINANCE

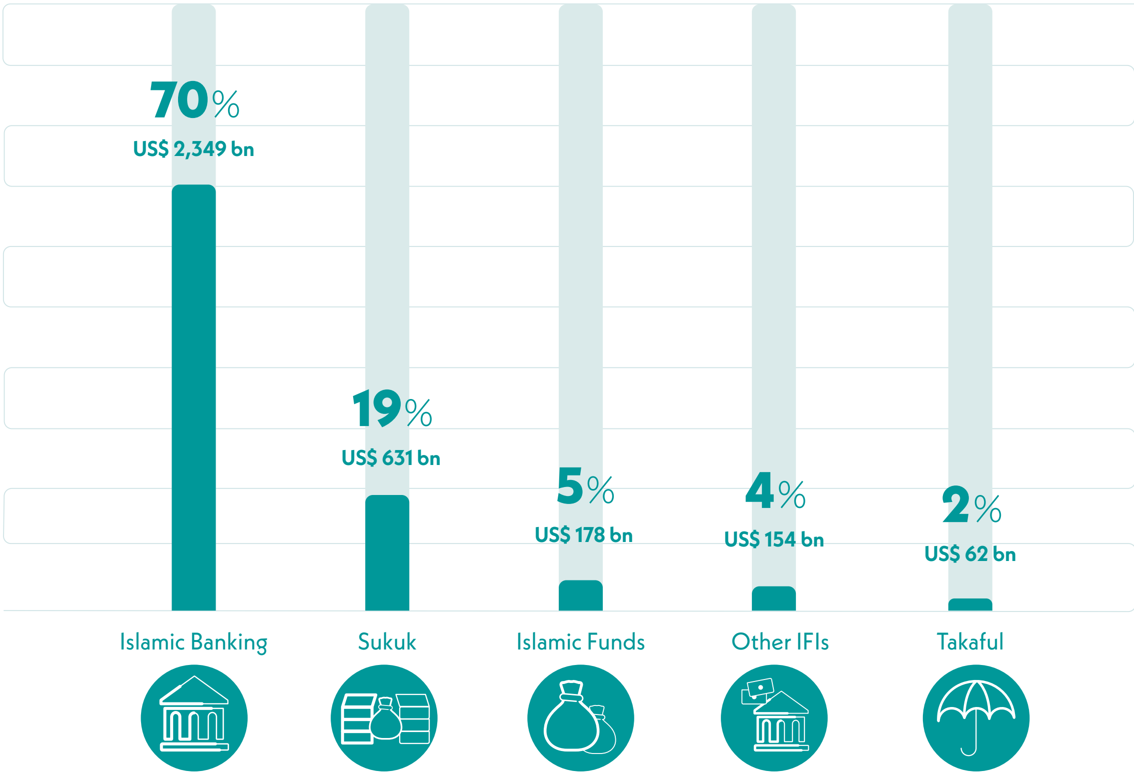
What is Islamic finance? The term encompasses all banking and finance activity which is guided by the teachings of the Quran and the principles of Shariah law. Institutions active in Islamic finance require access to a Shariah scholar who is ultimately responsible for compliance with Islamic standards. Based on IFDI 2021, there are some 1,500+ recognised Shariah scholars worldwide.

- Ban on usury
- Ban on uncertainty or speculation
- Ban on financing forbidden sectors
- Profit and loss sharing principle
- Asset-backing

- No interests
- No derivatives
- Investment screening
- No guaranteed income
- Contracts must be based on a tangible underlying asset

As in conventional finance, regulations and standards vary somewhat across jurisdictions; this is also true for Islamic finance. Companies promoting Shariah compliant products require access to the skills of one or more Shariah scholars familiar with the interpretation of Islamic law in the given target market of reference. Scholars and legal experts from the different schools of Islam are striving to reach a consensus. International bodies such as the 'Auditing and Accounting Organisation for Islamic Finance' (AAOIFI), the 'Islamic Financial Services Board' (IFSB), the Islamic Development Bank Institute (IsDBI), and the 'International Islamic Financial Markets' (IIFM) have published industry standards and guidelines. Standardisation is an important prerequisite for the growth of the sector and its adoption by conventional investors. Islamic financial products are open to all investors and often classed under the general umbrella of responsible investments.

Breakdown of global Islamic finance assets (2020, US$ bn)



Source: Islamic Finance Development Report 2021

ISLAMIC AND SUSTAINABLE FINANCE AFFINITY

Islamic finance strives for fairness, the empowerment of all stakeholders, the pursuit of ethical practices and social responsibility – values that sit at the heart of the growing global shift towards sustainable finance. While largely a niche sector, the similar values mean Islamic finance has the potential to rapidly grow and play a more active role in fostering a sustainable future. The Covid pandemic has acted as a catalyst for sustainable finance, shining a light on the need to ensure that any economic recovery is sustainably minded. This has seen the issuance of sustainable securities double in a couple of years and a growing demand for new and innovative sustainable products – green sukuks included. Islamic finance benefits from a great opportunity in this regard to combine value creation and the pursuit of ESG impacts for all stakeholders.

Both offer products that serve Muslim and non-Muslim investors alike and possess strong practices and policies which complement each other. Indeed, contractual equality, ethical governance and responsible investing are core principles of Islamic finance and this holds true for sustainable finance. Islamic finance inherently applies certain practices that are widely used in sustainable financing, such as negative-based screening to avoid specific activities, industries or products that are deemed immoral or unlawful under Shariah law. ESG principles could also be integrated in Shariah-compliant fund products as a complementary methodology by operating an inclusion-based screening for specific sectors, products, or practices with positive impacts. Although sukuk remains the preferred financial vehicle for green financing, this could assist in the further development of the social financing sector via products such as *zakat*, *sadaqah*, and *waqf*.

A LEADING SUSTAINABLE FINANCE HUB GLOBALLY

Luxembourg has not only embraced the global trend towards green and sustainable finance but has taken on a leading role: today ranking as the 5th greenest financial centre globally (GGFI 8), being home to half the world's listed green bonds and more than a third of Europe's responsible investment funds. Luxembourg is also a proud founding member and lead donor of the UN's network of Financial Centres for Sustainability (FC4S) and actively supports its work.

Luxembourg will strongly promote the green agenda in its financial services sector in the years ahead. The Government has made this goal one of its priorities in its coalition agreement. As part of a national Sustainable Finance Roadmap, the government has set up a national Sustainable Finance Initiative (LSFI) to coordinate activities and develop a national strategy to further develop Luxembourg's role as an international platform for sustainable finance. A new legal framework for green covered bonds is a further illustration of how Luxembourg is developing its product range in this sector, with the aim of helping to raise capital for sustainable projects.

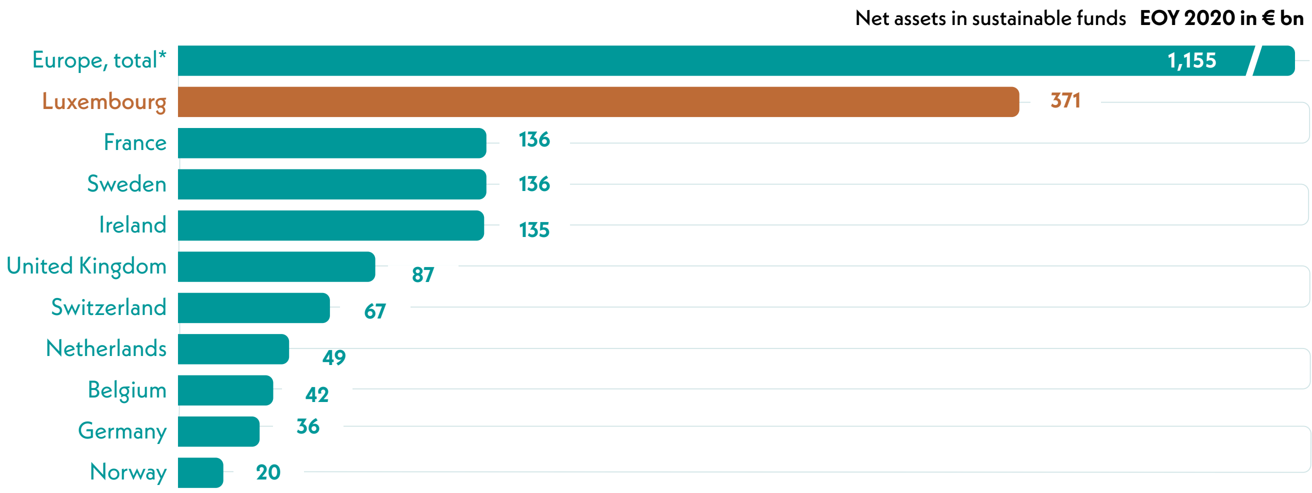
Sustainable finance encompasses much more than green finance and supports the 17 Sustainable Development Goals laid down by the UN. The Covid-19 crisis has already put the 'S' in ESG in greater focus.

