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LEGAL INFRASTRUCTURE FOR ISLAMIC FINANCE IN QATAR

BY

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ABSTRACT

This study aimed at contributing to the development of legal infrastructure for Islamic finance in Qatar and as such evaluated the existing legal and regulatory framework. The evaluation criteria are an adaptation of conventional finance indicators for Islamic finance, and they are: Sharia governance, the cost of information, transaction, and enforcement, financial market development, financial stability, and investor and consumer protection. The major areas of private law evaluated were contract, finance, company, insolvency. In addition to dispute resolution, the major areas of pubic law evaluated are financial regulator law, securities exchange regulator law. Qatar is found to be a jurisdiction of high legal and regulatory quality for the practice of Islamic finance. The study is expected to be useful in strengthening the legal and regulatory framework for Islamic finance and placing Qatar in competitive edge locally, regionally and globally.

مستخلص

تهدف هذه الدراسة للمساهمة في تطوير الأسس القانونية للتمويل الإسلامي في دولة قطر، وقيمت في سبيل ذلك الإطار التنظيمي الحالي، واعتمد في التقويم على تعديل مؤشرات أداء التمويل التقليدي لتلائم تقويم التمويل الإسلامي، والمؤشرات هي حوكمة الشريعة وتكلفة المعلومات والمعاملات والتنفيذ، وتطوير القطاع المالي، والاستقرار المالي، وحماية المستثمر والمستهلك، ومن أبرز القوانين الخاصة محل التقويم قانون العقود والتمويل والشركات والإفلاس، ومن أبرز القوانين العامة محل التقويم قانون جهة تنظيم القطاع المالي وقانون جهة تنظيم الأسواق المالية، وخلص البحث للجودة العالية للبيئة القانونية القطرية لأغراض التمويل الإسلامي، وتتجلى أهمية الدراسة في تقوية الإطار القانوني والتنظيمي للتمويل الإسلامي على نحو يرتقي بالبيئة القانونية القطرية لمستوى المنافسة محلياً وإقليمياً وعالمياً.

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CHAPTER 1 INTRODUCTION

Having launched *Qatar National Vision 2030* in 2008, His Highness the Emir of Qatar describes it as follows:

> ***Qatar's National Vision is authentic. It has emerged from intensive consultation across Qatari society. It is based on the guiding principles of Qatar's Permanent Constitution. It reflects the aspirations of the Qatari people and the resolve of their political leadership.***

The 2030 vision was the first for Qatar. It unified efforts and clarified the objectives of the Qatari society. In lying out the objectives, the document relied on many of the general rights and obligations listed in the constitution. They include the right to education, health, worker rights, the rights of families, and the right to safety. In addition, such references included constitutional texts relating to cultural heritage, such as justice, benevolence, freedom, equality, and the best of moral values. The vision document also referred to constitutional texts relating to the national economy, including the right to engage in economic activities for the purpose of increasing production and achieving socio-economic development, yet subject to protecting the environment so as to keep such development sustainable.

While references to constitutional texts in the vision were essential in such a far-reaching document, the vision document also reflected the Islamic values of the constitution and the Qatari society. For example, Article 1 of the constitution states that

"Qatar is an independent sovereign Arab State. Its religion is Islam and Sharia is a main source of its legislations…" In addition to including limits and boundaries on behaviors, Sharia offers a set of public policy guideposts known as Sharia objectives. The four pillars of the 2030 vision (i.e. human, social, economic, and environmental development) go hand in hand with these Sharia objectives, including the protection and fulfillment of religion (al-Din), life (al-Nafs), intellect (al-Aql), progeny (al-Nasl) and wealth (al-Mal).[1] This not only made it easier for Qatari law to be Sharia-compliant, but also stimulated private and public bodies in Qatar to fulfill Sharia objectives. Such context provides Qatar with a competitive advantage as a jurisdiction for Islamic finance.

Islamic finance is now a multi-trillion-dollar industry growing fast in Qatar, in the region and all over the world. Its high-stake stakeholders are not limited to end-users, but extends to hard-core financial institutions, governments (e.g. central banks and finance ministries), in addition to regional and international organizations. Adherence to Sharia-compliant finance is by no means exclusive to Muslims (the British government, HM Treasury, 2014), and (the International Monetary Fund IMF, 2002, 2017) sometimes exceed that of Muslims themselves.

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[1] There are a number of Sharia-objectives frameworks, and this one is among the well-documented, as referred to byt Al-Ghazali and others, with three levels of priority: necessities (Daruriyat), complements (Hajiyaat) and embellishments (Tahsiniyaat) (Amin et al., 2015)

However, the development of Islamic finance takes a bottom-up approach (Wilson, 2011). The preference of some end-user Muslims not to engage in Sharia non-compliant activities led to the evolution of the industry. The preferences of such end-users who are mostly illiterate in finance theory, politically weak, and poor, led to the congregation of considerable heads of states several times to discuss how to make finance Sharia-compliant, not only in theory (academically), but also in practice (politically).

While mere concern about Sharia compliance is sufficient to draw such end-users away from the global financial system, the industry is making sure such information does not get revealed. In addition, the appointment of Sharia governance professionals is a carefully exercised business decision, which affects not only Sharia compliance, but also the profitability of such institutions. Moreover, since business people excel in managing risks of various kinds, if their flexible Sharia scholars show extra transparency, they can still cover things up well. Such information asymmetries are capable of destroying the Islamic finance industry beyond repair.

On the other hand, many financial regulators either prevent Islamic finance, or make its cost prohibitive. Sometimes, such regulators do not notice the industry's existence, leading, inter alia, to exclusion from liquidity management tools, monetary and fiscal policy instruments, and safety net schemes. In addition, Islamic finance transactions have to comply not only with the property right laid down by Sharia, but also those required by the law of a particular jurisdiction. Property rights are usually, at best, designed on utilitarian economic basis, without Sharia in mind. If a transaction falls foul

of the legal requirement, there is hardly a guarantee that the property rights of Sharia-adhering parties to Islamic transactions are protected.

The Islamic financial services industry deserves public policy support and levelled playing field. The institutional support infrastructure comprises of legal, regulatory and supervisory, transparency and disclosures, systemic liquidity and safety net, payments and clearance and Sharia governance frameworks. Among these the legal infrastructure is indeed pivotal.

1.1 Problem Statement

There are many legal and regulatory challenges faced by Islamic finance. In facing such challenges, the idea of solving them by issuing Islamic finance laws is of vital importance. The major challenges can only be resolved through legal intervention, yet law is neither the only available policy instrument, nor the best for all situations. Law is a powerful policy instrument, but without the right objectives, such power cannot be put into good use. Islamic finance law in Qatar has not been discussed in terms of Islamic finance policy goals.

1.2 Purpose

The purpose of this research is to review the Islamic finance law in Qatar with a motivation to further contribute to the development of legal infrastructure for Islamic finance in the country.

1.3 Research Questions

The primary question of this research is “How robust is Islamic finance law in Qatar?” This question relies on two sub-questions, which this study attempts to address.

1. What criteria can be used to undertake a gap analysis and evaluate the Islamic finance law in Qatar?
2. How does the law do against the evaluation criteria?

1.4 Significance

This study builds the basis for evaluating Islamic finance law and developing further the legal infrastructure to achieve regional competitive position. First, there are gaps in the literature on evaluating Islamic finance law, and this study contributes to filling such gap. Second, instead of evaluating law per se, this study evaluates law as a policy tool, recognizing the existence of other policy tools which can fit the purpose better. This research contributes to this uncommon perspective in the study of law. Third, evaluation is not limited to mere measurement, but extends to a healthy decision-making culture. The benefits of evaluation, including this study, include the following (Austrian Development Agency, Evaluation Unit, 2009):

1. Maximizing the effectiveness and efficiency of public policy.
2. Increasing transparency and responsibility in decision-making.
3. Improves communication and common understanding between stakeholders.

4. Builds an organizational culture with a focus on results (not means), a willingness to be evaluated, and a focus on continuous improvement (Pal, 2010).

1.5 Methodology

Answering the research questions requires qualitative research methods. The first question requires description and analysis of Islamic finance law evaluation criteria. Therefore, the first part of this study reviews the literature relating to the evaluation of Islamic finance law. Starting from the current evaluation criteria for conventional finance, and their fit for Islamic finance, the study not only investigates criteria which are unique to Islamic finance (e.g. Sharia compliance), but also those which, while applicable to conventional finance, may have a higher significance in Islamic finance (e.g. Stability).

The second part of the study evaluates Islamic finance law in Qatar against the criteria established in the first part. Primary legal sources are among the primary data needed for this part. Among the laws in Qatar of relevance to Islamic finance are the following:

Dispute resolution laws

CIVIL AND COMMERCIAL PROCEDURE LAW - Law No. 13 of 1990

Private laws

- Law no (22) of 2004 on the Civil Code
- Law No. 27 of 2006 on the Commercial Code
- Law No. 11 of 2015, promulgating the Law of Commercial Companies

- Law No. 25 of 2002, regarding Investment Funds
- Law no. (17) for the year 2004 Regarding Organization of Ownership and Use of Real Estate and Residential Units by non-Qataris
- Law No. 2 of 2002, regarding GCC citizens ownership of real estate
- Law No. (13) of the year 2000 on Organization of Foreign Capital Investment in the Economic Activity

Public laws

- The Central Bank and Financial Institutions Law No. 13 of 2012
- Law No. 8 of 2012 concerning Qatar Financial Markets Authority
- [The regulations of QCB and QFMA]
- Law No. 2 of 2015 concerning Public Finance

Qatar Financial Centre (QFC) is another regulatory environment within Qatar. The study will consider the laws and regulations of QFC for comparison purposes.

In order for the proposed criteria to be comprehensive enough to evaluate the whole body of Islamic financial law in one jurisdiction, they should be systematic. Non-systematic criteria can be subjective and limited, despite their importance and relevance. In particular, some policy goals can be conflicting, and evaluating laws based only on some of them does not reveal the conflict. For example, because financial stability conflicts at some point with efficiency, limiting evaluation criteria to financial stability neglects efficiency.

Because of its qualitative nature, measuring law is challenging. One of the few success stories in such endeavor is the Doing Business project of the World Bank, aiming at

providing objective measurement of business regulations and their enforcement across jurisdictions. The design of each of its 11 indicators is informed by a multi-discipline research, involving, inter alia, law, economics, and finance. Having set-up clear objectives, mostly related to economic efficiency, the indicators are set to measure the achievement of laws and regulations of such objectives. The outcome is one aggregate number, the Distance To Frontier, which countries thrive to maximize in order to increase their global rank (World Bank, 2016). Although this study may not be as rigorous, Doing Business will inspire its methodology.

The researcher is a legal advisor, specializes in legislation, has had some experience in the legal work of Islamic finance institutions, and is a student of Islamic finance in Qatar Faculty of Islamic Studies (QFIS) of Hamad Bin Khalifa University (HBKU). Despite the advantages of such previous knowledge, the researcher is aware of the bias such knowledge may have on his research, and proposed to limit such bias through the methodology described in this section.

In the literature review, the researcher reviewed the literature on Islamic finance law. Such ex ante literature review can affect the objectivity of this study if it influences the ex post literature review on the evaluation criteria for Islamic finance law. The researcher acknowledges such risk and proposed to minimize it through prioritizing the outcome of the ex post literature review.

In addition to resource constraints, one key limitation of this study is its relationship with Qatar. Due to the researcher's specialization in Qatari law, the legal context of

Qatar has a potential influence on the generalizability of the study. While the outcome of the study (i.e. the evaluation criteria) is generalizable to jurisdictions similar to Qatar, it may not fully account for the context specificity of other jurisdictions. For example, non-Muslim countries may be interested less in Sharia compliance and more in stability and sector profitability. Although such limitation can be reduced by studying more jurisdictions based on their variance and uniqueness, sensitivity to the context of such jurisdictions requires specialization. Legal systems are complex and involve interaction between various legal provisions in various places, and without specialization, one can easily reach the wrong conclusion relying on the wrong law.

There are a number of delimitations in this study. First, this research proposes to study the subject from the point of view of the policy maker or the regulator, and not industry players. Otherwise, the evaluation criteria may focus on other factors (e.g. micro profitability). Second, since this study investigates Islamic finance law evaluation criteria, it is of a legal nature. Although the study proposes to investigate Islamic finance development policies, it does so in so to the extent that they can be utilized for the evaluation of law as a policy instrument. Nevertheless, there are policy instruments which can achieve policy objectives better than law. For example, financial depth may well be better achieved through marketing and changing the perception of Islamic finance. In addition, although supervision and monitoring go beyond rulemaking, proper utilization of such regulatory instruments can lead to better attainment of policy objectives. For example, macro-prudential regulation may require more regulatory discretion with decision-making robustness than legislative dictation, whereas extra

legislative details may be needed for micro-prudential regulation. Finally, due to resource constrains, this study excludes laws relating to trust, charities, Zakat, Waqf, and insurance.

CHAPTER 2 LITERATURE REVIEW

This literature review investigated the literature relating to the scope of the research and its methodology, focusing on the following areas:

1- Evaluating Law as a Policy Instrument
2- Financial Sector Policy Objectives
3- Issues in Islamic finance law

2.1 Evaluating Law as a Policy Instrument

The purpose of this part is to elaborate on evaluation as a research method, and discuss the relationship between evaluation, public policy, and law as a policy instrument. The literature on evaluation is to be found in the fields of research methods, economics, and public policy. Generally, "Evaluation is the systematic assessment of the worth or merit of some objects" (Stufflebeam and Shinkfield, 1985). Evaluation is used in public policy analysis. Public policy is "a course of action, or inaction, taken by a public body to address a problem" (Pal, 2010). Evaluation assumes the existence of the object to be evaluated. "As obvious as this seems, it reminds us that the very first step in any policy evaluation is trying to understand the policy and its programs [...]- what is the problem, what are the goals, and how are programs designed to address that problem?" (Pal, 2010). Typically, the development of public policy takes a cycle, the key components of which are problem definition, policy design, policy implementation, and policy evaluation. The first three components are discussed below:

- Problem definition: in public policy, a problem is a gap between what is and what should be (Pal, 2010). The definition of public policy above, and many others, is problem oriented. There is an assumption that a government will not intervene unless there is a public problem justifying its intervention. The problem definition stage in policy development clarifies needs and objectives. Essentially, it ensures that the problem and its causality links are well understood. In addition, it allows for a ranking of the problem in government agenda. Most importantly, it is the foundation stone on which subsequent steps in the policy cycle are built. Therefore, a proper problem definition undertaking can save time and resources.
- Policy design: this stage is about proposing the best solution to tackle the problem defined in the previous step. It involves tasks such as proposing options and showing the impact of each (Impact Assessment), calculating the benefits and costs of each and sum them into a net benefit (Cost-Benefit Analysis), and assessing the risks (Risk Assessment) (Baldwin et al., 2012). Key in this stage is the provision of policy instruments that suits the needs of the policy problem (e.g. laws, regulation, and resources). The focus of program design is on solution effectiveness.
- Policy implementation: the literature on implementation is the focus of the literature on public administration and management (Pal, 2010). Essentially, policy implementation is concerned with organizations and resources that are tasked with implementing the policy design made in the previous step. The aim

in this stage is to best utilize the policy instruments provided in the policy design stage.

Evaluations are conducted on a number of scopes. Because of its position at the end of the policy cycle, one may assume that evaluation is supposed to take place after the conclusion of a policy in order to evaluate the final effect of such policy (i.e. summative evaluations). However, limiting evaluations to summative is inadequate because they can be conducted before or during the formation of other stage of the policy cycle (formative evaluations). The main types of evaluations are discussed below:

- Needs Assessment/ Problem definition: evaluation in the needs assessment stage can be similar to the problem definition stage in policy analysis. However, unlike problem definition in policy analysis where policy is being formed, an evaluation of needs aims at defining the problem or need of an existing policy. Evaluation at this stage is usually needed for poorly defined public problems or needs.
- Policy design: evaluating policy design entails assessing the effectiveness of the choice of policy instruments to solve a policy problem. For example, evaluating a law (as proposed in this study) is a form of policy design evaluation: such evaluation examines the effectiveness of a particular law, among other policy instruments, in tackling a specific policy problem that it aims to solve.
- Policy implementation: evaluating policy implementation entails researching the quality of the policy implementation stage. For example, it may study the components and processes of complex or unnecessary public organizations in

order to assess the need for its continuation, or just to present such intelligent information to a decision-maker. In addition, an evaluation may research policy effectiveness that can be generated from the utilization of policy instruments in the implementation stage, and whether such utilization is cost efficient.

- Outcome and impact: summative evaluations are conducted at the end of programs on a macro level to measure the outcome of the whole intervention, and compare actual net benefits with estimates of the policy design stage. In addition, evaluations can be conducted to understand the intended and unintended impact of a particular policy. They give opportunity for policy-makers, policy-implementers, and other stakeholders to learn and reflect. Although summative evaluations are conducted at the end, their effect can be retrospective: the mere probability that a summative evaluation may take place, irrespective of whether it does, can be sufficient to improve performance at each stage of the policy cycle.

The public policy context clarifies many basic concepts in the evaluation of law. First, the basis on which law will be evaluated (the evaluation criteria) is derived from the stated problem definition and the objectives of the policy behind the law, not through ex post arbitrary legal interpretations. Second, what gets evaluated is the performance of a particular law in achieving policy objectives, compared not only to other laws, but also to other policy instruments. Third, laws are evaluated not only in the design stage (e.g. the power it grants a regulator), but also in the implementation stage (e.g. whether current institutions and resources are sufficient to utilize the powers granted in the law

in an effective and cost efficient manner). Forth, unless policy problems are caused by law or can be effectively and efficiently solved by law, law needs not be used as a policy instrument in the first place.

Unclear policies lead to purposeless laws with unmeasurable outcomes. Ideally, an evaluation is conducted on a law whose policy statement includes clearly defined problem definition and goals. However, many public policies are so vague and implicit that one is justified in wondering whether or not the government knows what it is doing (Dye, 2011). While policy goals are obvious and measurable at times (e.g. to increase GDP), the goals can be undefined or difficult to define in many situations.

In the presence of quality issues in public policy, it is difficult for an evaluation to be made in the first place. Without defining the objectives of a law, an evaluation cannot moves to its core purpose (i.e. measuring the gap between what is and what should be). This is why evaluators spend a great deal of effort on understanding the basics: what the problem is, what are the goals, and what the government has already done to solve such problem (Pal, 2010).

2.2 Financial Sector Policy Objectives

Having discussed the significance of policy problems and policy objectives for the formation of evaluation criteria, this study investigated the literature on financial sector policy objectives under a number of relevant academic disciplines, especially financial economics and development. It will also be useful in order to agree on terminology. This

section discusses a number of basic studies and policy documents issued by relevant international standard-setting bodies.

2.2.1 World Bank's Global Financial Development Reports

The World Bank's "global financial development report" series is an attempt to summarize and contextualize its large research collection on the areas of economics, finance, and development. In its first report in the series, the World Bank summarized the main functions of financial systems, the explanation behind their evolution, and what they do best, as follows (World Bank, 2012):

1. Information production: by producing information about possible investments, they facilitate information and price discovery, minimizing adverse selection, and improved efficiency of resource allocation.
2. Intermediation: they intermediate in packaging and mobilizing savings and funds from economic units with surplus funds to those in deficit.
3. Corporate governance: they facilitate corporate governance and monitoring of firms receiving investments, minimizing moral hazard.
4. Risk management: they facilitate risk diversification and management.
5. Trade: they facilitate the exchange of goods and services.

Based on the above, the 2012 report defined financial development as "a process of reducing the costs of acquiring information, enforcing contracts, and making transactions" (World Bank, 2012). While an ideal approach to measuring financial development is by measuring how each country does on each of the five financial

system functions described above, data is not sufficient to make such measurement; therefore, some studies used proxies to measure financial development (World Bank and International Monetary Fund, 2005). Therefore, the World Bank used four measures of the characteristics of financial systems: depth, access, efficiency, and stability (World Bank, 2012).

2.2.2 Financial Sector Assessment: A Handbook

The IMF is concerned with financial sector policies, yet due to its vision and objectives, it focuses more on stability. Issued in 2005, the Handbook shines among other IMF and World Bank publications because it "draws particularly on the World Bank–IMF experience in conducting the Financial Sector Assessment Program (FSAP) and on the broader operational and policy development work on financial systems in both institutions" (World Bank and International Monetary Fund, 2005).

The Handbook argues a stable and developed financial system is based on three Pillars:

- Pillar I—Macroprudential surveillance and financial stability analysis.
- Pillar II—Financial system supervision and regulation to help manage the risks and vulnerabilities.
- Pillar III—Financial system infrastructure:
  - Legal infrastructure for finance, including insolvency regime, creditor rights, and financial safety nets.
  - Systemic liquidity infrastructure.
  - Transparency, governance, and information infrastructure.

The handbook is divided into twelve chapters. Although all of them are important for financial sector policy analysis, a few chapters are more relevant for legal and regulatory purposes. Chapter 4 presents the overall framework for financial sector structure and development assessment, including analytical tools for financial sector scope, concentration, efficiency, competition and adequacy of access. The chapter attempts to analyze the factors behind missing or underdeveloped services and markets, as well as the obstacles in the country that prevent the provision of a broad range of financial services. Chapter 5 provides an overview describing the process for assessing the effectiveness of financial supervision and regulation of banking, insurance, and securities markets. Chapter 9 discusses key components of the legal framework for the effective operation of financial markets. The scope of the legal framework includes rule of law, law governing financial infrastructure, and sector-specific laws. In particular, it includes the legal framework relating to the following areas:

- The laws governing banking, insurance, and capital markets.
- Government debt management law.
- The general laws governing insolvency and the creditor rights regime, ownership, contracts, contract enforcement, accounting auditing and disclosure, formation of trusts and asset securitization, and the functioning of the payment system.
- Company laws, other corporate governance laws, consumer protection laws, and land laws.
- Enforcement systems for secured and unsecured credit, legislative procedures for liquidation and rescue (restructuring), procedures for debt recovery and informal workout practices, and mechanisms for carrying out legal procedures.

2.2.3 IRTI's Study on the Islamic Financial Sector Assessment Program

The Islamic Research and Training Institute issued a study titled "Towards Developing a Template to Assess Islamic Financial Services Industry (IFSI) in the World Bank - IMF Financial Sector Assessment Program (FSAP)." This study was initiated in the framework of the IDB-World Bank Working Group on Islamic Finance (WGIF). The purpose of the study was to identify issues and "gaps" that need to be addressed to facilitate an Islamic Financial Sector Assessment Program (iFSAP).

Initiated in the aftermath of the Asian crisis in 1999, The Financial Sector Assessment Program is a comprehensive and in-depth analysis of a country's financial sector. The IMF conducts the assessment along in advanced economies, and the IMF and World Bank jointly conduct the assessment for developing economies and emerging markets. However, the Study found the FSAP not sufficient to assess the development and stability of the Islamic Financial services Industry.

The purpose of the IRIT study is to explain the rationale for the inclusion of Islamic finance assessment in FSAP, develop the needed additional indicators, assessment criteria, and assessment methodology for Islamic finance to be used in FSAP. The need for an iFSAP is increasing along with the increasing the size of the Islamic finance industry in financial systems around the world.

2.2.4 ICD Thomson Reuters Islamic Finance Development Indicator

The Islamic Finance Development Indicator was developed by Thomson Reuters and the Islamic Corporation for the Development of the Private Sector (ICD), the private sector development arm of the Islamic Development Bank (Thomson Reuters and ICD, 2015). The indicator is a composite weighted index that measures the global development of the Islamic finance industry by assessing its performance through specific criteria, which is also used to assess individual jurisdictions. The evaluation criteria are grouped under five headings: qualitative development, knowledge, corporate social responsibility, governance, and awareness. The key components of the index include the following (Thomson Reuters and ICD, 2015):

1. Quantitative development of Islamic finance institutions and markets ('Quantitative')
2. The industry's social contribution in line with Islamic principles ('Social Responsibility')
3. The quality of Sharia governance to ensure that Islamic financial institutions and instruments comply with sharia standards ('Sharia Governance')
4. The quality of Governance and Risk Management measures to protect stakeholders ('Corporate Governance')
5. The availability and quality of education to ensure that the industry's professionals are well-versed in Islamic commercial jurisprudence and Islamic finance principles ('Education') f. The output of research to ensure that the industry's foundations and development are based on substantive knowledge ('Research')
6. Awareness to facilitate better consumer protection and understanding of the principles on which Islamic finance is founded ('Awareness')

7. Development of an enabling and supportive regulatory infrastructure for Islamic banking, Sukuk, Takaful, and funds (‘Regulation’).

The index is a significant breakthrough in its evaluation criteria and performance measurement of Islamic finance. In addition, its underlying ongoing monitoring program is a great source of information. However, policy makers and regulators need to be wary in using this index because of its industry orientation. In other words, this index intends to assist industry players more by indicating the level of competition and regulation in a specific jurisdiction relative to the globe, yet it is not intended for the evaluation of government intervention in general or the evaluation of law in specific jurisdictions in particular. Therefore, without underestimating its significance, this index alone is not sufficient for the purpose of evaluating law per se.

2.2.5 The Ten-Year Framework and Strategy for the Development of the Islamic Financial Services Industry

In 2007, after extensive endeavor led by the Islamic Financial Services Board (IFSB), the Islamic Development Bank, and the Islamic Research and Training Institute (IDB/IRTI), the key international Islamic finance infrastructure institutions issued the “10-Year Framework and Strategy for the Development of the Islamic Financial Services Industry” (the 10-Year Framework), the main policy document on the development of the Islamic financial sector (Islamic Financial Services Board and Islamic Research and Training Institute, 2007). The 10-Year Framework is an attempt to make authoritative and explicit the implicit direction to which the industry is (or should be) heading, guiding regulators

in developing their national Islamic finance development policies. In 2014, the 10-Year Framework was supplemented by the "Midterm Review," a document reviewing the content and the progress made under the framework (Islamic Research and Training Institute and Islamic Financial Services Board, 2014).