With Islamic finance particularly focused on financial inclusion, microfinance is critical for providing access to many communities that lack access to Shariah-compliant facilities. Microfinance was the area in which the sustainable labelling agency LuxFLAG focused its work when it was created in 2006. As of July 2021, it has labelled over 354 investment products, covering €154,77bn, across 11 jurisdictions, with promoters from over 17 countries.

Luxembourg, as the leading European domicile for microfinance vehicles (MIVs), is well poised to provide support in this regard. The Grand Duchy accounts for almost a third of global MIVs assets under management (AuM).

Many Islamic fund managers have already gone beyond compliance with traditional Shariah rules to add ESG screening to their investment process. Indeed, Islamic law encourages this. Certain Islamic asset management companies have signed up to the UN Principles for Responsible Investment. Luxembourg is the largest EU domicile for sustainable and impact funds. The adoption of recognised ESG standards by Islamic asset managers opens the possibility of cross selling their Islamic funds to the European institutional asset management market.

Luxembourg as the largest European domicile for responsible investing



* EU27 and Liechtenstein, Norway, Switzerland, United Kingdom

Source: European sustainable investment funds study 2021: Catalysts for a greener Europe

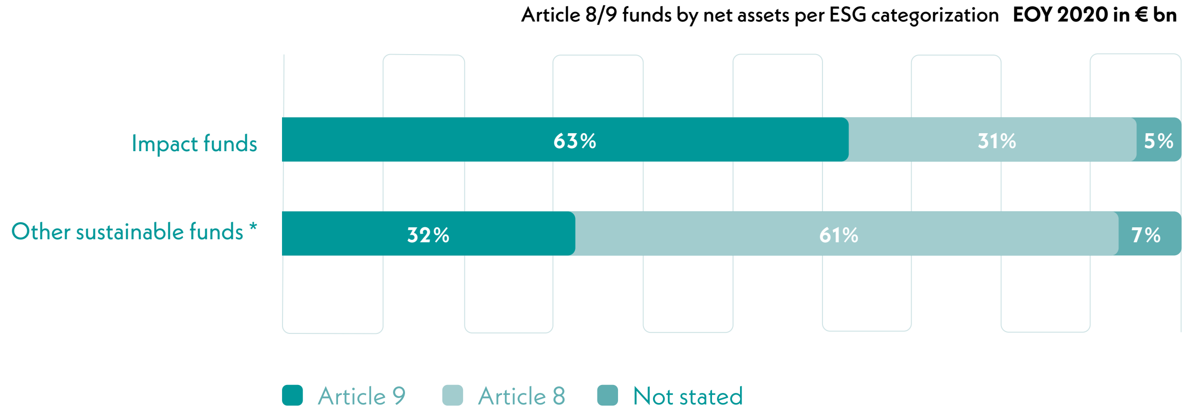
AN ESTABLISHED SUSTAINABLE FUND PRACTICE AT THE HEART OF EUROPE

Luxembourg is aligned with EU latest legislation including the Sustainable Finance Disclosure Regulation (EU Reg 2019/2088) also known as SFDR and the EU Taxonomy regulation (EU Reg 2020/852). For fund providers, the implications are manifold. According to the new regulation they will need to explain in pre-contractual disclosures how sustainability risks are considered in their investment process as well as how sustainability risks may impact the returns of their financial products.

In addition, they will need to assess if and to what extent their funds fall in one of the following categories, i.e., funds that promote social or environmental characteristics ("Article 8 funds") or funds that have sustainable investment as their main objective ("Article 9 funds"), and comply with the respective reporting requirements.

Luxembourg financial regulatory authority, the CSSF, has implemented in December 2021 a fast-track procedure to push further the application of the EU Taxonomy regulation (the TR FastTrack Procedure) for Management Companies of UCITS (ManCos) and Alternative Investment Fund Managers (AIFMs) to facilitate the CSSF filings of Taxonomy updated prospectuses.

Funds domiciled in Luxembourg



* Including funds with ESG or environmental focus or funds that combine impact objectives with other ESG or environmental factors.

Source: Morningstar Direct, zeb. research calculations. Methodological remark: analysis excluding money market funds, closed end funds, fund or funds and feeder funds. Coverage of approx. 77% of funds domiciled in Luxembourg, as per 5/31/2021.

Source: European sustainable investment funds study 2021: Catalysts for a greener Europe

AN ESTABLISHED EUROPEAN PARTNER

02

AN ESTABLISHED EUROPEAN PARTNER

MAIN FEATURES OF THE LUXEMBOURG FINANCIAL CENTRE

- Economic, political, social and financial stability
- A state-of-the-art IT infrastructure specifically aimed at providing speed, security and reliability to the financial centre
- Decades of experience and established expertise in serving international clients on a cross-border basis
- A culture of investor protection
- A legal, regulatory and tax framework that caters to the specificities of international finance in compliance with EU and global standards
- Strong ties between the public and private sector

THE FINANCIAL CENTRE IN A NUTSHELL

50% **of green bonds worldwide** are listed in Luxembourg

24% solvency ratio (EU minimum is 8%)

€5.3tn Europe's **leading** investment fund centre worth **€5.3 tn**, the **second largest investment fund centre in the world** after the United States

The world leader in the **cross-border distribution** of **retail investment funds**
Source: PwC, 2022

AAA Consistently rated **AAA** by all major credit-rating agencies.

GDP growth of 6.9% above the EU average of 5.4% in 2021

25.8% Very low public debt, **25.8%** of **GDP**

11th for **English proficiency worldwide**

€508bn **Premier international wealth management** centre in the Eurozone

Home to Europe's leading international bond listing centre, the **Luxembourg Stock Exchange**

LUXEMBOURG STOCK EXCHANGE

Sources: GFCI, CSSF, ABBL, PwC, Eurostat, Eurobarometer, the World Bank

ISLAMIC FINANCE IN LUXEMBOURG

Luxembourg is a long-standing partner to the financial communities of Muslim countries in Asia and the Middle East. To these markets the Grand Duchy offers financial services that can be designed and delivered to conventional or Islamic finance standards.

Luxembourg has established its credentials as an Islamic finance centre: it was the first European country to authorise an Islamic insurance company, the first European market to list a sukuk, the first Central Bank in Europe to join the IFSB and the first sovereign State to issue a euro-denominated sukuk.

Luxembourg is the fifth largest Islamic fund centre and first outside the Muslim world, ranked by the number of Islamic funds established in the market.

Luxembourg provides a base from which to offer Shariah-compliant products and services to European Muslims, which represent 6% of the European population. A number of major banks, legal and audit firms, fund administration companies and other service providers in Luxembourg have active and well-trained Islamic finance teams.

Luxembourg does not have a standing Shariah authority, in recognition of the existence of different interpretations of Shariah law. Nevertheless, the financial centre welcomes standardisation as an important driver for growth of the sector in Europe.

In 2013, the Association of the Luxembourg Fund Industry (ALFI) published a set of 'best practice guidelines' for setting up and servicing Islamic investment funds. These have become an international standard in the sector.

"The level and quality of Shariah-compliant advisors and professionals in Luxembourg is unsurpassed, complementing the sophisticated and well-established legal framework for Islamic financial institutions and investors in Luxembourg."

Haitham Al Refaie,
Tawreeq Holdings Group CEO

LEGAL ENVIRONMENT

Luxembourg has built a longstanding reputation over the last 25 years as a major Islamic finance centre in Europe with consolidated expertise to support the development and structuring of Islamic finance products for global investors. The Luxembourg financial sector supervisory authority (CSSF) and the insurance sector regulator (CAA) have many years of experience in the authorisation and supervision of Shariah-compliant fund and insurance structures. The CSSF, for example, signed Memorandum of Understandings (MoU) with Qatar and Abu Dhabi in 2015 and 2017 to provide mutual assistance and exchange of information in the sector.