The output of the strategic analysis in the 10-Year Framework is a list of 14 strategic recommendations. However, instead of sounding like strategic goals, the recommendations seem to be the outcome of contested international political negotiations over the choice of terminology. Given the difficulty of agreeing on international documents, the effort put in developing such documents by the extensive number of stakeholders involved is undeniable, yet not flawless. Such flaws are partly a reflection of deficits, not only in the limited vision of some practitioners and regulators, but also in the literature on Islamic finance development. Some of the key pitfalls of the documents include the following:

- Weak categorization and prioritization.
- Research quality issues: specificity, objectivity, validity, and measurability.
- Industry and practitioner orientation.
- Weak theoretical foundation.

Weak categorization is evident in the multiple references to financial stability objectives along many of the goals (e.g. 2nd, 4th, 7th, 8th, and 9th). Weak categorization and prioritization is also shown in the number of recommendations dedicated to international cooperation (e.g. the 11th, 12th, and 13th). While such cooperation is

desirable, it is not an objective in itself; rather, it is a mean to other ends, a sub goal at most. Featuring cooperation in more than one recommendation distracts attention and decreases the weight of other goals.

An example of research quality issues is the 8th recommendation, urging the industry to "Develop appropriate legal, regulatory and supervisory frameworks that could effectively cater for the specificities of the [Islamic Financial Services Industry (IFSI)] and ensure tax neutrality between [Institution offering Islamic Financial Services (IIFS)] and their conventional counterparts." Such recommendation is, at best, broad, fragmented, and unclear. It is not certain what is meant by legal framework. Is it the financial regulator law, or does it go beyond? Is it particularly linked to tax neutrality? What are the "specificities of the IFSI" in relation to such legal context? Most importantly, how, at all, can such goal be measured?

The document and the recommendations seem as if drafted by reactive regulators who were "captured" by the financial industry (conventional and Islamic). The recommendations are not explicit in reflecting the expectation of lay Muslims, let alone Muslim scholars (i.e. its target population). For example, while, in theory, Sharia compliance is the only basis which absence renders transactions and institutions non-Islamic, and despite the extensive deviation from such basis in practice, the 10-Year Framework and its recommendations do not seem to reflect such reality; rather, it seems to falsely assume that the majority of Islamic finance institutions and transactions are Sharia compliant. In addition, while stability policies can contradict developmental

policies, one can achieve a possibility frontier where both are achieved to an extent. However, not only do the recommendations seem to favor risk management over development, but also do not attempt to reach such efficient frontier.

The weak theoretical foundation is shown in mixing conventional with Islamic development literature without adaptation. For example, the 3rd recommendation on financial inclusion is formulated in a similar manner to conventional financial sector development policies. At least, it should have stated that Islamic finance institutions are required to enhance access, not to finance in general, but to Islamic finance in particular. Indeed, it is not the purpose of the 10-Year Framework to restate conventional financial development goals.

The Midterm Review (of the 10-Year Framework) was a self-reflection exercise, featuring continuity and change. For example, new goals were added to the goals of the 10-Year Framework (i.e. the recommendations), and it was discovered, inter alia, that "Having in place a set of Key Performance Indicators to track progress and performance is therefore crucial to ensure the objectives of the 10-Year Framework are met" (IFSB, 2014).

However, adherence to continuity and change led the Midterm Review to repeat many of the issues of its predecessor. This is evident in its threefold broad categorization of the recommendations of the 10-Year Framework (i.e. enablement, performance, reach), and the newly added goals. Moreover, the Midterm Review had its own unique shortfalls. First, since the recommendations of the 10-Years Framework were not

intended, or drafted, to serve as goals, it follows that anything built on them will likely be as fragile as its base. Among the numerous examples of the first issue are the Key Performance Indicators for the 8th recommendation discussed above (to which an information technology element was added). The KPIs are:

1. Percentage of member countries with tax neutrality, legal enablement and other basic enablers of Islamic banking as enumerated in ten recommendations from the 2007 Framework and reviewed in this document.
2. Level of new and social media adoption by IIFS.

The KPIs are as vague as the goal they are supposed to measure. The implementation plan added in the Midterm Review for the 8th recommendation does not help explain the situation:

Table 1: 8th Recommendation Stakeholders and their Roles

Stakeholder	Role
Central Banks and Supervisors	Develop and enforce enabling supervisory framework
Governments	Ensure tax neutrality, legislation and other public sector support required by the industry
Financial Institutions	Engage with supervisors and governments to articulate the special characteristics and needs of the industry
Other Private Institutions	Provide required specialist support (legal, accounting, compliance, IT, etc.) to apply the framework in practice
Multilateral Bodies	Identify and promote best practices in legal, regulatory and supervisory framework

Source: (IFSB, 2014)

If some of the recommendations happen to be good enough to serve as goals, the attempt of the Midterm Review to measure them is flawed. One need to go not too far to discover this issue: the 1st recommendation urges the industry to "Facilitate and encourage the operation of free, fair and transparent markets in the Islamic financial services sector," a polite way to say that countries which somehow make illegal Islamic finance institutions and transactions should refrain from doing so. However, its KPIs are set as if such historic issue does not exist. Although KPIs are useful for financial development in general, Islamic or otherwise, the KPIs of the Midterm Review are concerning: it means that the stakeholders drafting the document are unable to distinguish between conventional and Islamic finance. Indeed, the Midterm Review is as much an internationally-negotiated document as its predecessor.

2.2.6 Strategic Plan for Financial Sector Regulation in Qatar

Qatar is a Muslim country, with Muslim nationals, yet many of its banks (including the central bank) are not operated on a Sharia-compliant basis. The central bank issued a Strategic Plan for Financial Sector Regulation including Qatar Central Bank, Qatar Financial Markets Authority, and Qatar Financial Center Centre (QCB et al., 2010). The plan included elements related to micro and macro-prudential regulation, payment systems, customer and investor protection, regulatory cooperation, and building human capital, yet the plan says too little about sector development. The plan says far less about Islamic finance, dedicating for it two paragraphs of the 42 page document. In addition, four action points were Islamic finance specific:

- Enhance the licensing criteria for Islamic financial institutions in line with Sharia standards.
- Strengthen corporate governance standards, the role of the Sharia Board, and conduct of business requirements for Islamic financial institutions.
- Enhance prudential standards and reporting on capital adequacy, solvency and liquidity.
- Develop the framework for liquidation of Islamic institutions.

It can be argued that such action points, coupled with the objectives of the central bank law, are sufficient, yet such lack of details reflects lack of dedication. Since there is no detailed (or dedicated) strategy for the development of Islamic finance in Qatar, it is difficult to understand problems, needs and policy objectives in order to evaluate Islamic finance policy instruments in Qatar.

2.3 Issues in Islamic Finance Law

A number of sources pointed to a number of legal issues with Islamic finance law. There are a number of dispute resolution issues in Islamic finance (Wilson, 2012a). First, courts can interpret Sharia differently (Bälz, 2005). Fully fledged Sharia courts are scarce around the world. Most nation-states have either civil or common law legal systems, which follow different procedural and substantive rules. Because Islamic finance contracts are built on Sharia, contradicting legislation and judicial precedents may lead to a number of unintended consequences, such as Sharia violation or contract unenforceability (White, 2012). Some workarounds include drafting lengthy contacts, but such contracts can work as far as they do not conflict with the mandatory rules of the legal system. Second, establishing Sharia courts may not solve the issue entirely

because even Sharia courts can interpret Sharia differently (Hasan and Asutay, 2011). Because of the differences in Sharia interpretation among Sharia scholars and judges, the risk and uncertainty of interpretation can still be high. Unlike legislation, which a normal judge is expected to stick to, there are many schools of Sharia jurisprudence (Fiqh), and a judge has liberty to choose the juristic opinion that suits the case. This lack of harmonization and standardization means that two similar cases may well be decided differently.

There are issues related to the structuring of Islamic financial contracts in general. Unlike conventional banks, which business is almost built on one contract (i.e. loan), Islamic finance contracts take a variety of forms, each with its own risks (Vogel and Hayes, 1998). For example, since interest-bearing loans are not Sharia compliant, Islamic finance contract rely on sale and investment based finance structures. However, for the sake of financial stability, banking laws usually prohibit banks from making any finance other than through interest-bearing loans, and specifically ban trade and investment finance contracts (Wilson, 2012a).

Despite its similarities with other Islamic finance contracts (AAOIFI, 2010), Sukuk have unique risks and legal issues. First, although Sukuk are intended to act like fixed-return financial instruments, the convergence between Sukuk and conventional securitization can lead to Sharia violation. For example, while a special purpose vehicles (SPVs) have certain uses in conventional securitization (e.g. bankruptcy remoteness), getting an SPV to commit Sharia violations is not permissible (DeLorenzo and McMillen, 2007). Second,

Sukuk can be based on contracts which, while being Sharia compliant individually, can violate Sharia collectively (Kahf, 2015). For example, Sukuk can be based on Murabaha contract, but Sukuk in this case will represent debt, and it violates Sharia to trade debt for money.

From a regulatory perspective, there are legal issues with the laws regulating banking and financial institutions. First, while the banking regulation laws may not forbid Islamic finance per se, they usually have the effect of forbidding Islamic finance, or making its cost prohibitive (Aldohni, 2011). For example, such law may prohibit a bank from engaging in trade of good, real estate, and investments, effectively forbidding the Islamic finance contracts the Islamic financial institution is based on (Wilson, 2012b). Second, ignorance of the unique characteristics of Islamic finance may prevent a banking regulator from delivering on a number of its mandates (Aldohni, 2011). In addition, there are legal issues with the laws regulating financial markets. Under the assumption that transparency and information disclosure is a regulatory objective, Islamic finance needs specific disclosure requirements (Aldohni, 2011). For example, the law may require a Fatwa report to be published in any offering of the securities concerned, public or otherwise. Because of the nature of Islamic finance contracts, taxation laws can have the effect of preventing Islamic finance by making the cost of Islamic finance prohibitive (Amin, 2009). Many Islamic finance contracts involve double transactions incurring double taxation (e.g. Murabaha and lease purchase), and there are taxes on property ownership and transfer, increasing the cost of Islamic real estate finance.

In summary, despite the variety of sources discussing legal issues in Islamic finance, they seem to follow some pattern. First, due to the uncertainty of Sharia, and the lack of private law clarifying it, there is uncertainty when Sharia is involved in interpretation and dispute resolution. Second, due to the immaturity of regulatory objectives relating to Islamic finance, and reliance on conventional finance regulations, Islamic finance is not properly regulated, leading to uncertainty and risks.

The Islamic finance legal literature tends to be less policy oriented. First, the focus of much of the literature is on micro-level legal issues. Examples of such issues include Sukuk, dispute resolution, financial risk regulation, and specific disputes. Second, the literature is not explicit on objectives, goals, or evaluation criteria. For example, an article on the legal issues in Sukuk may describe certain behaviors, laws, or contracts as having legal issues without pointing whether the issues are of Sharia compliance, profitability, risk, or otherwise.

CHAPTER 3 EVALUATING ISLAMIC FINANCE LAW

As discussed in the methodology section, evaluators prefer to evaluate by reference to a pre-existing evaluation criteria, but the lack of such criteria pushes evaluators to go back a step to define them before carrying out their evaluation. Common forms of such criteria include policy objectives. Financial sector policy objectives are investigated under several academic disciplines, especially finance, economics, and development. Therefore, investigating the literature on financial sector development policies is useful in understanding the evaluation criteria for Islamic finance law.

Identifying financial sector policy objectives is not straightforward. By its nature, the academic profession demands more sophisticated statistical models and theories, irrespective of its practical utility.[2] On the other hand, financial regulations usually emerge in response to financial crisis. As a result, regulators have an incentive to take a passive and reactive approach to financial regulation with more bias towards stability to the disadvantage of development. On the whole, policy makers can hardly develop a clear idea about which financial sector policy objectives to have. Luckily, some parties, especially international standard-setting bodies, are less involved in such conflicts of interests, providing a more holistic view of financial sector policy objectives.

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[2] For example, having investigated the literature on the rationale for financial regulation, (Peláez and Peláez, 2009) concluded that the vision is not clear.

It is worth noting that despite their different objectives, investigating conventional financial sector policies is a useful starting point for the study of Islamic financial sector policies. Finance is Islamic when it complies with Sharia, and there are unique objectives to Sharia texts. Conventional finance policies have been put to achieve policy objectives which are not necessarily in line with Sharia objectives. However, due to its history and development cycles, contemporary Islamic finance was born in an age of conventional finance. Therefore, studying conventional finance policies with a particular focus on their strengths is useful to understand the context within which Islamic financial systems will operate. In addition, with correct adaptation, many conventional financial sector policy objectives can be adopted in Islamic financial systems.

It is worth emphasizing that there is a common confusion between good economic theory and Islamic finance. Indeed, Islamic finance usually leads to good economic outcomes, but it is methodologically improper to treat them the same. The study investigates in length and groups together conventional financial sector policies in order to distinguish them from pure Islamic financial sector policies.

3.1 Financial Sector Policies

Since it is easy for policy makers, and sometimes academics, to forget the rationale and foundations on which their strongly-held propositions are built, it is useful to start the policy discussion by agreeing on some basic concepts and terminology.