From a regulatory perspective, the supervisory authorities do not set any conditions with regard to the compatibility of assets with Shariah law. Whether the project in question is setting up a bank, a sukuk, or an investment fund, the CSSF will seek to ensure that all applicable Luxembourg legal requirements are complied with. In the case of a fund, the CSSF will wish to establish that the persons involved in the management have adequate expertise and that the sales documentation (where applicable) is sufficiently clear to allow investors to understand the consequences of their investment.

LUXEMBOURG AND ISLAMIC FINANCE TIMELINE

1978
First Islamic finance institution established in a non-Islamic country

1983
First Islamic insurance company in Europe

2002
First stock exchange in Europe to list a sukuk

2008
Government establishes a Task Force to promote Islamic finance

2009
Specialised Islamic finance training courses launched by the banking institute

2010
- First Central Bank in Europe to join the IFSB
- Circulars clarify the treatment of Islamic finance structures
- Founding member of the IILM facility

2013
Luxembourg fund association publishes "best practice guidelines" for servicing Islamic funds

2014
First sovereign state to issue a sukuk in €

SHARIAH COMPLIANT INVESTMENT FUND PRODUCTS

03

SHARIAH COMPLIANT INVESTMENT FUND PRODUCTS

THE INVESTMENT FUND TOOLBOX

Luxembourg is the leading centre for internationally distributed investment funds. Combined with service providers that have experience in Islamic finance, this has made it an ideal location for the setting up, administration, and cross-border distribution of Shariah compliant investment vehicles.

The Luxembourg financial sector toolbox contains a wide selection of regulated and unregulated investment vehicles, any of which can be used to establish a Shariah compliant investment fund. The choice of regime will largely depend on the investment strategy and the target investor group; these factors will influence the structure and the level of product regulation required. In this, the challenges faced by a Shariah compliant portfolio manager are similar to those faced by any other portfolio manager. Shariah compliant asset allocation can be achieved by putting in place a robust investment strategy and a careful selection process.

Most Luxembourg vehicles can be set up in an 'umbrella' form, where segregation is achieved by creating multiple compartments, each with distinct assets and liabilities. One or more of these compartments can be established as Shariah compliant. Fund promoters use Luxembourg to distribute Islamic funds globally.

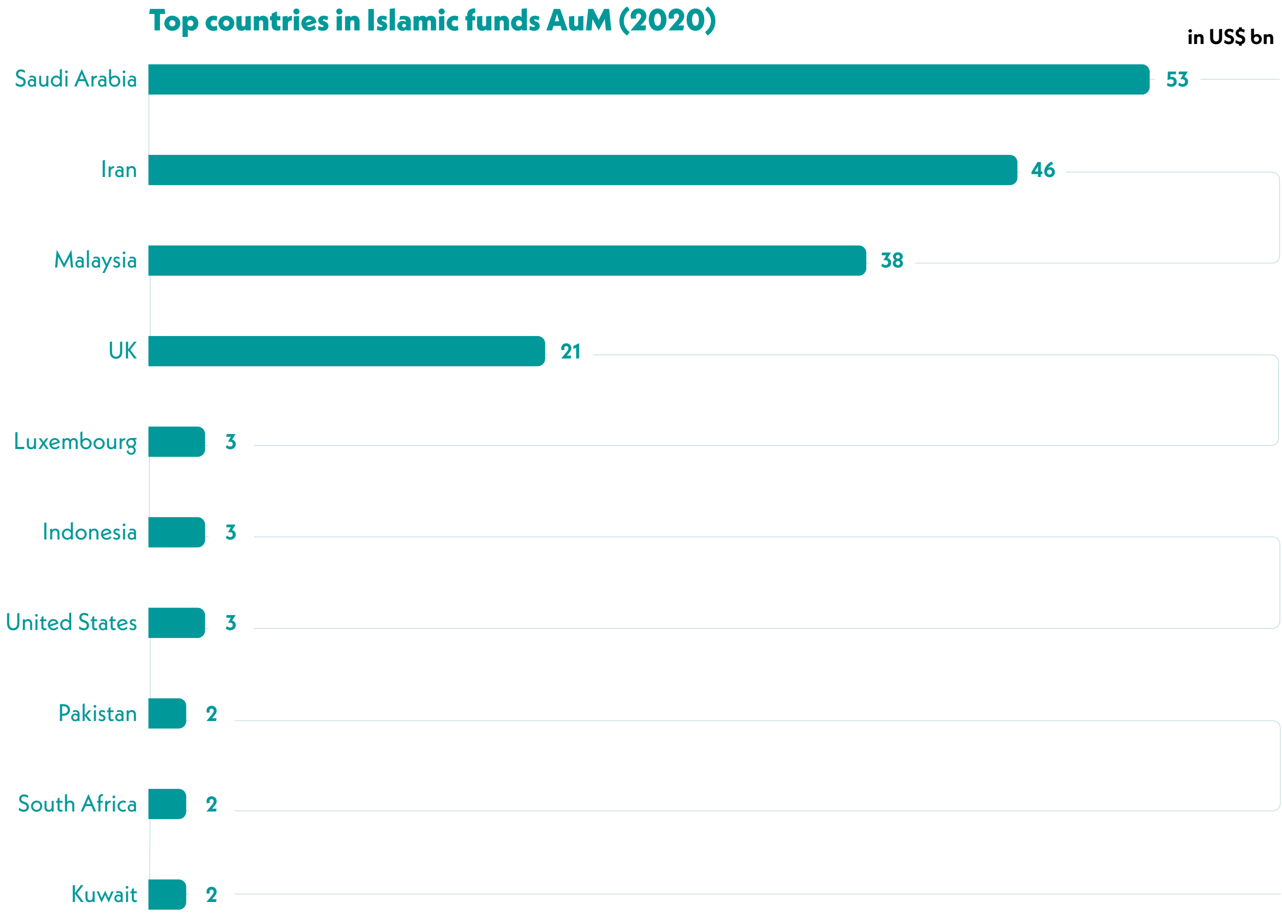
GOVERNANCE OF SHARIAH COMPLIANT FUNDS

The assets of a fund are usually managed by an investment manager or advisor, under the ultimate responsibility of the fund's board of directors or its management company.

The specific features of an Islamic scheme normally require that the board of directors (or the manager in the case of a management company) appoint a Shariah advisor or a board of Shariah advisors to ensure that the investment strategy is compliant.

FIFTH LARGEST ISLAMIC FUND DOMICILE IN THE WORLD

Luxembourg is the fifth largest domicile for Shariah compliant investment funds, ranked by the number of Islamic funds in the market.



Source: ICD-REFINITIV Islamic Finance Development Report 2021

The Islamic mutual fund industry in Luxembourg has grown by 122% over the past six years, with a total AuM of $6.7bn by Q3 2021, making Luxembourg among the top-five countries in this segment globally. Furthermore, Luxembourg is the leading European Islamic fund capital, with 30 Shariah-compliant funds by Q3 2021, composed mainly of mutual funds.[1]

[1] FitchRatings 2021.

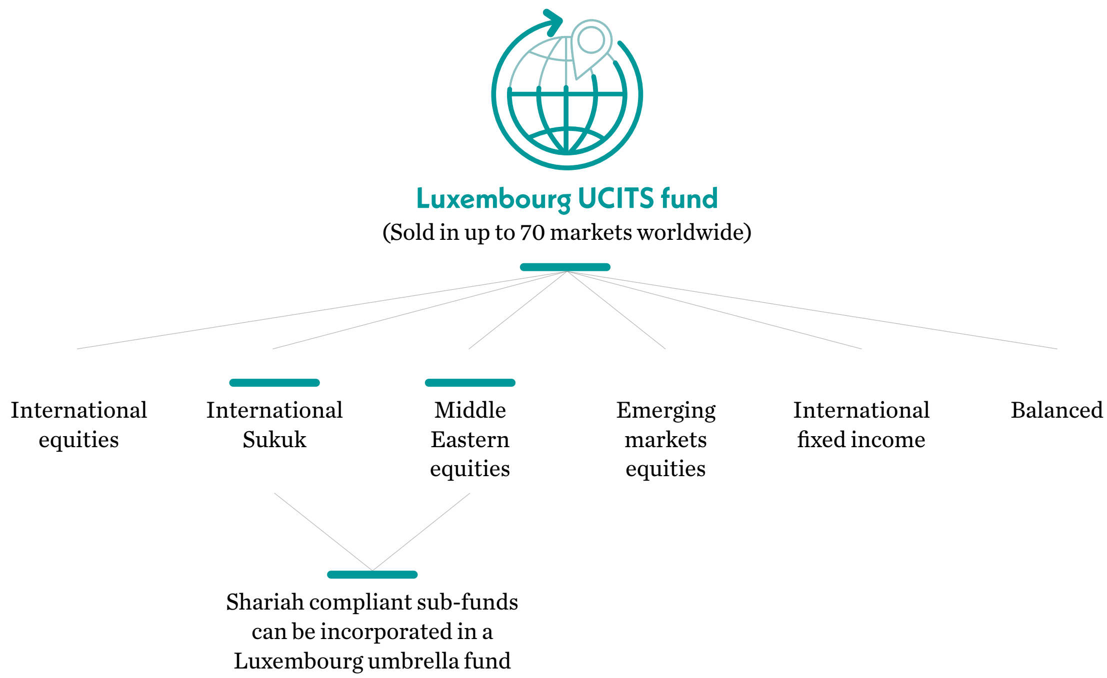
RETAIL FUNDS

Over the last 25 years, Luxembourg has built and reinforced its position as the most popular domicile for Undertakings for Collective Investment in Transferable Securities (UCITS).