A financial system "consists of institutional units and markets that interact [...] for the purpose of mobilizing funds for investment and providing facilities, including payment systems, for the financing of commercial activity" (IMF, 2006). It includes "financial institutions (banks, insurance companies, and other nonbank financial institutions) [,] financial markets (such as those in stocks, bonds, and financial derivatives) [and] the financial infrastructure (which includes, for example, credit information–sharing systems and payment and settlement systems)" (World Bank, 2012).

Since the financial sector is essentially a market of financial products and services, regulation theory can explain a great deal about its context. Based on the efficient market hypothesis, markets ought to be left free from intervention unless there is a market failure (Peláez and Peláez, 2009). Market failure is an "an equilibrium allocation of resources that is not Pareto optimal. (Winston, 2006)" Market power, natural monopoly, information asymmetry, public goods, and externalities are common causes of market failures (Winston, 2006). However, in order for government intervention to be efficient, not only is there need to demonstrate the existence of market failure, but also a demonstration that government intervention is going to be effective in eliminating or at least reducing market failure. A government intervention to correct market failures that fails to increase efficiency is commonly known as a government failure (Winston, 2006).

Flawless government intervention is a fallacy (Peláez and Peláez, 2009). It is unreasonable to assume that governments are rational and have perfect information on

which they base their intervention. In addition, there is no guarantee that the government will work for the public interest (Stigler, 1971). Evidence suggests that the cost of government failure is usually higher than the cost of the market failure the intervention intended to correct, with many interventions made on markets that had little or no failure, and other interventions which changed the allocation of resources with the effect of creating new winners and losers. In addition, scenarios of interventions that add injury to existing market failure are not inevitable. Therefore, it is useful for government interventions to have, at least, the objective of fixing market failure.

Regulation is a policy instrument that gained a reputation of being the solution of choice for correcting many market failures. Essentially, regulation is “the employment of legal instruments for the implementation of social-economic policy objectives” (Hertog, 2000). Another definition emphasizes that regulation is a sustainable and intentional attempt of behavior modification for the purpose of achieving such objectives (Black, 2002). However, the word “regulation” is increasingly associated with a number of other concepts which define a great deal of its attributes (Black, 2002). First, the purpose of regulation is assumed to be fixing market failure, so anything that is not directed towards such objective is not regulation. Second, there is an assumption that a regulatory state expresses an intention to increasingly rely on markets in the delivery of goods (including public utilities) as far as possible. Third, although created and financed by the state in many instances, regulators are expected to enjoy a high degree of independence from the state in their regulatory decision-making.

It is worth noting that many financial regulators and policy makers seem unable to reflect much of the basics discussed above in their behaviors. For example, financial regulators may rush to implement prudential regulations for the sole purpose of complying with some international standard, without much consideration of whether or not they may lead to government failure. In other words, financial regulators can focus more on financial stability policies without considering their effect on financial development in particular or economic development in general. In addition, a biased or confused regulator can favor state-owned banks in its implementation of international standards, leading to more market failures. Nevertheless, there are a number of areas where government intervention and regulation of the financial sector can create efficiency.

3.1.1 Financial Infrastructure

A high-level definition of financial development describes it as “a process of reducing the costs of acquiring information, enforcing contracts, and making transactions” (World Bank, 2012). Legal, informational, and transactional technology infrastructures are the foundation stones which have to be dealt with first for a financial system to function (World Bank and International Monetary Fund, 2005). This definition highlights the main

functions of financial systems, the explanation behind their evolution, and what they do best, described by the World Bank as follows (World Bank, 2012):[3]

1- Information production: by producing information about possible investments, they facilitate information and price discovery, minimizing adverse selection, and improved efficiency of resource allocation.
2- Intermediation: they intermediate in packaging and mobilizing savings and funds from economic units with surplus funds to those in deficit.
3- Corporate governance: they facilitate corporate governance and monitoring of firms receiving investments, minimizing moral hazard.
4- Risk management: they facilitate risk diversification and management.
5- Trade: they facilitate the exchange of goods and services.

As emphasized in the definition above, financial development is not about increasing the size or income of the financial sector. While there is little dispute on the link between financial development and economic growth, due to its unique, there is wide acceptance that a bigger financial sector is not necessarily better (King and Levine, 1993). In particular, although financial deepening is generally good, pure financial deepening may be contrary to economic growth. Hence, instead of encouraging financial sector enlargement per se, this definition focuses on eliminating barriers to the proper functioning of financial systems in general, and unnecessary costs in particular, irrespective of any incidental increase in the size of the financial sector.

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[3] There are other similar categorizations of the functions of financial markets, as in, for example, (World Bank and International Monetary Fund, 2005).

It is worth noting that mainstream economic theory, including the efficient market hypothesis, does not fully account for information, transaction, and enforcement costs. First, although the efficient market hypothesis assumes perfect information, such assumption is far from real: "our understanding of economic life is incomplete if we do not systematically take account of the cold winds of ignorance" (Stiglitz, 2002). Second, despite how economic theory praise the price mechanism, Coase's statement on the nature of the firm emphasizes the significance of transaction cost: "the main reason why it is profitable to establish a firm would seem to be that there is a cost of using the price mechanism" (Coase, 1937). Furthermore, "it is the existence of these costs—these market imperfections—that creates incentives for the emergence of financial contracts, markets, and intermediaries" (Coase, 1937). Third, enforcing property rights is so basic for financial systems and economies in general that economists seem unwilling to question its efficiency and effectiveness (Djankov et al., 2003). If economic actors are rational and have perfect information, courts may not have been needed in the first place. However, not only are parties unable to discover the whole truth themselves, the self-interest of such parties, coupled with the fact that enforcement has a cost, incentivizes parties to default on their agreements.

Information is not only the foundation stone for financial sectors, but also a source of market failure in the financial sector, requiring government intervention. First, because of low rivalry and excludability, information is considered a public good (Stiglitz, 2002). Since public goods are under-produced by markets, government intervention can facilitate its production. Second, the efficient market hypothesis assumes costless

information, yet information is costly. As a result, arbitrage is costly, and the behaviors of consumers in the economy differ because it is costly for them to search for the highest quality for the lowest price. (Stigler, 1961)

Solving information asymmetries is a significant justification for the evolution of financial institutions, markets, and systems. Asymmetrical information is “a situation that arises when one party’s insufficient knowledge about the other party involved in a transaction makes it impossible to make accurate decisions when conducting the transaction” (Mishkin, 2013). Asymmetrical information before a transaction is adverse selection, and ex post asymmetric information is moral hazard. Financial regulators attempt to decrease the cost of information through transparency and disclosure laws. Defying the efficient (financial) market hypothesis, the superiority of intermediaries is explained by their information superiority and the unique tools they have to minimize the effects of information asymmetries.

Transaction cost is "the resources necessary to transfer, establish and maintain property rights” (Zerbe and McCurdy, 1999). Because of the transaction cost of undertaking the functions of financial systems, society’s savings are prevented from going to those with the best ideas and projects, thus curtailing economic development. Transaction Cost, according to Coase, include the cost of “discovering what the relevant prices are,” of “negotiating and concluding a separate contract for each exchange transaction which takes place on a market,” and “it seems improbable that a firm would emerge without the existence of uncertainty” (Coase, 1937). In addition, “uncertainty, frequency of

exchange, and the degree to which investments are transaction-specific" are transactional aspects which affect behaviors in markets (Williamson, 1979). Components of transaction cost can be summarized as follows (Zerbe and McCurdy, 1999):

1- Searching for the party for the transaction
2- Communicating the desire to bargain and the terms of bargain
3- Engaging in negotiation to reach an agreement
4- Drafting a contract
5- Inspecting for compliance with the terms of the contract

The intermediary role of financial institutions illustrates well the role of financial systems in decreasing transaction cost. Financial institutions evolve and excel in financial systems by decreasing the costs and risks of doing finance through markets and the price mechanism (Levine et al., 2000). Such cost minimization is achieved not only through specialization and economies of scale, but also through diversity and economies of scope (Mishkin, 2015). In addition, countries with financial intermediaries that are better at doing the functions of financial systems described above grow faster than countries with less developed financial systems (Levine et al., 2000).

Minimizing transaction costs demands a variety of measures. One way to decrease such cost is to liberalize financial markets, facilitating the entry of intermediaries who excel on minimizing such cost. Another way to minimize transaction cost is to decrease the cost of using the price mechanism to acquire financial services, decreasing the need for

intermediaries in the first place. For example, corporations can satisfy many of their financial needs through sound financial markets.

While “the essence of an idealized universal court is the resolution of a dispute among two neighbors by a third, guided by common sense and custom,” and without being restricted by procedural formalities or evidence rules, this is not the case in many jurisdictions (Djankov et al., 2003). Increasing formality increases enforcement cost not only by requiring more sophisticated enforcement mechanisms and expertise, but also through delaying enforcement, decreasing the present value of rights.

On the other hand, a number of reasons led to such increase in judicial formalism (Djankov et al., 2003). First, formalism is a way of restricting courts from interpreting the law in such way that deviates from the intentions of the legislator. Second, formalities can be useful in balancing the advantage of the politically more powerful in relation to the least advantaged in society. Third, formalism can enhance consistency and uniformity in order to facilitate trade and stabilize expectations. However, despite such benevolent causes, not only is dispute resolution formality as it exists in many jurisdictions too costly for achieving such purposes, but it also causes negative externalities on the whole economy by increasing transaction cost (Djankov et al., 2003).

The importance of enforcement in financial systems is beyond doubt, yet the role of law and legislation is not limited to enforcement, and extends to information and transaction infrastructure as well. For example, defining creditor and investor rights and

corporate governance mechanisms minimizes information costs, and allowing for the creation, perfection, and enforcement of collateral minimizes transactions cost.

Information, transaction, and enforcement costs refer not only to actual costs, but also to potential and expected costs. As a result, ambiguous (or the absence of) law causes uncertainty and distorts future expectations, which is a risk that increases such costs.

While this study investigates such potential costs and risks here, they are distinct from the mandate of regulators and the obligations of regulates to follow certain risk management standards to enhance financial stability. Such distinction is related to the distinction between private and public law, as discussed below. Micro-risks affect macro stability, and both risks need to be managed, yet by different persons. Micro risks arise from the nature of the relationship between private parties, while macro risks relate to the relationship between regulators and regulatees.

While an ideal approach to measuring financial sector policy is by measuring how each country does on each of the three costs or the five functions of financial system described above, data is not sufficient to make such measurement. In addition financial sector evaluation rely less on the observance of pre-defined codes and standards, and countries can have unique financial development issues which require specific investigation. Therefore, such evaluation tends to be "less categorical, more subjective, and arguably more difficult than assessing the relevant standards and codes" (World Bank and International Monetary Fund, 2005). To overcome such issues, some studies use proxies to measure financial development (World Bank and International Monetary

Fund, 2005). For example, the World Bank used four measures of the characteristics of financial systems: depth, access, efficiency, and stability (World Bank, 2012).

The significance of the definition of financial development above cannot be underestimated because of its strong link to the rationale and ultimate objectives behind financial sector regulation. However, its high level of abstraction may hinder its utilization in practice. Breaking its core into more specific objectives can facilitate its achievement.

Therefore, in addition to decreasing information, transaction, and enforcement costs, this study will focus on the following financial sector policy objectives:

1- Financial sector development.
2- Financial stability.
3- Investor and consumer protection.

Financial sector development objectives focus on areas such as market structure and freedom (demand and supply side) for the purpose of enhancing access to finance, financial sector effectiveness and efficiency, and service quality and diversity. Financial stability objectives focus on areas such as macroeconomic and systemic financial stability and micro financial stability, with the observance of international standards being a major means to achieving such objectives. Because of the strong relationship between stability and development objectives, regulators and policy makers can be so overwhelmed by their similar requirements that they lose sight of the distinction

between them, leading to distortion in achieving them.[4] Therefore, it is preferred that both topics are studied and understood separately before consolidating any joint public policy in this regard. Investor and consumer protection focuses on matters scuh as fairness and transparency in financial markets.

3.1.2 Financial Sector Development

A more specific definition of financial development (i.e. developing the market for financial services) describes it as "a process of strengthening and diversifying the provision of [financial] services to meet the requirements of economic agents in an effective and efficient manner and thereby support, as well as stimulate, economic growth" (World Bank and International Monetary Fund, 2005).

This definition highlights a number of specific elements in a way that increases its utility in practice. First, strengthening and diversifying the provision of financial services is considered among the ultimate objectives of financial sector development. Such emphasis focuses the efforts of policy makers and regulators to satisfying market needs, instead of, for example, performing the tasks that will improve their public image, or ensuring the satisfaction of the financial industry. An example of such tasks is under-regulation or over-regulation of financial risks where development of financial services is not an explicit policy objective. One of the most utilized policy instruments to achieve

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[4] For example, (World Bank and International Monetary Fund, 2005) propose a three pillars for assessment, which mix in them stability and development objectives.

such objective is the liberation of markets from entry and exit restrictions, as well as minimizing the cost of regulation. Measuring this aspect requires an in-depth market review.

Second, while market liberalization addresses supply-side issues, reference in the definition to meeting the requirements of economic agents emphasizes the importance of demand-side. Not only are such needs satisfied by market liberalization, but also through positive actions on the part of policy makers and regulators to increase access to financial services in a way that includes the weakest and most vulnerable agents in the economy (i.e. financial inclusion/ market breadth). Third, provision of financial services needs to be effective and efficient. Effectiveness requires adequate provision of the range of financial services required by economic agents, as discussed above. Efficiency addresses the quantity, quality, and cost of financial services. Efficiency and effectiveness are usually enhanced through market liberalization. Indeed, efficiency and effectiveness requires measurement of both. The last part of this definition links it to economic growth, and more specifically to the five functions of financial systems in economies listed above. The importance of such link lies in emphasizing the public interest objective of financial systems, discrediting the claim that financial systems are intended to serve the interests of financial institutions.

Financial depth, access to finance (or financial inclusion or breadth), product diversity, and efficiency are the key concepts related to the objectives of financial sector development.

> *"An effective banking system will be characterized by considerable depth (measured, for example, by total assets); breadth in terms both of customer base (lending to a wide range of sectors and regions, without neglecting the needs of creditworthy borrowers in any sector or region) and of product range (maturities, repayment schedules, flexibility, convenience, risk profile, and nonbanking products where permitted); and efficiency." (World Bank and International Monetary Fund, 2005)*

Financial depth illustrates the proxy approach to measuring financial system effectiveness. Financial depth, the size of the financial system relative to the economy, is considered "the most common way to characterize financial systems" (World Bank, 2012). All things equal, it measures the ability of the financial system to serve the economy. Although various indicators are used to measure financial depth, such as private credit to GDP for financial institutions, and market capitalization to GDP for financial markets, some indicators are considered more accurate than others. *Private credit to GDP*, for example, may be preferred over *financial assets to GDP* because it excludes credit to the government: "a financial system that simply funnels credit to the government or state-owned enterprises may not be evaluating managers, selecting investment projects, pooling risk, and providing financial services to the same degree as financial systems that allocate credit to the private sector" (King and Levine, 1993).

Financial depth is a proxy to measure many of the basic functions of financial systems: "users of financial depth hypothesize that the size of financial intermediaries is

positively related to the provision of financial services" (King and Levine, 1993). Not only is financial depth considered a comprehensive indicator for financial development, it is also strongly correlated to economic growth and poverty reduction (World Bank, 2012). Despite such correlation, such indicator is less specific about what policy makers should do to cause the development of financial systems.

Demand-side market liberalization views the market from the consumer point of view. The topics studied under this category include access to financial services (e.g. financial inclusion or market breadth) and consumer power. Financial inclusion, or broad access to financial services, is defined as "an absence of price or nonprice barriers in the use of financial services" (Demirgüç-Kunt et al., 2008). In terms of scope, access to financial services means more than access to basic finance and deposit accounts: "it is just as much about enhancing the quality and reach of credit, savings, payments, insurance, and other risk management products in order to facilitate sustained growth and productivity" (Demirgüç-Kunt et al., 2008). Access to financial services is wider than use. Unlike increased use of financial services, which measures outcomes, increased access relies on equality of opportunity: access "refers to the supply of services, whereas use is determined by demand as well as supply" (Demirgüç-Kunt et al., 2008). Therefore, financial inclusion, and broader access to financial services focus on enabling persons who demand financial services to access them, especially those who either cannot access financial services for reasons beyond their control or can access them at prohibitive cost (involuntarily excluded), while financial inclusion is less concerned

about persons who can access financial services but are voluntarily excluding themselves (World Bank, 2014).

Although increasing access to finance is a substantial component of financial development, “this access dimension of financial development has often been overlooked” (Demirgüç-Kunt et al., 2008). Financial access is “indeed strongly associated with economic development” (World Bank, 2012). Lack of access, caused largely by information asymmetries, is associated with slower growth and persistent income inequality or poverty traps: “poor individuals and small enterprises need to rely on their personal wealth or internal resources to invest in their education, become entrepreneurs, or take advantage of promising growth opportunities” (Demirgüç-Kunt et al., 2008).

3.1.2.1 Product range

Strengthening and diversifying the provision of financial services requires an active effort by policy makers and regulators to facilitate the provision of the range of services the market needs, as well as improving the quality of each one of them. There are positive externalities associated with the positive role of finance in the economy, as summarized in the five functions of financial systems above. However, for a number of reasons, not all needed (and desirable) financial services are provided. Indeed, some firms may be ignorant of their need of such services, so the regulators may have little options (or mandate) to fix anything. Other instances may require and justify more state involvement, as in the case of low competition in the markets of financial services

leading to easier profit opportunities, rendering the return on investing in the supply of new or innovative financial services is not attractive. Therefore, one of the most utilized policy instruments to ensure the supply of needed financial services is the liberation of markets from entry and exit restrictions, as well as minimizing the cost of regulation.

3.1.2.2 Efficiency

Efficiency is a relationship between ends and means. “When we call a situation inefficient, we are claiming that we could achieve the desired ends with less means, or that the means employed could produce more of the ends desired” (Heyne, 2008). Because of the role of financial systems in the economy, the higher costs of inefficient financial systems are born by households, firms, and governments (World Bank, 2012). In addition to driving costs down, many benefits can be gained from the optimal allocation of resources in the financial sector, such as improving the quality of products and services, and the degree of innovation in the sector, improving demand for finance and extending access to finance (Claessens and Laeven, 2005). Since efficiency increases in more competitive markets, market liberalization is a useful mean to increase efficiency. This study groups market liberalization strategies into supply-side and demand-side.

Supply-side market liberalization views the market from the producer’s point of view (e.g. the financial intermediary). The topics studied under this category include market structure, concentration, and levelling the playing field. Market structure categorizes the level of competition within am market through measurements such as

"concentration ratios (assets of largest three or five banks to total banking assets), number of banks, and Herfindahl indices" (World Bank and International Monetary Fund, 2005). In addition, contestability of the market and the threat of entry can influence intermediary behavior, and can be indicated through "formal entry requirements, share of bank applications rejected over the past five years, and openness of the sector to foreign entrants" (World Bank and International Monetary Fund, 2005).

Despite its desirability, the literature on financial development "has not paid much attention to competition in the financial sector" (Claessens and Laeven, 2005). Without justifying such lack of attention, a number of reasons can explain part of it. First, compared to other sectors (e.g. utilities), competition regulation is not a priority for financial markets (Baldwin et al., 2012). Second, while efficient financial institutions also tend to be more profitable, the relationship is not very close; for example, an inefficient financial system can post relatively high profitability if it operates in an economic upswing, while an otherwise efficient system hit by an adverse shock may generate losses (World Bank, 2012). Third, although not true per se, competition is seen as adversely affecting stability (Competition Committee, 2011). Fourth, competition can lead to quality deterioration and a race to the bottom (Baldwin et al., 2012).

3.1.3 Investor and Consumer Protection

Investors (including shareholders and creditors) obtain various rights and powers over firms they finance: shareholders vote on key corporate matters, appoint directors, and

can hold directors responsible, while creditors can be entitled to repossess collateral and reorganize the firm that defaults on its debt or violates its debt covenants (La Porta et al., 2000). In order to exercise such unique rights, investors share a number of common rights, such as the right to access corporate information and to enforce their rights. Despite the general view that financial markets ought to be left free and unregulated, it is widely accepted that the state intervention to protect investor rights (e.g. through legislation) is not only efficient, but also necessary (Djankov et al., 2008).

A number of studies investigated the differences between financial systems that are bank-centered (e.g. the ones in Germany and Japan) and market-centered (e.g. the ones in the United States and the United Kingdom) (Demirgüç-Kunt et al., 2013). However, while there is evidence that economies tend to rely more on securities markets as they develop, it is also argued that (e.g. due to the information superiority of financial intermediaries) market-centered economies are not strictly dominant. As a result, the bank-market distinction was criticized as missing the point: both systems can be effective in exerting corporate governance. The key issue is not whether a system is bank or market centered, but whether investors are protected (La Porta et al., 2000). As a result, both the financial systems of Germany and the United Kingdom are good in protecting investors, while Italy is not (La Porta et al., 2000). Therefore, investor protection is a better framework for understanding the development of financial systems.

3.1.3.1 Creditor Rights and Insolvency

Debt enforcement entails the right (granted by the state through law) to seizure and sale of debtor property. Such right is not only just to enforce, but also efficient and necessary for the existence and proper functioning of credit and debt finance systems (Leroy and Grandolini, 2016). Ideally, debt is enforceable at no cost or externalities. Much of the information that exists in many financial markets adheres to such ideal by focusing more on the ability of the debtor to pay (or the probability of default). However, such ability or probability is strongly linked with the efficiency and quality of creditor and insolvency standards in legal systems. While a bad debtor will increase the cost of finance on itself, a bad debt enforcement system increases the cost of finance on the whole economy.

Transparent and efficient collateral systems increase the inclusion and efficiency of financial systems (World Bank and UNCITRAL, 2011). First, a collateral system needs to allow for the creation, recognition, and enforcement of security rights on property. Second, security rights need to be public and accessible by third parties at low cost (e.g. through a public registry system). Third, since financial systems are based on information, information about the financial risks of finances (e.g. credit bureaus and credit rating agencies) increases the efficiency of the financial system. Fourth, a credit system needs to account for insolvent entities, and whether to liquidate and end their businesses or reorganize them and give them another chance.

3.1.3.2 Shareholder rights and corporate governance

Shareholder protection (and the quality of corporate governance) has a strong impact on the pattern of corporate finance in different economies. More specifically, countries with laws that protect shareholders affects the "breadth and depth of their capital markets, the pace of new security issues, corporate ownership structures, dividend policies, and the efficiency of investment allocation" (Djankov et al., 2008).

Insider-dealing is widely seen as a key determinant of the quality of shareholders rights in an economy (Djankov et al., 2008). In markets with little shareholder protection, outside investors face a near certainty that the returns on their investments will never materialize because the insiders (i.e. controlling shareholders or managers) simply keep them (La Porta et al., 2000). It is also emphasized that laws in particular shape the ability of insiders to expropriate outsiders, affecting confidence and market development. Therefore, instead of wasting effort on various corporate governance issues, governments can best serve their economies by focusing their attention on protecting investors through regulating insider-dealing.

3.1.3.3 Financial Customer Protection

Financial consumer protection is a widely accepted financial sector objective (G20/OECD Task Force on Financial Consumer Protection, 2014). The goal of consumer protection generally is to protect them from consumer detriment. Consumer detriment is a loss in economic welfare which occurs when consumers are misled into making purchases of goods and services which they would not otherwise have made, or pay more for

purchases than they would if they had been better informed (*Consumer Policy Toolkit*, 2010). Consumer detriment can be structural or personal. Structural detriment is caused by market conditions which affect a large number of customers, including abuse of monopoly power and other market failures, while personal detriment is caused, inter alia, by scams and frauds, misleading advertising, unfair marketing practices, unfair contract terms, sale of unsafe products, and inadequate redress in response to complaints.

Consumers in the financial sector need special attention. Although access to financial services brings opportunities, it also brings many of the risks associated with inadequately regulated innovative financial institutions with diverse incentives. In addition, financial products and services are increasing in complexity, whereas the level of financial literacy remains low in many countries (G20/OECD Task Force on Financial Consumer Protection, 2014).

3.1.4 Financial Stability

Financial stability can be defined as "(a) an environment that would prevent a large number of financial institutions from becoming insolvent and failing and (b) conditions that would avoid significant disruptions to the provision of key financial services such as deposits and investments for savers, loans and securities to investors, liquidity and payment services to both, risk diversification and insurance services, monitoring of the users of funds, and shaping of the corporate governance of non-financial firms" (World Bank and International Monetary Fund, 2005).

Financial stability looks at the functions of financial systems from a different perspective: if depth measures all functions with the assumption of perfect information and rational agents, stability assumes imperfect information and irrational agents. Financial stability got so much attention by financial regulators to the disadvantage of financial development objectives, as if the sole purpose of a financial regulator is to ensure stability. However, such attention is not unwarranted. Information is the foundation stone for financial systems, and instability in the production and flow of such information leads to financial instability. Put differently, financial crisis occurs "when information flows in financial markets experience particularly large disruption, with the result that financial frictions increase sharply and financial markets stop functioning" (Mishkin, 20131). Such instability is sometimes termed financial panic: the imperfection of market information and the irrationality of market agents cause disrupted flow of information, leading to strong and hasty reactions (i.e. panic). Financial instability can be linked to the inability of markets agents to understand some financial innovation, and the associated over-pricing of financial assets, exaggerating information asymmetries (Mishkin, 2013).

There are high expectations from regulators in the area of financial stability, which were standardized and harmonized for global financial stability (Basle Committee on Banking Supervision, 2012). A major components of any effective supervisory framework for financial institutions is prudential regulation (World Bank and International Monetary Fund, 2005). It includes topics such as capital requirements, corporate governance, risk management, risk concentration, and internal controls.

3.2 Islamic Financial Sector Policies

Because Sharia has unique objectives, Islamic financial sector policy objectives are different from the conventional policies. Sharia is Islamic law, as found in divine Islamic scripture (e.g. Quran and Sunnah). Because of the divine nature of such law, in order for any behavior or goal to be Sharia compliant, they need to adhere not only to the text, but also the objective behind it. Due to the comprehensiveness of Sharia, it is not safe to assume that the conventional concept of development, based on a combination of secular moral values (e.g. equality or utility), is Sharia compliant per se.