Originally designed as retail investment products, UCITS are now widely sold both to the public and to institutional investors across the globe. Luxembourg UCITS not only benefit from a passport for distribution within the European Union, but are also recognised for distribution in another 40 jurisdictions worldwide including countries in Asia, Latin America, and the Middle East, a network that is unique in the industry.

Out of the 334 foreign investment funds registered for sale in the UAE, 75% (251) are domiciled in Luxembourg. Similarly, 73% of foreign funds in Bahrain are domiciled in Luxembourg.[2] At a global level, 59% of all cross-border funds are domiciled in the Grand Duchy.

This expertise in cross-border distribution makes Luxembourg the ideal location for the domiciliation of Shariah compliant funds for sale to retail or institutional investors around the world. Any UCITS may be set up as a Shariah compliant fund.



ALTERNATIVE INVESTMENT FUNDS

Alternative fund structures reserved for well-informed and professional investors can be made Shariah compliant. A range of vehicles exist for investment in transferable securities and alternative investments such as real estate, private equity, venture capital and hedge funds.

Professional investment fund initiators wishing to take advantage of the European passport must appoint an authorised Alternative Investment Fund Manager (AIFM) to manage their fund in compliance with the Alternative Investment Fund Directive (AIFMD) as implemented in Luxembourg legislation.

[2] PwC Global Fund Distribution 2021.

THE "THIRD-PARTY" MANCO OR AIFM

Islamic asset managers looking to domicile funds in Luxembourg for fundraising across the EU but not yet ready or willing to create their own local oversight structure (authorised AIFM or Management Company) and incur in set-up costs, can also opt for the 'third-party management' model. In this scenario, the fund distribution and oversight activities are done from a third-party Management Company or AIFM whereas investment management remains a responsibility of the Islamic investment manager. Asset managers looking to launch only a few alternative funds in Luxembourg can also opt for setting up a sub-fund in an existing umbrella fund structure managed from a third-party management company. This can be a cost-effective solution for smaller Islamic players or for non-European Islamic asset managers willing to domicile and distribute funds via Luxembourg with the support of a well-known brand.

THE "REGISTERED" AIFM

Smaller AIFMs can also choose, however, a simple registration. AIFMs which are 'below-threshold' can thus opt for registration as they are exempt from many AIFMD requirements such as the need to appoint a depositary given their smaller asset size. The threshold for registration is €500 mn or €100 mn if leveraged. A registered AIFM cannot, however, market its funds across the EU unless it opts in for authorisation under the AIFMD full regime or complies with the less burdensome EuVECA or EuSEF passport regimes.

The set-up of an unregulated AIF with a 'registered' AIFM is cheaper and quicker than setting up an authorised AIFM or adopting the third-party management company model and does not as such preclude the asset manager from upgrading the AIFM at a later stage by obtaining the authorisation from the regulator for EU passporting.

STRUCTURING ALTERNATIVE INVESTMENT FUNDS

The four main professional investment structuring solutions in Luxembourg are:

- The SIF, which provides an operationally flexible and fiscally efficient multi-purpose vehicle that can be used for all asset classes
- multi-purpose vehicle that can be used for all asset classes
- The SICAR, which is specifically designed for private equity investment and venture capital
- The RAIF, an indirectly regulated vehicle via its AIFM
- The UCI Part II, a flexible but more regulated pooled vehicle

The SICAR and the SIF are both lightly regulated investment vehicles subject to approval and on-going supervision by the CSSF. The CSSF ensures that the management bodies and the depository bank entrusted with custody of the assets have sufficient repute and professional expertise. However, it is worth adding that the portfolios of Luxembourg funds can be managed by managers based outside of Luxembourg. Neither SIFs nor SICARs are required to comply with detailed investment restrictions or leverage rules. Nevertheless, a SIF must adhere to the principle of risk diversification, however, the CSSF may allow derogations on the basis of appropriate justification. By contrast, a SICAR may concentrate its holdings into one project, the only requirement being to invest in risk capital.

The most recent addition to the Luxembourg fund toolbox is the RAIF, which is not subject to any regulatory approval by the CSSF, permitting a significantly enhanced time-to-market for new fund launches, a feature especially appreciated by private equity and venture capital fund initiators. The RAIF offers many of the same features as the SIF and the SICAR, but removes the double layer of regulation: only the manager is regulated (AIFM) - the fund itself is not.

The UCI Part II exists for promoters of funds that do not meet all the criteria for a UCITS but which are substantially regulated and therefore also accessible to retail investors in Luxembourg.

"Luxembourg's SIF law was particularly attractive as it provided the possibility for an aspiring multi-family office like SEDCO Capital to establish a single umbrella vehicle that invests in a number of diverse asset classes and to offer such a vehicle to investors globally. It also allowed SEDCO Capital to establish considerable economies of scale and to provide its clients transparency, independent custody and administration."

Hasan Al Jabri,
Chief Executive Officer, SEDCO Capital

LUXEMBOURG'S LIMITED PARTNERSHIP REGIMES

Alternative investment funds may also be structured as limited partnerships. Luxembourg revisited its limited partnership regime in 2013 by launching two limited partnerships based on the Anglo-Saxon regime: the *Société en Commandite Simple*, known as a common limited partnership or 'SCS'; and the *Société en Commandite Spéciale*, known as a special limited partnership, or 'SCSp'. Founded on the principle of contractual freedom, the main difference between the two LPs is that the SCSp does not have legal personality (like an English limited partnership) while the SCS does have one (like a Scottish limited partnership). Luxembourg LPs can be used as a regulated AIF (i.e. SIF, SICAR, RAIF or UCI II), and if they qualify as such can be marketed across Europe via financial services passporting and be structured as an umbrella fund with segregated compartments.

PROFESSIONAL INVESTORS

The SICAR, SIF, and the RAIF are designed for investors who require a lower level of protection. Investors must be "well-informed", which is a term encompassing institutional and professional investors, or anyone else who declares his or her adhesion to the status and invests at least €125,000 or can produce confirmation from a credit institution or management company certifying their appropriate experience and knowledge.

LEGAL FORMS

From a legal perspective, any Luxembourg vehicle can be used to set up a Shariah compliant fund. In general, Luxembourg funds may be structured as:

- a public limited company (SA)
- a private limited company (Sàrl)
- a partnership limited by shares (SCA)
- a limited partnership (SCS)
- a special limited partnership (SCSp)
- a common investment fund (FCP)

SECURITISATION VEHICLES

Luxembourg securitisation vehicles (SVs) provide a flexible and tax neutral regime for financial products. Currently, there are over 1,300 securitisation vehicles in Luxembourg, comprising approximately 9,000 compartments.

A number of Shariah compliant SVs have been set up in Luxembourg, which has gained wide recognition as an international structured finance hub.

A key reason for the popularity of Shariah compliant SVs is the wide range of eligible assets, which can be securitised through a Luxembourg SV. Risks relating to the holding of assets, whether movable or immovable, tangible or intangible income streams, as well as risks resulting from the obligations assumed by third parties or relating to all or part of the activities of third parties, may be securitised.

Securitisation transactions in Luxembourg over recent years have included diverse classes of assets, such as equity investments, real estate, CLOs, commodities, receivables, and whole businesses. Luxembourg SVs have been used in several *murabahah* and *ijarah* structures.

Luxembourg SVs are in principle unregulated entities, that is, they are not subject to authorisation and supervision by the local regulator, the CSSF. However, SVs issuing securities to the public on a continuous basis must be approved and supervised. The acquisition of securitised risks by a Luxembourg SV has to be financed through the issuance of securities, the value or remuneration of which is linked to such risks. Luxembourg SVs may be financed through the issuance of sukuk.

More recently, Luxembourg amended its 2004 securitisation law allowing unregulated SVs issuing securities via private placement regime to carry out the active management of risks linked to bonds, loans or other debt instruments. By allowing active management, the revised securitisation law makes SVs significantly more attractive, especially for CLOs/CDOs managers who frequently adjust their loans and receivables in the portfolio in order to ensure the best possible return.

An SV can be formed either as a corporation or as a co-ownership of assets without legal personality, (a securitisation fund, managed by a Luxembourg based management company). Securitisation funds constituting a co-ownership provide a closer connection to the securitised assets and easily ensure compliance with Shariah principles.

In each of the above cases, the SV may be structured with multiple compartments, whereby each compartment represents a distinct part of the assets and liabilities of the SV. The SV may issue several classes of sukuk, each class being allocated to a specific compartment of the SV.

A SV organised as a corporate entity is fully subject to Luxembourg corporate tax. However, distributions made to its investors (such as dividends or other income) are considered as deductible for corporate tax purposes. In this regard, ATAD I law applies for fiscal years starting on or after 1 January 2019 introducing interest deduction limitation rules into the Luxembourg tax framework, which may limit the deductibility of exceeding borrowing costs at the level of the securitisation vehicle.

The SV is exempt from the annual net wealth tax. Payment of dividends or other income is not subject to withholding tax. A securitisation fund organised as a limited partnership is considered transparent for tax purposes and will not be subject to corporate or net worth tax in Luxembourg. Distribution of profits is not subject to Luxembourg withholding tax. Due to the lack of legal personality of the securitisation fund in this case, investors may, where applicable, claim treaty benefits from the jurisdictions in which the securitised assets are located.

The table on the following page compares the Luxembourg structures commonly used for Islamic investment funds and provides an overview of their legal and regulatory framework.

Summary of structures commonly used for Islamic finance

	"Directly" regulated AIF			"Indirectly" supervised AIF & unregulated vehicles			
	UCI Part II	**SIF**	**SICAR**	**RAIF**	**Securitisation vehicle**	**Unregulated SCS/SCSp**	**Standard Luxembourg corporates**
European passport	Yes.	Yes.	Yes.	Yes.	No, unless it falls under the scope of the AIFMD regime.	No, unless it falls under the scope of the AIFMD regime or the EuVECA or EuSEF regimes.	No, unless it falls under the scope of the AIFMD regime or the EuVECA or EuSEF regimes.
Authorisation and supervision by the CSSF	Yes.	Yes.	Yes.	No authorisation required but the RAIF is indirectly supervised from the CSSF via its AIFM.	No (unless continuous issues of securities to the public).	No.	No.
AIFM registration regime	Possible.	Possible.	Possible.	No.	Possible.	Possible.	Possible.
Capital requirements	› FCP: €1.250.000 to be reached no later than 6 months following the authorisation by the CSSF. › Self-managed SICAV / SICAF: €300.000 at the date of authorisation and €1.250.000 within 6 months following its authorisation.	€1.250.000 to be reached no later than 12 months following the authorisation by the CSSF.	€1.000.000 to be reached no later than 12 months following the authorisation by the CSSF.	› FCP: €1.250.000 to be reached within 12 months from the entry into force of the management regulations. › SICAV: €1.250.000 to be reached within 12 months from the incorporation of the SICAV.	If the securitisation vehicle is set up as a company, it depends on the form: › SA / SCA: €30.000 › Sàrl: €12.000 If the securitisation vehicle is set up as a fund, there is no minimum capital requirement.	No minimum capital requirement	Depends on the form: › SA / SCA: €30.000 › Sàrl: €12.000 No minimum capital requirement for other legal forms.
External authorised AIFM requirement	Required in case the entity is an AIF that is not self-managed and above the AIFMD threshold.	Required in case the entity is an AIF that is not self-managed and above the AIFMD threshold.	Required in case the entity is an AIF that is not self-managed and above the AIFMD threshold.	Always required.	Required in case the entity is an AIF that is not self-managed and above the AIFMD threshold.	Required in case the entity is an AIF that is not self-managed and above the AIFMD threshold.	Required in case the entity is an AIF that is not self-managed and above the AIFMD threshold.
Umbrella structure	Yes.	Yes.	Yes.	Yes.	Yes.	No unless the entity is a regulated AIF (e.g., SIF, SICAR).	No unless the entity is a regulated AIF (e.g., SIF, SICAR).
Eligible investors	Unrestricted.	Well-informed investors.	Well-informed investors.	Well-informed investors.	Unrestricted.	Unrestricted.	Unrestricted.
Eligible assets	Unrestricted. › The investment objective and strategy of the fund is subject to the prior approval of the CSSF.	Unrestricted.	Restricted to investments in securities representing risk capital.	Unrestricted, unless it invests in a portfolio of risk capital (such as a Sicar).	Unrestricted.	Unrestricted.	Unrestricted.

SHARIAH COMPLIANT REAL ESTATE & PRIVATE EQUITY FUNDS

Luxembourg is one of the leading locations for cross-border private equity, venture capital, and real estate investment funds (PE/RE), appealing to investors who seek a robust platform for international investment strategies, combined with a flexible regulatory regime and efficient tax treatment. 18 out of the 20 largest PE houses around the world have operations in Luxembourg with several of them increasingly moving deal-making and other decision-making roles to the Grand Duchy.[3] An increasing number of fund managers, particularly from the MENA region, have created Shariah compliant PE/RE investment vehicles in Luxembourg.

The initiator of a PE/RE fund benefits from the increased flexibility offered to professional fund structures with regard to capitalisation, subscriptions and redemptions, distributions, asset valuation methods, the segregation of assets in separate compartments (sub-funds) and risk management. The combination of all these factors weighed in the decision of setting up an AIFM in Luxembourg, which saw a significant increase among PE firms – from 47% of them holding such licences in 2018 to 63% in 2021.[4] These factors also enable the scheme to be adapted to Shariah requirements.

The legal forms that appear to be the most flexible for structuring PE/RE are those that allow for strong control over the management of the structure.

ASSET SELECTION AND FINANCING IN SHARIAH COMPLIANT FUNDS

Real estate and private equity investments are by their very nature long term and illiquid investments, i.e., the assets are tied up for a long duration and the turnover of assets may be slow. The challenges related to long-term investments are more pronounced in a Shariah compliant fund, as conventional debt financing is prohibited. However,the problem can be addressed by financing acquisition of assets through alternative instruments, for example by issuing sukuk relating to a suitable Islamic contract such as *sukuk al-murabahah* (sales based financing) or *sukuk al-ijarah* (lease based financing).

Leverage restrictions will need to be determined on a case-by-case basis. The payment or receipt of interest as well as debt financing are considered as usury.

In practice, it is generally accepted that a Shariah compliant SICAR, SIF, or RAIF may engage in leverage using Shariah compliant financing instruments. However, it may not receive or provide conventional loans or otherwise invest in traditional interest-bearing instruments.

Another solution is to open the investment to additional equity-based investors using the *musharakah* model: partnership-based financing. These Islamic financing structures can easily be replicated through existing Luxembourg structures. Therefore, the asset managers have relative flexibility in structuring the transaction in such a way that it meets the requirement of Shariah rules and principles while bringing tax and operational efficiency to the structure.

[3] Luxembourg Private Equity Association (LPEA) 2021.
[4] Ibid.

"Luxembourg is the jurisdiction of choice for funds and has naturally also become a first-class player with regards to Shariah compliant funds. A number of conventional umbrella retail funds, whether managed by Asian, Middle Eastern or international groups, now offer Shariah compliant sub-funds. Alternative structures are also more and more used for structuring in respect of Islamic financial principles. Shariah funds have thereby certainly pathed the way for the current ESG trend."