Although both law and Sharia have objectives that need to be followed, the relationship between text and objectives seems more evident in Sharia. While individual transactions may be deemed permissible under Sharia, their combination to achieve illegitimate ends violates Sharia objectives. For example, sale is permissible under Sharia, but structuring a sale and a purchase back transaction with the objective of getting around the Riba prohibition violates Sharia.

3.2.1 Conventional Financial Sector Policies in Islamic Financial Systems

The 10-Year Framework is regarded the main universal policy document on the development of the Islamic financial sector (Islamic Financial Services Board and Islamic Research and Training Institute, 2007), along with the “Midterm Review” (Islamic Research and Training Institute and Islamic Financial Services Board, 2014). While the first gave general recommendations, the latter was an attempt to turn the recommendations into actions. The measures (KPIs) used in the Midterm Review appear

to be quick adaptations of conventional financial sector KPIs without serious consideration of the different moral basis on which each set of KPIs is built. In particular, the Midterm Review either accepts conventional financial KPIs as they are, or fits the word "Islamic" somewhere in the KPI. This approach is illustrated in Table 2 below.

Table 2 Some Mid-term Review KPIs

Recommendation	Key Performance Indicator
1. Facilitate and encourage the operation of free, fair and transparent markets in the Islamic financial services sector.	1.1 Progress made by member countries on World Bank governance metrics 1.2 Percentage of member countries operating free market financial systems 1.3 Level of transparency of Islamic banks compared with conventional counterparts
2. Enhance the capitalisation and efficiency of IIFS to ensure that they are adequately capitalised, well-performing and resilient, and on par with international standards and best practices	2.1 Average capital adequacy of Islamic banks 2.2 Average ROE of Islamic banks 2.3 Average ROE of Takāful companies 2.4 Market capitalisation of member country capital markets
3. Enhance access by the large majority of the population to financial services, and enhance access to funding for SMEs and entrepreneurs	3.1 Percentage of population with access to financial service 3.2 Number of Islamic micro finance institutions in member countries 3.3 Percentage of Islamic banks offering SME and entrepreneurial finance 3.4 Number of member countries with SME and entrepreneurial finance programs (public sector or NGOs) that are Sharī`ah compliant

To be more specific, the first three recommendations and their KPIs will be analyzed. First, while the objective of the first recommendation is Islamic financial sector development, its first and second KPIs (on governance metrics and free markets) do not refer to Islamic finance whatsoever. Although the third KPI (on transparency) mentions

Islamic banks, transparency is a feature of good financial systems in general. Second, while the second recommendation addresses financial stability in financial systems involved with Islamic finance, and despite utilizing expressions from the Islamic finance literature in describing banks and insurance providers (e.g. Takaful), its four KPIs are no different than the ones needed for the stability of conventional financial systems. Third, while the objective of the third recommendation is supposed to be enhancing access to *Islamic* finance, neither its wording nor its KPIs reflect this desire.

Since the wording of the third recommendation of the 10-Year Framework does not refer to Islamic finance at all, the IFSB could have saved space and ink by leaving the goal of extending access to finance for another policy document issued by another international standard setting body. Assuming the IFSB aims at addressing access to Sharia-compliant finance in particular, the Midterm Review KPIs still do not specifically serve such objective. The first KPI does not refer to Islamic finance, nor is it specific to it. Although the second and third KPIs are as relevant in a non-Sharia-compliant financial system as they are for Islamic finance, they can be considered more specific to the nature of Sharia finance because achieving such objectives requires active adaptation of the business models of Islamic finance institutions. Similar to the second and third KPIs, the fourth KPI is specific about Sharia compliance in finance.

Not to disregard the highly regarded 10-Year Framework and Midterm Review, and despite the relevance of conventional financial sector policies, they are not suitable for Islamic finance as they are (Muljawan, 2015). First, conventional financial sector policies

do not account for the most important feature of Islamic finance. Islamic finance is by definition Sharia compliant. Describing finance as Islamic or Sharia compliant is the reason the Islamic finance industry existed; otherwise, stakeholders would have pursued conventional finance. Second, while some of these policies are still relevant and useful in Islamic finance, they need to be adapted to suit the context and objectives of Sharia and Islamic finance.

It is worth noting that the role of Sharia in Islamic finance can vary depending on the location and the objectives of regulators. Because Sharia is the law and the way of life in Muslim countries, the role of Sharia in Islamic finance in such countries is far-reaching. On the other hand, secular countries may have other policy objectives behind developing Islamic finance, such as enhancing their economic growth and attracting the funds of Sharia-prudent Muslims in other countries. In such countries, the role of Sharia needs not reach farther than what is necessary to achieve such objectives. For example, Sharia compliance may be considered a subtitle of the topic of corporate governance of Islamic finance institutions, or of risk management, whereas Muslim countries would require a systemic Sharia governance framework that extends to regulations and laws and sometimes to their constitutions. In all cases, any attempt to evaluate Islamic finance policies cannot be valid without Sharia compliance (and its related issues) being a central theme.

3.2.2 Islamic Finance Policy Objectives

Based on the discussion above, there are two approaches to deriving Islamic finance policy objectives depending on the nature of such policies. The first is to derive them from Sharia and its objectives straight away, which suits the case of unique Sharia objectives. The second is to derive them from existing financial sector policy objectives, but with the Sharia context in mind, which links Sharia to the field of finance and its general objectives. Taking into account the specificities of the context in Qatar, this section will elaborate on the Islamic finance policy objectives which this study will use as evaluation criteria for Islamic finance law in genera. The main elements of the evaluation criteria are as follows:

1. Sharia governance
2. Decreasing information, transaction, and enforcement costs.
3. Financial sector Development
4. Investor and consumer protection.
5. Financial Stability.

3.2.2.1 Sharia Governance

Although Sharia is what makes Islamic finance Islamic, there are major issues with the arrangements assuring that Islamic finance is done in accordance with Sharia. Lake of such assurance can lead to a number of issues, including the following:

1. Violating Sharia: while this issue may not concern non-Muslim countries much, the legal systems of Muslim countries required to comply with Sharia.

2. Misleading information: Islamic finance institutions can gain a lot by claiming that they (or their products) are Sharia compliant. Therefore, at least from a market transparency perspective, using the name “Islamic” improperly is a fraudulent act.
3. Uncertainty: uncertainty in the interpretation and application of Islamic finance contracts increase financial risks. Uncertainty issues are more relevant in global Islamic finance transactions (e.g. Sukuk) where harmonization of interpretation is needed.
4. Financial risks: Sharia risk can cause withdrawal risk, liquidity risk, market instability and other financial risks.

As a result of such issues and others, and because of the nature of Islamic finance, Sharia governance is the most important policy objective in an Islamic financial system.

Sharia governance refers to the system by which Sharia compliance is achieved (Hasan, 2012). A Sharia governance framework of a jurisdiction can have features that set it on a micro-macro spectrum.

- An extremely micro approach does not regulate Sharia governance and relies on promoting the interests of micro economic units and market efficiency.
- An extremely macro approach will have a fully sharia-based legal system that forbids and prevents Sharia violations irrespective of the actions taken by institutions.

If Sharia governance is market driven, financial institutions will self-regulate themselves through private law. They will likely confirm to minimum Sharia standards and

disclosure standards. Public law assists private law to achieve better Sharia governance through the following (IFSB, 2009):

- Implementing international best practices.
- The regulator laws (central bank, capital market) regulating financial institutions and regulator level Sharia governance.
- A national Sharia advisory body, whose job may include harmonizing Fatwa and product approval.
- Control on negative Fatwa (e.g. criminalizing).
- The constitution of the country requiring laws to be Sharia compliant.

Examples of legal Sharia governance issues include contracts which can be declared void if the contract refers to Sharia as a source of rules. In addition, a corporate action by directors may fall ultra vires if the article of association of IIFS mandates that the corporation deals in accordance with Sharia. A common way to escape such liability is for parties to bind themselves to Sharia "as declared by the bank's Sharia board," but this is not necessarily an ideal solution from Sharia Objectives perspectives.

The choice of Sharia governance approach influences the content of Sharia standards that are to be applied on Islamic finance contracts. Under the centralized approach, the content is pre-defined. However, under the decentralized approach, the content (i.e. Sharia) can change in an unpredictable and inconsistent manner. First, the content is usually undefined, opening the door for Sharia boards to interpret the Fiqh applicable to the transaction in a very flexible manner. Second, the conflict of interest issues with the

decentralized approach increases their tendency to abuse the flexibility in interpretation (Hassan, 2016).

3.2.2.2 Decreasing Information Transaction and Enforcement Costs

Sharia has certain objectives in relation to property rights and commerce. An example of such objectives includes the following:[5]

1. All property is essentially and ultimately owned by God Almighty.
2. Property is important and out to be protected and invested.
3. Property rights ought to be protected.
4. There are moral values that control transactions.
5. Property has to be gained and invested in legitimate Sharia means and methods.
6. Property ought to be utilized and consumed efficiently.
7. The use of property ought not to harm the environment.
8. Property out to be distributed with equity and justice in mind.
9. Charity is a virtue.

3.2.2.3 Islamic Financial Sector Development

Whereas financial stability as it relates to Islamic finance was the focus of many financial regulators, such regulators thought far less about Islamic financial sector development. The following parts will give indications about the unique aspects in Islamic finance development that require more attention, especially if the regulators are more used to conventional financial sector development.

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[5] القرضاوي يوسف (2008). مقاصد الشريعة المتعلقة بالمال

Depth

Although financial depth seems less affected by the Sharia context, a simple Islamic financial depth indicator may be inadequate in serving its intended purpose. With the assumption that financial systems deliver on their intended functions, depth merely claims that an appropriate size of the financial sector relative to the economy enables it to carry out its functions (e.g. minimizing adverse selection and moral hazard). In an Islamic finance context, such functions are assumed to include Sharia compliance. For example, private Islamic finance to GDP indicates the size of the Islamic finance industry that is doing the functions of finance the Sharia-compliant way.

However, there are methodological issues with seeking to increase Islamic financial depth as a policy objective. First, such increase can be caused by an increase in general financial depth (conventional and Islamic) due, for example, to general economic growth. Second, such increase can be caused by an increase in the share of Islamic finance relative to conventional finance. Indeed, the second aspect is more specific about the relationship between conventional and Islamic finance, yet the first aspect is more passive in measuring the effectiveness of Islamic finance. In fact, the original financial depth indicators were not designed to differentiate between conventional or Islamic financial development.

Access

Access to Islamic finance can be rather different from access to conventional finance. As discussed above, in analyzing access to finance, there are three types of stakeholders:

users, voluntarily excluded, and involuntarily excluded. Financial inclusion policies focus more on the involuntarily excluded, since the voluntarily excluded are assumed to have access to finance. Although Muslims exclude themselves from the conventional financial system, they are doing so pursuant to divine commands. Therefore, they can hardly be described as having access to finance or as voluntarily excluding themselves from the financial system (El Hawary and Grais, 2005). Therefore, Muslims cannot simply be described as having access to finance unless they have access to Islamic finance.

One major implication of such interpretation is that access to Islamic finance is a universal concept that is not necessarily linked to wealth. Sharia-compliant microfinance is not necessarily the only focus of Islamic finance inclusion policies. If the financial system of a particular jurisdiction does not recognize Sharia-compliant finance, a rich Muslim is as much hindered from access to finance as a poor Muslim. In addition, access to Islamic finance for such rich Muslim is also hindered if his rural area does not have an Islamic bank. The rich are supposed to be more capable of seeking personalized and sophisticated Sharia-compliant financial services in a conventional financial system (i.e. pay more for Sharia compliance). Therefore, hindered access to Islamic finance by the rich is a more obvious sign of issues in service universality. Although, as a matter of fact, the majority of Muslims are poor, and access to finance policies in their countries (e.g. access to Islamic finance) is likely to benefit them the most, all classes of Muslims require access to Islamic finance (rich and poor). Based on the above, in addition to access to Islamic finance being a necessary policy objective, such objective needs to be universal and not limited to microfinance.

Product Range

Despite the pressing demand for a variety of financial products and services, Islamic finance products (and services) are necessarily harder to make than conventional finance products. First, Islamic finance products need to be Sharia-compliant. Unlike the simple loan contract in conventional finance, Islamic finance can only be made through Sharia-compliant finance contracts, which cannot involve an interest-bearing loan and a number of other common forms. While Sharia is wide and flexible enough to accommodate many of the key categories of financial services, the cost of making such products is a bit higher because Islamic finance institutions need to have the expertise and knowledgeable stuff not only in basic finance theory but also in Sharia. The impact of this requirement depends on the level of Sharia governance of the jurisdictions. Second, Islamic finance is riskier. As discussed in the stability section below, there are unique risks in Islamic finance contracts, and many of the known risk in conventional finance are exemplified in Islamic finance.

Efficiency

Efficiency and competitiveness are good for Islamic and conventional financial systems alike. However, due to the need to comply with Sharia, the playing field is so unlevelled that institutions offering Islamic finance services are at a competitive disadvantage by their nature. Such inequality of opportunity is due to reasons such as the following:

- Financial institutions can falsely claim that they are Sharia compliant.

- Because Islamic finance is riskier (on a micro level), Islamic finance institutions incur more costs and charge more than conventional financial institutions.
- In some jurisdictions, Islamic finance institutions are not permitted to enter the financial market.
- In some jurisdictions, Islamic finance products and services are not permitted.
- In some jurisdictions, the cost of Islamic finance is prohibitive (e.g. due to double taxation).
- Some governments may discriminate between Islamic and conventional finance (e.g. in deposits, loans, or ownership of the stocks of financial institutions).

This unlevelled playing field can have a number of adverse consequences on the growth and competitiveness of Islamic finance institutions. First, tough and unfair competition can drive genuine Islamic finance institutions out of the markets, or incur severe losses, hindering their performance. Second, it can lead to a race to the bottom where genuine Islamic finance institutions not only decrease the quality of its services, but also of its Sharia values on which it was established in the first place. As a result, Islamic finance institutions will design and structure their products in a way that appears to comply with the texts of Sharia, but violate it by violating its objectives.

3.2.2.4 Islamic Financial Sector Stability

Although financial stability is needed in all financial systems, its implementation requirements for Islamic finance are different. First, Islamic finance institutions face similar risks to those faced by conventional financial institutions, but with exaggerated

effects. Second, Islamic finance institutions face unique risks due to their compliance with Sharia (Khan and Ahmed, 2001). For example, unlike a conventional loan, a Murabaha finance contract involves not only credit risk, but also market risk, and each risk is different depending on the stage of the transaction (IFSB, 2005). Major implications of such distinctions are that international risk management standards (e.g. Basel) may not suit Islamic finance as they are, and risk management standards need to account for the unique risks and risk attributes associated with Sharia compliant financial products.

3.2.2.5 Investor and Consumer Protection

Since Sharia compliance is expensive in a globalized world, there are incentives for Islamic finance institutions to perform covert Sharia violation operations in their pursuit of profit. Since violating clear Sharia text is discoverable, such financial institutions may opt for complex financial products which appear to comply with the divine text while violating its objectives (Usmani, 2007).

With regard to creditor rights and insolvency, Sharia recognizes the right of creditors to debt recovery, yet such right is different from the one in conventional finance. First, loan is a charity contract in Sharia. Second, debt cannot bear interest. Third, an insolvent creditor has to be given another chance.[6]

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[6] See: Holy Quran.2.Verse 280

Profit and loss Sharing Investment Account (PSIA) is a unique case for Islamic bank insolvency and bankruptcy purposes. Since conventional interest-bearing saving and investment accounts are forbidden in Sharia because they are based on an interest-bearing loan contract, saving and investment accounts are based on Mudaraba in Islamic finance. Mudaraba is a company contract in Sharia, PSIA holders are considered shareholders in Sharia, and they bear the consequence of losing their stake. However, because the contract underlying PSIA is in fact an innovation to overcome the ban on conventional saving accounts, regulators and Islamic banks may well treat it similar to the conventional saving accounts for insolvency purposes. As a result, PSIA holders become inferior to shareholders in their ability to control investments. Because they are investors in the eyes of Sharia, Sharia compliance requires that they are paid last (i.e. with shareholders) when an Islamic bank is bankrupt, while interest-bearing conventional saving account holders are prioritized, and are entitled to their principal plus interest in bank bankruptcy. However, Sharia compliance per se in such instance does not grant Islamic banking consumers the same protection to their conventional banking counterpart.

Regarding shareholder rights and corporate governance, there is a higher need for Shareholder rights and corporate governance for the purpose of Islamic finance. First, Islamic finance institutions are riskier than conventional ones. Second, Islamic finance requires more transparency and disclosure than conventional finance.

Consumers are more vulnerable in Islamic finance than in conventional finance. First, in addition to the risks in conventional finance relating to misleading information, Islamic finance institutions can mislead their customers regarding the Sharia compliance of their products and services. Second, there are unique unfair contractual conditions that Islamic finance consumers are more likely to be offered. For example, financers of long-term real estate finance can dictate that in case of default, the whole debt has to be paid immediately, and ownership of the financed real estate remains with the financer. Such conditions are unfair despite being Sharia compliant on their face.

Saving accounts in Islamic banks are major concerns for consumer and depositor protection. One major difference distinguishing Islamic banks from others is the use of Mudaraba contract for saving accounts. Because of the prohibition of interest, it is the best available alternative for saving accounts to bear a return. However, providing such accounts is not straightforward. First, because Mudaraba is an investment contract in which the investor bears the risk of non-return or loss of investment, it is normally prohibited under conventional banking laws, which usually protect the principal and the interest of a loan-based saving account. Second, Profit Sharing Investment Account (PSIA) holders are described as the weakest parties in Islamic finance. Even though they are investors, they are inferior to shareholders in their ability to control investments. Their power is so limited that shareholders can dictate on them the share of profit that they retain. Because they are investors, Sharia compliance requires that they are paid last (i.e. with shareholders) when an Islamic bank is bankrupt, while interest-bearing

conventional saving account holders are prioritized, and are entitled to their principal plus interest in bank bankruptcy.

3.3 Evaluating Law

In order to evaluate law, it is important to understand its position in the context of public policy. Strictly speaking, laws can be defined as "commands of a sovereign" (Bix, 2015). However, while such definition is concerned with the nature of law, it does not reveal the context in which law is made. From a public policy point of view, law is one of many policy instruments which can give effect to public policy, and is certainly not the only instrument available to a sovereign. Policy-making excellence lies in the optimal utilization of all available policy instruments.

> ***"This view of the firm points up the important role which the legal system and the law play in social organizations, especially, the organization of economic activity. Statutory law sets bounds on the kinds of contracts into which individuals and organizations may enter without risking criminal prosecution. The police powers of the state are available and used to enforce performance of contracts or to enforce the collection of damages for non-performance. The courts adjudicate contracts between contracting parties and establish precedents which form the body of common law. All of these government activities affect both the kinds of contracts executed and the extent to which contracting is relied upon" (Jensen and Meckling, 1976).***

3.3.1 Sources of Legal Issues

Legal issues can be linked to four broad sources: universal, international, national, and micro (Chapra and Khan, 2000).

Universal issues are caused by immature literature in Fiqh or Islamic finance. Fiqh refers to Fiqh Al-Muamalat, which is the branch of knowledge of commercial rules as derived from Sharia sources. Examples of issues caused by immature Fiqh include diverse interpretations of IFC, Tawarruq and Inah permissibility, binding promise, sale of debt, and early payment compensation criteria.

Islamic finance literature is the knowledge that combines finance with Fiqh Al-Muamalat, or is a derivative of such Fiqh. Examples of issues caused by inadequate literature include lack of sharia compliant money market instruments, hedging instruments, and safety net mechanisms.

There are also universal issues which are caused by ethical considerations relating to Fiqh. Examples include credit card rates and taking advantage of customer needs, early payment ethics and the ability of managers to refuse it, and the bank's inflated profit of a declining Musharaka land financing which has been appropriated for the public interest. Not only is it problematic to solve such issues through setting rules (setting rules for early payment and Sharia compliance), but also such issues may best be left without regulation to keep the market flexible. For example, if the law (or Fiqh) defines in detail an exhaustive list of conflict of interest situations, other situations may escape;

but if the law sets principles, parties will be expected to respect the spirit of the rules, and are expected to comply better if there is a ‘comply or disclose’ policy.

International issues are caused by inadequate international cooperation in areas which are best solved on an international level. International refers to an interaction between two or more nation states as recognized by international law: interactions between international private parties are excluded.

The key role of international cooperation is to standardize best practices. Such institutions rely on the outcome of the literature, so if there is a universal issue, it is not the main role of international institutions to deal with it. For example, they can help scholars gather in one place, but they are not supposed to influence the academic literature that emerges from scholars. Rather, they are expected to standardize the outcome of such literature.

Issues on this level include inadequate standardization (e.g. of Sukuk contracts), bad standards (i.e. IILM instruments and Sharia compliance), and lack of national commitment to implement such standards (e.g. AAOIFI standards). Such issues cause other issues, including inefficiency, a race to the bottom, and Sharia arbitrage. For example, if Tawarruq is not internationally recognized as forbidden, the country or the IIFS with the least Sharia requirements will fill its balance sheet with Tawarruq which is less risky and costly compared to other IFC. Therefore, it is best for such issues to be solved on international level, and it is best for international standards to be implemented simultaneously.

National issues are caused from national laws. This part of the paper draws attention to the fact that not all legal issues are caused by national laws. Inadequate national laws can be caused by universal or international issues, so if a legal system does not base its laws on best practices or theory, it will fall behind. However, there are areas of national law which have no specific international standard (e.g. court system, contract law, banking law).

Micro issues are caused by micro economic units. Such units are given autonomy to agree in contracts within the limits of public law and the mandatory rules of private law, and such parties have the capacity to avoid the issues caused by other levels. Ignorance is the main cause of micro legal issues. This includes sharia ignorance (non-compliant contract form), legal ignorance (bad contracts). For example, parties may refer to Sharia as a source of law for contract interpretation, but ignore the fact that law refers only to national laws.

3.3.2 Islamic Finance Law

Islamic finance law is the entire body of law in one jurisdiction that affects Islamic finance in that jurisdiction. In this sense, it is important to note that Islamic finance law is not a piece of statute law with the title “Islamic finance law” but the content of such legislation and other law as they affect Islamic finance in the relevant jurisdiction. Therefore, Islamic finance law can include a wide variety of legal sources, such as constitutional articles, statute legislation, regulatory legislative instruments, and court

decisions (if binding). This study will focus on key legal areas in private law, public law, and dispute resolution.

3.3.2.1 Private law

Private law is the "body of law dealing with private persons and their properties and relationships" (Garner and others, 2004). Private law includes fields such as the law of contract, tort, company, commerce, property, family, and trade.

Contract law

The operations of Islamic banking depend on certain Sharia-compliant finance contracts on its operations. Islamic finance contracts (IFC) are finance contracts which are structured to suit the business model of IIFS and comply with Sharia and the law of a particular jurisdiction (Kahf, 2015) They can be categorized as classical or hybrid. Classical contracts are the ones derived from Fiqh without much modification. The main contracts are sale, lease, and sharing, but there are other relevant ones (Mortgage, Wakala, Qard). Hybrid contracts are invented to suit the business model of IIFS. They include Murabaha, Ijara hybrids, Declining Musharaka, lines of credit, liquidity management contracts, and Sukuk.

Financial law

Financial law is the part of private law that defines the relationship between financial institutions and customers. It can define finance products (contracts) in a way that limits party autonomy compared to ordinary contracts. It is likely to include finance,

investment, and insurance contracts. Unlike the central bank law, the financial law is the law that can give legal basis for IFC, and allows them to be enforced in courts. In addition, finance law may restrict IIFS from operating within Sharia. For example, the law may define deposits in a way that protects the principal and the return, which prevents Islamic banks from offering Sharia compliant saving accounts to a great extent. An Islamic finance law that defines to any extend Islamic finance contracts can limit legal uncertainty.

Company law

Company law is the branch of law that regulates the formation, operation, and ending of a company. There are private and public law aspects of company law. In private law, parties are free to draft company contracts. In public law, the regulators will set extra mandatory rules for establishment, operations, and liquidation. Such regulators include not only the ministry of trade, but also central banks and financial markets regulators.

It is important that the law allows Islamic finance companies to exist, operate, and end in a Sharia compliant manner and without inappropriate cost, especially Musharaka and Mudaraba. The law may define an exhaustive list of company forms which may not comply with Sharia. If the law refuses to recognize Mudaraba, Profit Sharing Investment Account (PSIA) holders will be fully unprotected; not only is this bad for the interest of the depositor, but also it causes systemic risks (liquidity, bank runs).

Investment contracts can be based on company law. Regarding company finance, the law may only recognize bonds as a means of financing, and disregards Sukuk. This will not only cause confusion regarding whether Sukuk financing is allowed, but also the corporate governance and transparency requirements on bonds may not apply on Sukuk. In addition, investment funds are a special kind of companies, and they need to be defined so as to allow for Islamic finance. If law prevents Sukuk investments, they may be issued under the investment funds law. However, if the law sets a minimum requirement for concentration, it will not allow investment Sukuk.

Insolvency law

Insolvency and Creditor Rights (ICR) refers to branches of law not limited to bankruptcy, but also including contract enforcement, mortgage and securities law, and company law. Bankruptcy is the field of law that aims at distributing the assets of the insolvent person efficiently, giving the insolvent a fresh start, and allowing for re-organization for businesses under financial stress. The law deals with the treatment of secured creditors, the priority of debt, the authority of directors in the insolvent company, and the regulation of re-organization so that the rights of creditors are not lost. ICR laws are a mixture of public and private law. In private law, creditors and debtors can agree on what happens in insolvency and similar events. In public law, the law gives the court detailed guidelines on the procedures of bankruptcy to the extent that they are similar to regulators of this area. In addition, the public registries of securities and land are matters of public law.

IIFS are creditors most of the case, and investors in Islamic finance are likely to be creditors. Interest in ICR is shared among all financial institutions, but IIFS need to secure their ICR rights more because of the unique financial risks to Islamic finance. Therefore, a jurisdiction with bad ICR may not necessarily violate Sharia, but will make Sharia compliant finance costly.