Emmanuelle Entringer,
Counsel, Arendt & Medernach

TAXATION OF THE MURABAHAH CONTRACT

In accordance with the guidelines issued on 12 January 2010 by the Luxembourg direct tax administration (ACD), the murabahah profit (i.e., the consideration for the deferred payment) realised by a Luxembourg company may, subject to certain conditions to be fulfilled at the level of the transaction documents, be taxed on a linear basis over the period of the murabahah transaction, regardless of the actual payment dates of the murabahah profit.

This is important as the Luxembourg vehicle would otherwise immediately be taxed on the difference between the acquisition price of the murabahah asset and its marked-up sale price under the murabahah contract, while the actual payments would be made on a deferred basis.

Furthermore, the Luxembourg indirect tax administration (AED) clarified in its guidelines dated 17 June 2010 that a murabahah contract on a real estate asset located in Luxembourg may, subject to certain conditions, only be subject to a reduced rate of real estate transfer tax. The guidelines confirm that such real estate transfer taxes are not levied on the murabahah profit (i.e., the consideration for the deferred payment).

If they relate to commodities, these transactions would most likely be defined as transactions relating to goods and therefore be liable to Value-added Tax (VAT) combined with a facility to defer payment. However, unallocated metals could be treated as a supply of services and not as a supply of goods for VAT purposes. It is also worth noting that in Luxembourg, the 'physical' sale or purchase of gold coins or ingots is not subject to VAT.

REAL ESTATE: ADDITIONAL CONSIDERATIONS

Shariah compliant real estate investments can be achieved in different ways, for example by using a mudarabah or ijarah contract, depending on the commercial objectives.

The mudarabah model mirrors the conventional structure of real estate funds from a legal perspective. For example, a mudarabah contract is similar to the relationship between a fund manager (general partner) and investors in a fund (limited partners), or a management company and its unit/share holders.

By contrast, an ijarah contract is considered to be a lease agreement. In general, the rules governing ijarah are similar to those governing conventional leases, subject to a number of restrictions or modifications.

Fund vehicles in Luxembourg provide various options when structuring mudarabah contracts. The choice of the appropriate vehicle generally depends on the style (i.e. core, value added or opportunistic), operating model and preferred tax treatment of the fund. Continuing with the mudarabah contracts example within the sphere of regulated real estate funds, SIFs and RAIFs provide a useful degree of flexibility.

"When, back in 2004, we had the ambition of launching one of the first Shariah compliant pan-European real estate funds for our Middle Eastern clients, we could not find a better place than Luxembourg in terms of flexibility, expertise and regulations for the set-up and operational management of our innovative product. We have since then expanded our offering to a diversity of asset classes through our network of partners / originators. We intend to grow our Luxembourg platform with both additional resources and new product launches in the coming years."

Kamal Ikherrazen,
Head of Operations, Wafra Capital Partners Luxembourg.

TAXATION OF INVESTMENT FUNDS

Luxembourg is an attractive jurisdiction for setting up tax efficient fund structures. Luxembourg investment funds tax treatment is designed to preserve the tax neutrality of investments made through investment funds compared to a direct investment strategy in compliance with European and international tax treaty law. International investors can furthermore leverage the country's extensive double-tax treaty (DTT) network which encompasses over 80 DTTs in force and over 11 in negotiation. In this respect, some of the tax treaties concluded by Luxembourg extend their benefits to Luxembourg based investment funds (case-by-case analysis).

Specific investment fund tax regimes have been introduced in Luxembourg for the fund industry. For example, UCIs and SIFs (and RAIF modelled as a SIF) benefit from an exemption from Luxembourg corporate income tax, municipal business tax and net wealth tax. However, an annual subscription tax (*taxe d'abonnement*) ranging between 0.01% and 0.05%, assessed on the Net Asset Value (NAV) of the undertaking, applies depending on the form adopted. Under certain circumstances a full exemption may apply. The SICAR (or a RAIF modelled on a SICAR) regime, on the other hand, may exist in the form of a fiscally opaque limited corporation or in the form of a tax transparent limited partnership (SCS or SCSp). An opaque SICAR is subject to corporate tax on its worldwide profits but it benefits from an exemption on revenues stemming from transferable securities invested in venture capital and private equity investments making it particularly attractive for these types of strategies. A SICAR is exempt from the annual net wealth tax as opposed to commercial corporate entities.

SUKUK

04

SUKUK

Luxembourg has positioned itself as a leading centre for originating, structuring, and distributing sukuk certificates in international markets. Commercial banks are active both in primary dealerships, such as the IILM and in secondary trading. This is principally driven by demand from locally incorporated Islamic investment vehicles; however, Luxembourg also has the capacity for broader distribution into the European market.

THE LUXEMBOURG STOCK EXCHANGE (LUXSE)

Established in 1928, the LuxSE is the principal centre for the listing of international securities, handling listings in more than 60 different currencies and currently lists some 37,000 securities, predominantly bonds, on behalf of more than 2,500 issuers from over 100 countries around the world. Furthermore, 118 countries list their sovereign debt in Luxembourg for a total of 1,298 securities from sovereigns or quasi-sovereigns currently listed.

THE LUXEMBOURG GREEN EXCHANGE (LGX)

In September 2016 the LuxSE introduced the Luxembourg Green Exchange, or LGX, the world's first platform that exclusively displays securities that raise proceeds for projects and companies that are fully aligned with recognised international sustainability standards. With the creation of LGX, LuxSE has become the first exchange to establish a dedicated service that bridges investors' need for increased transparency and issuers' commitment to assure quality of reporting. With a total of **1,234 green, social, sustainability and sustainability-linked (GSSS) bonds** displayed at the end of 2021, **totalling €640bn** and issued by 222 issuers from 47 countries, LGX successfully maintained its leading position in sustainable finance globally.

Luxembourg offers a full-service process that includes listing, trading and reporting. It is competitive in terms of speed, transparency, value for money and post-listing services: 99% of all securities are listed in less than 2 days.

The LuxSE was the first European stock exchange to enter the sukuk market, in 2002. This pioneering issue by the state of Malaysia was followed by further sovereign and corporate sukuk from Malaysia, Saudi Arabia, the United Arab Emirates, Pakistan, Turkey, South Africa, Qatar, and other countries.

In 2014, Luxembourg was the first sovereign state to issue a sukuk denominated in Euros.

Sukuk issuers in Luxembourg have a choice of two markets:

- The Regulated Market complies with European legislation and securities may be distributed throughout the EU. This market is regulated by the CSSF. On 26 January 2011, the CSSF issued a Circular concerning the content of prospectuses relating to sukuk.
- The Euro MTF market enables non-European issuers who do not require a European passport to obtain a listing in a recognised financial centre in Europe. Issues on the MTF market are authorised by the LuxSE itself. This is the largest MTF market in Europe.

The LuxSE offers straightforward listing procedures and a competitive fee structure. All securities are registered with international clearing and settlement organisations and are automatically admitted to trading on the Universal Trading Platform (UTP) of NYSE Euronext. The application file including the sukuk draft prospectus can be submitted in English, German or French and the CSSF will correspond in any of these three languages as chosen by the applicant.

In principle, admission to listing on the LuxSE's official list goes hand in hand with the admission to trading on one of LuxSE's markets. However, since 2018 the LuxSE offers the possibility for issuers to have securities admitted on its official list without being admitted to trading on the LuxSE-regulated market or Euro MTF. This, thanks to the creation of a dedicated section of the LuxSE's official list, namely the LuxSE Securities Official List (the LuxSE SOL). LuxSE SOL is designed for issuers looking for visibility and for whom admission to trading is not a prerequisite.

In the current environment marked by the acceleration of market digitalisation using Distributed Ledger Technology (DLT), notably through the imminent adoption of the EU blockchain pilot regime, the LuxSE admits security tokens registered on DLT on the LuxSE SOL. The admission of security tokens on the LuxSE SOL represents a true milestone for EU financial markets as it provides for a unique, innovative, robust, and publicly accessible solution for issuers and investors of these instruments. This constitutes another significant step towards the digital transformation of Luxembourg's capital markets infrastructure.

TAX TREATMENT FOR SUKUKS

The guidelines of the ACD clarify that the tax treatment of sukuk is identical to the tax treatment of debt instruments in conventional finance (although the income is linked to the performance of the underlying asset) and the remuneration of sukuk is considered as interest payment. Accordingly, payments made under a sukuk transaction should generally be deductible, provided such expenses are incurred in the corporate interest of the enterprise of the sukuk issuer. Furthermore, no withholding tax should apply on payments to foreign holders of sukuk issued by a Luxembourg issuer.

From an international tax perspective, payments of returns under a sukuk transaction should qualify as interests under the relevant article of the DTT concluded in accordance with the OECD Model Convention.

From a VAT perspective, sukuks transactions could be regarded as transactions related to securities and therefore may benefit from a VAT exemption; however, due to the diversity of underlying contracts, a case-by-case analysis is necessary.

WEALTH MANAGEMENT FOR ISLAMIC FAMILIES

05

WEALTH MANAGEMENT FOR ISLAMIC FAMILIES

Luxembourg's wealth management industry has developed and matured alongside a diversified ecosystem of financial sector experts and service providers. Wealth managers use their know-how to design personalised strategies to fit each client's particular needs. They work with specialists in the banking sector, asset management and fund administration, life insurance and capital markets, providing value propositions to international institutional and private clients.

Luxembourg private bankers have the advantage of being multilingual, multicultural, and familiar with international business, tax, and regulatory environments. A number of banks have an established track record setting up tailor-made Islamic finance structures for private clients.

FAMILY OFFICE SERVICES

Entrepreneurs or families dealing with complex financial circumstances often have a greater need for support services. In this situation, a family office can assume the day-to-day administration and comprehensive management of a family's assets. Whether wealthy individuals have their personal wealth management and business banking handled under one roof, or whether they decide to keep their personal and business banking apart, Luxembourg's ecosystem offers a large pool of professionals with the skills and ability to craft holistic and multidisciplinary solutions for such clients.

A family office can take several different forms, depending on the needs and wealth of the family in question. While independent financial advisors offer investment management, wealth and estate planning, "multi-family offices" provide a holistic overview and customised outsourced solutions, blending lifestyle and financial needs into a single package. Next to financial wealth management, the multi-family office offers additional services often going beyond financial considerations, such as taking care of household expenses and employees, overseeing rental properties, handling artworks or other assets, or conducting employment services for household staff. Multi-family offices tend to work with a maximum of four or five families, but it can be fewer depending on the level of services required. Families with wealth in excess of €200 million generally opt to establish their own offices.

A "single-family office" is an organisation dedicated to the management of the affairs of one family, providing a high-end and tailored service to meet their needs. Luxembourg hosts a large number of single-family offices dedicated to serving the wealthiest families. As these family offices do not market their services to third parties, they do not require further regulation beyond that required of all financial firms.

AN ESTABLISHED REGULATED FRAMEWORK FOR MULTI-FAMILY OFFICES

Luxembourg adopted a legal and regulatory framework for Multi-family offices, placing them alongside banks and asset managers under the supervision of the CSSF as Professionals of the Financial Centre (often referred to as 'PSF'). As a result, Multi-Family Offices comply with obligations relating notably to the transparency of its remuneration, to the combat against money laundering and terrorism financing and to confidentiality rules. Certain regulated professionals are automatically authorised to act as Family Offices.

INVESTMENT STRUCTURING

There are a series of holding vehicles not qualifying as regulated investment funds that can be used to control a portfolio of Shariah compliant business interests.

The SOPARFI, a non-regulated holding company designed to optimise the management of holdings in a group of (typically, international) companies. It can benefit from Luxembourg's extensive DTT network and the EU "Parent-Subsidiary" Directive which translates into an extensive participation exemption regime, under which a Luxembourg SOPARFI may, under certain conditions, benefit from a 100% corporate tax exemption on dividends and capital gains derived from qualifying Luxembourg and foreign holdings. Qualifying participations may further be exempt from net worth tax in Luxembourg.

The family wealth management company (SPF) is an investment company that facilitates the administration and management of wealth on behalf of individuals. Its sole purpose is the acquisition, holding, management, and disposal of financial assets, to the exclusion of any commercial activity. It is exempt from corporate income tax and is only subject to an annual subscription tax of 0.25% with a maximum of €125,000 p.a.

PHILANTHROPY

There is a growing trend for investors to support philanthropic causes, either during their lifetime or by means of a legacy. The legal environment in Luxembourg enables investors to realise these aims by setting up a foundation sheltered under the aegis of *Fondation de Luxembourg*. This foundation enables the donor to benefit from professional support at all stages, from the identification of a suitable project through to impact assessment, while relieving the donor from the burden of administration.
The objectives of a sheltered foundation must be in the "general interest", as defined in Luxembourg law, and avoid any conflict of interest. Within these parameters there is wide scope for the establishment of a foundation that complies with Shariah rules.

LIFE INSURANCE AND TAKAFUL

06

LIFE INSURANCE AND TAKAFUL

Luxembourg is a major international insurance centre. There are 80 insurance companies accounting for €35bn life and non-life insurance premiums established and supervised in the Grand Duchy by a dedicated insurance regulator, the *Commissariat aux Assurances* (CAA).

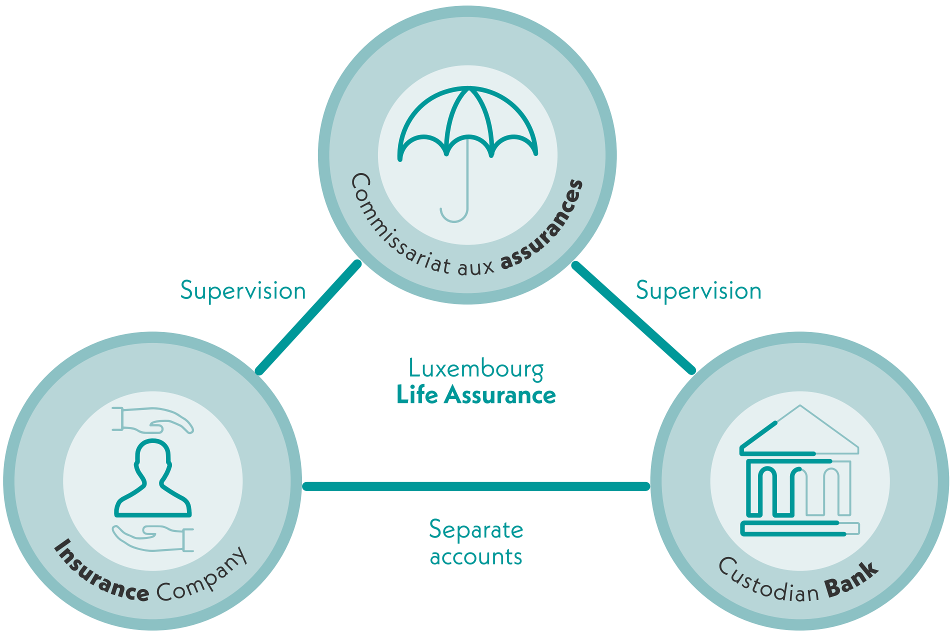
The Grand Duchy is a popular domicile for insurance companies because it offers long term political, economic, and social stability, financial expertise and a modern legislative environment.

Luxembourg is the leading financial centre for the distribution of cross-border life insurance products in the Eurozone. This is reflected by the presence of close to 40 world-leading life insurance companies in the country, which have built strong expertise in offering tailor-made insurance products, notably unit-linked life insurance plans for globally mobile clients.

Over the years, Luxembourg life insurance has evolved into a sophisticated long-term wealth management solution, meeting the needs of a highly demanding international clientele. It has become a very popular wealth-planning tool for globally mobile clients including Islamic families seeking wealth protection and a return on Shariah compliant investments. With 58% of life assurance business emanating from cross-border sales, takaful companies can tap into existing distribution expertise to reach Muslim customers based in Europe. Today, Luxembourg takaful products are being sold cross border into Germany and France, linked to a range of investment funds and asset management tools.

THE TRIANGLE OF SECURITY

For the policyholders of a life insurance policy, Luxembourg offers investor protection and a level of security unique in Europe, with a system of protection known as the "triangle of security", between the regulator, the custodian, and the insurance company. This ensures the legal and physical segregation of investors' assets on one hand and those of shareholders and creditors of the insurance company on the other. Moreover, policyholders have the status of the highest-ranking creditors with a priority claim on the assets.



GLOSSARY

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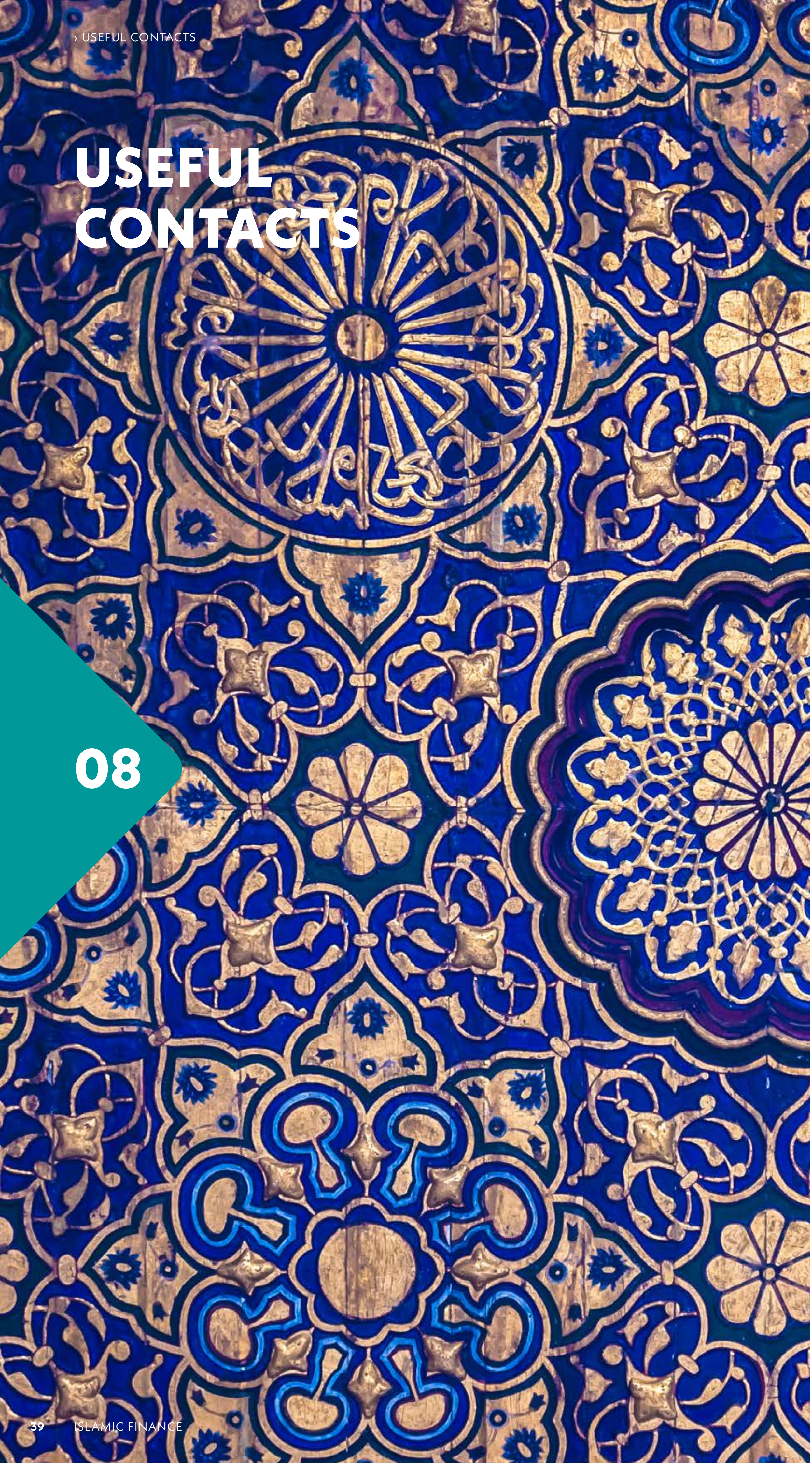
2004 Securitisation Law	The Law of 22 March 2004 on securitisation, as amended
2004 SICAR Law	The Law of 15 June 2004 on the investment company in risk capital, as amended
2007 SIF Law	The Law of 13 February 2007 on specialised investment funds, as amended
2007 SPF Law	The Law of 11 May 2007 on the family wealth management company, as amended
2010 UCI Law	Law of 17 December 2010 on undertakings for collective investment, as amended
2013 AIFM Law	The Law of 12 July 2013 relating to Alternative Investment Fund Managers, as amended
ACD	Administration des Contributions directes
AED	Administration de l'Enregistrement et des Domaines
CAA	Commissariat aux Assurances, the Luxembourg insurance supervisory authority
CDO	Collateralised debt obligation
CLO	Collateralised loan obligation
CLP	Common limited partnership (introduced by the 2013 AIFM Law)
Companies Law	Law of 10 August 1915 on commercial companies, as amended
CSSF	Commission de surveillance du secteur financier, the Luxembourg financial supervisory authority
DTT	Double Tax Treaty
EOY	End-of-year
FCP	Fonds commun de placement, an unincorporated co-ownership of assets
IILM	International Islamic Liquidity Management Corporation
iJARAH	Lease based financing, hire-purchase
LuxSE	Luxembourg Stock Exchange
LGX	Luxembourg Green Exchange
LuxSE SOL	LuxSE Securities Official List
MTF	Multilateral trading facility
MUDARABAH	Agency partnership: one partner provides capital and the other effort, typically used for asset management accounts

MURABAHAH	Cost plus financing, typically used for house purchase schemes
MUSHARAKAH	Partnership whereby each partner contributes capital, typically used for private equity
PARENT-SUBSIDIARY DIRECTORY	EU Directive of 7 January 2012
RAIF	Reserved Alternative Investment Fund
2016 RAIF Law	Law of 14 July 2016 on reserved alternative investment funds, as amended
Registered AIFM	AIFM under the thresholds of the 2013 AIFM law with a lighter regulatory regime
SA	Société anonyme (public limited company)
SADAQAH	a voluntary charity given on an ad-hoc basis
Sàrl	Société à responsabilité limitée (private limited company)
SCA	Société en commandite par actions (partnership limited by shares)
SCS	Société en commandite simple (limited partnership)
SCSp	Société en commandite speciale (special limited partnership)
SICAR	Société d'investissement en capital à risque (investment company in risk capital)
SICAV	Société d'investissement à capital variable (investment company with variable capital)
SIF	Specialised investment fund
SLP	Special limited partnership (introduced by the 2013 AIFM Law)
SOPARFI	Société de participations financiers
SPF	Société de gestion de patrimoine familial (family wealth management company)
SUKUK	a financial product equivalent to a bond in conventional finance which complies with Shariah law
UCI	Undertaking for collective investment
UCITS	Undertaking for collective investment in transferable securities
VAT	Value added tax
WAQF	an endowment to a religious, educational or charitable cause
ZAKAT	mandatory annual wealth tax for Muslims intended for the poor



USEFUL CONTACTS

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USEFUL CONTACTS

Ministry of Finance
www.mf.public.lu

Luxembourg for Finance
www.luxembourgforfinance.lu

Luxembourg Financial Sector Regulator (CSSF)
www.cssf.lu

Association of the Luxembourg Fund Industry (ALFI)
www.alfi.lu

The Luxembourg Bankers' Association (ABBL)
www.abbl.lu

Insurance Commission
www.commassu.lu

Insurance Companies Association
www.aca.lu

Luxembourg Finance Labelling Agency (luxflag)
www.luxflag.org

Luxembourg House of Training
www.houseoftraining.lu

Luxembourg Stock Exchange
www.bourse.lu

Luxembourg Private Equity and Venture Capital Association
www.lpea.lu

Luxembourg Association of Family Offices
www.lafo.lu

Luxembourg Association of Corporate Service Providers
www.limsa.lu

Luxembourg Bar Association
www.barreau.lu

Luxembourg Sustainable Finance Association
https://lsfi.lu

Fondation de Luxembourg
www.fdlux.lu

ADA Microfinance
https://www.ada-microfinance.org/en

The University of Luxembourg
www.uni.lu

ABOUT LUXEMBOURG FOR FINANCE

Luxembourg for Finance (LFF) is the Agency for the Development of the Financial Centre. It is a public-private partnership between the Luxembourg Government and the Luxembourg Financial Industry Federation (PROFIL). Founded in 2008, its objective is to develop Luxembourg's financial services industry and identify new business opportunities.

LFF connects international investors to the range of financial services provided in Luxembourg, such as investment funds, wealth management, capital market operations or advisory services. In addition to being the first port of call for foreign journalists, LFF cooperates with the various professional associations and monitors global trends in finance, providing the necessary material on products and services available in Luxembourg. Furthermore, LFF manages multiple communication channels, organises seminars in international business locations, and takes part in selected world-class trade fairs and congresses.

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