The issue of secured creditors may affect Sukuk and Islamic finance contracts if the mortgage and securities registration law is inadequate. This can happen for asset based Sukuk where the Sukuk holders own the assets represented by the Sukuk but such ownership is not formally registered in the public land register. Sukuk holders will end up with non-enforceable ownership rights in case the company issuing Sukuk went insolvent (Salah, 2010). In addition, parties can engage in securitization contracts which are based on standard conventional securitization contracts without giving due attention to Sharia. In order to make them behave like bonds and increase conventional investor demand and market liquidity, parties may issue investment Sukuk with guaranteed fixed profit in good and bad times, or plant a purchase undertaking mechanism to buy back the asset base for a fixed price- both are not Sharia compliant per se.

Other laws may set limits on investment in certain assets. Such laws include rules limiting foreign ownership in local companies, especially joint-stock companies. Others may limit ownership of real assets. This may cause direct conflict with Sukuk which is based on real assets that exist in the country having such rules as their ownership of

such assets will not be recognized. In other words, such land-based Sukuk are a fraudulent scheme if the issuer knows about the prohibition of foreign land ownership and does not disclose it.

3.3.2.2 Public law

Public law is the branch of law in which the state is a party in its sovereign capacity (Garner and others, 2004) and any branch of law where the state is not as such is private law. Areas of public law relating to Islamic banking include central bank law, government securities law, and criminal law.

Public law is not enough to regulate everything. The regulation of private law matters in public law needs not be interpreted as creating private law. For example, a public law (central bank law) defining and describing the form of a bond contract for the purpose of regulating bond issuance doesn't give legal basis for bonds: private law does.

It is also possible for a legislation regarding public law to set private law rules, but this needs to be set clearly. A private law legislation (Investment Funds law) that empowers a supervisory body to regulate it (Central Bank) is one example. A party violating such law may be subject to private law litigation with another private party (e.g. regarding the validity of the investment fund contract), a public law procedure in the administrative court against the state (regarding withdrawal of license) and a criminal court case (if criminal penalties are imposed). However, in the absence of private law, a party will find real difficulty suing a fund manager for rights under an investment fund

contract. For such reasons, there are many cases in which regulation alone is inadequate and law (private law) is needed.

Areas of public law relating to Islamic banking include central bank law, government securities law, and criminal law.

Central Bank

Among the objectives of the law of the financial sector regulator (e.g. the central bank) are ensuring financial stability and soundness, fulfilling macroeconomic objectives (e.g. control inflation and employment), maximizing the utility of stakeholders (i.e. supervisors, creditors, bank shareholders, depositors), and ensuring economic efficiency. Its law includes rules to support its objective, such as powers to license, regulate, supervise, and intervene in good and bad times. IIFS require special treatment. Not only does it require unique central bank rules, but also new supervision approaches.

The law needs to allow IIFS to exist and operate given their different business model without jeopardizing Sharia compliance. Normally, Islamic banks cannot be established in conventional systems because the law limits a bank’s objective to the seeking of profit through the trading of money. In case the law doesn’t set such objectives requirement for establishment, its operational requirements may make it unfeasible to establish, effectively prevent IIFS from establishment.

In terms of operations, conventional laws usually define the permissible activities of a bank in a way that prevents it from owning real assets for investment and from trading.

The law may also ask the bank to guarantee deposits and their interest. In effect, it is as if the law is looking at the balance sheet of an Islamic bank and purposefully forbidding every element there. In such jurisdictions, IIFS can take forms other than banks to gain freedom in operating according to Sharia (e.g. finance companies), but the economy will lose the benefit of Islamic banks: mobilizing the funds of Muslims.

Sharia governance needs to be ensured during the lifetime of the institution. This can be done on the level of the central bank through (IFSB, 2009):

- IIFS level SSB regulations, including minimum fit and proper standards, ensuring transaction and operational compliance, and preventing conflict of interest.
- Active supervision to minimize legal and Sharia compliance risk.
- A comply or disclose framework for Sharia compliance.
- Allow and regulate advisory services relating to Sharia Governance.
- Following best practices in this regard (e.g. IFSB standards).

In terms of prudential measures, the prudential standards for conventional banks (Basel) are not enough due to the unique risks of IIFS. The asset side of Islamic bank's balance sheets includes illiquid debts and risky real estate and other investments; the liability side includes PSIA accounts which are subject to severe withdrawal risk because they are not guaranteed. Basel's capital adequacy standard ignores the equity nature of

PSIA. Islamic banks are subject to higher liquidity risk. Due to the difference between conventional and Islamic finance contract, conventional surveillance mechanisms are inadequate for IIFS.

Systemic liquidity is higher for IIFS due to the lack of Sharia compliant liquidity and safety net measures (e.g. lender of last resort and inter-bank loans). In addition, the conventional deposit protection is not Sharia compliant, at least for PSIA holders who are expected to bear loss.

Regarding customer protection, there is a special need for clear transparency and advertising guidelines due to the complexity of IFC. More importantly, there are unique stakeholders who need to be protected (e.g. PSIA holders).

Securities Exchange Supervisor

The capital market supervisory law is the law that defines the relationship between market supervisors and market players. The goal of a capital market is the efficient resource allocation, and this may be done through seeking a perfect competition environment (e.g. information, product harmonization, more buyers and sellers, open entry and exit). Such market is concerned with the funding side of a company's balance sheet (money market, financial market, and equity market). Therefore, its laws will involve regulating transparency and disclosures, IPO and listing requirements, trading regulation with systemic risk in mind, and corporate governance regulations.

Such law relates to Islamic finance in a number of ways. First, it needs to allow listing Sharia compliant securities. For example, if the law defines Sukuk as those which are debt based, Musharaka based Sukuk will not be capable of listing. Second, it needs to have Sharia Governance. In addition to the institutional requirements, the regulator needs to account for the Sharia compliance of its securities for transparency purposes. Stocks which claim to be Sharia compliant need to be so from establishment (Halal balance sheet composition and company purpose), operations (compliant operations), and trading (preventing trading predominantly cash or debt based companies, so effectively preventing the trading of money or debt).

Public Finance

Public finance law refers to the methods the government is permitted to seek to fund itself. Other than by fees or taxation, this is commonly done through sovereign bonds and treasury bills. Such law may not allow for Sharia compliant public finance. This not only prevents the government from financing itself, but also deprives it from a macroeconomic tool to regulate money in the market. In addition, this creates an uneven playing field where conventional banks have access to risk free securities and Islamic banks suffer from excessive liquidity.

3.3.2.3 Dispute resolution

Most of the case, private law is based on the doctrine of the autonomy of contract: parties are free to govern their legal relationships contractually to a great extent. This

freedom is limited by mandatory laws and public policy, and the limitation varies with the forum jurisdiction (Ayres, 1998). The law may impose certain conditions on certain forms of contracts without giving the parties a chance to differ (e.g. a loan with interest contract is void). Public policy is a vague concept, and it varies between countries. Mandatory rules under the private law of a country may be considered a matter of public policy, but the concept can extend to other implicit rules. Situations involving the public policy defense include enforcing an arbitration award on a party during bankruptcy proceedings (Deitrick, 1984).

Parties can choose other governing rules than the law of the forum state. If they do it through litigation, their freedom will still be limited to the chosen law of the other state (Substantive law). However, they will have more freedom to differ if they choose arbitration as a dispute resolution mechanism. They can choose the set of rules that suits them, and the enforcement of such rules will be subject to less limitations.

The impact of private law enforcement on Islamic finance transactions is tremendous. The basic rule is that parties are free to contract, so Islamic finance contracts are permissible. However, some issues are mandatory by the private law of the state (e.g. the guaranteed return on a deposit). Parties may escape from this rule through choosing a different substantive law to govern the legal relationships, or add an arbitration clause.

3.4 Evaluation Criteria for Islamic Finance Law

Table 3 Evaluation Criteria for Islamic Finance Law

Evaluation criteria →		Sharia governance	Financial infrastructure			Financial sector development				Investor and consumer protection			Financial stability
↓ Area of law			Information	Transaction	Enforcement	Depth	Access	Product range	Efficiency	Creditor	Shareholder	Consumer	
Private law	Contract	√		√				√					
	Finance	√		√				√					
	Company	√		√				√		√	√		
	Insolvency	√			√					√	√	√	√
Public law	Central bank	√	√	√		√	√	√	√	√	√	√	√
	Securities exchange	√	√	√		√	√	√	√	√	√	√	√
	Public finance	√	√	√									
Dispute resolution		√			√					√	√	√	

Source: Researcher

Having discussed Islamic financial sector policies and legal evaluation, this section highlights the relevant areas of law for the purpose of evaluating Islamic finance law, and the relationships between different evaluation criteria, as shown in Table 3 above. First, this study recognizes Sharia governance evaluation as relevant in all areas of Islamic finance law. This does not discredit the preference of non-Muslim and some Muslim countries in adopting micro Sharia governance frameworks, limiting role of Sharia in relation to some areas of law. Sharia relevance may well conflicts with other

criteria, leading to Islamic finance innovation on the part of sector players to maintain Sharia compliance while maintaining a profitable business model.

Second, the evaluation matrix reveals conflicting objectives that need to be reconciled in order to reach an efficient outcome. For example, whereas the literature shows conflict in some criteria which needs to be conciliated, such as in the case of development and stability objectives (Competition Committee, 2011), Sharia adds another dimension that needs to be conciliated with the others. Sharia conflicts at some point with both development and stability objectives, both of which are in conflict with each other at some point. A study of Islamic financial systems cannot be complete without revealing such conflicts.

Third, public law does not establish property rights per se. Central bank and securities exchange regulations are not sufficient for building the pillars of financial infrastructure (i.e. information, transaction, enforcement) as this criterion relies heavily on the definition of property rights and other legal rights in private law. In addition, while developing product range may be a mandate of the financial regulator, such development cannot occur unless such products are legally permissible.

CHAPTER 4 EVALUATING ISLAMIC FINANCE LAW IN QATAR

According to the constitution of the state of Qatar, the religion of the State "is Islam and the Sharia Law shall be the principal source of its legislation."[7] This principle is supported in various places. For example, the Civil Code recognizes Sharia if the law is inadequate, contrary to regional trends which prioritize customs over Sharia.[8] In addition, the Commercial Code avoids legalizing and regulating interest, contrary to regional trends.[9]

The effect of such principle is that a sharia-violating law will be struck down by the Constitutional Court. This sets the assumption that laws will generally not violate sharia. A legislation stating that law is superior to sharia does not intend to violate it. It merely aims to build a Sharia position in relation to Fiqh schools of thoughts. In addition, given that Sharia is a source of law, it will be used for interpretation if the law is insufficient.

4.1 Private Law

The main laws regulating Islamic finance contracts in Qatar are the Civil Code and the Commercial Code. The Civil Code is based on the work of Al-Sanhory, who drafted the code in accordance with sharia (Bechor, 2007).

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[7] Article 1 of The Permanent Constitution of the State of Qatar

[8] Article 1 of Law no (22) of 2004 on the Civil Code

[9] Law No. 27 of 2006 on the Commercial Code

4.1.1 Contract law

4.1.1.1 Sharia Governance

However, while some countries accept violations of Sharia in their civil codes (e.g. by allowing interest), the Qatari law observes Sharia. This is also applicable to the commercial Code, which avoided interest clauses despite contradicting other similar Arab laws. This is more obvious in defining the limits of Islamic transactions. [10]

4.1.1.2 Financial Infrastructure and Product Range

According to the Civil Code, contract is the law of the parties (A171), but this principle is limited to issues which are capable of contractual agreement. Both Civil Code and the Commercial code set default clauses for some standard forms of contract. The forms include:

1- Sale (A419) The commercial code adds installment sale (A125)
2- Gift (A492)
3- Musharaka (A515)
4- Mudaraba (A554-563)
5- Qard (A564-572)
6- Ijara (A582-669)

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[10] For example, it defines a loan as "a loan of money (or suitable property) for the same amount of money (564)" and forbids Riba explicitly by stating that where the loan contract provides for a benefit greater than the amount agreed in the contract, other than the security to the right of the lender, the provision shall be annulled while the contract shall be valid (A568). It also regulates Gharar, and Gambling (A763).

7- Muzaraa (A660)
8- Istisna (A682)
9- Wakala (A716)
10- Amana/Wadiaa (A738)
11- Kafala (A808)

The law also sets the conditions of valid contracts, including for Arboon (A100), future usufruct as a consideration (A184), transfer (Hawala) of Debt (A324-353).

Contract law in Qatar, whether in the Civil Code, the Commercial Code, or elsewhere, is Sharia compliant to a large extent, and sometimes Sharia enforcing.

The civil code sets the basis of property (real estate) rights. Relevant principles include:

1- Jurisdiction: law of the country of the land applies to the rights and obligations of the land (A25).
2- Property rights: property rights include the right to use, to benefit from usufruct, and to dispose (A837).
3- Security rights include:
    a. Mortgage
    b. Lien (similar to mortgage, but claimed after a court decision)
    c. Pledge (Mortgage with the legal title of the property with the mortgagee (bank) or a third party)
    d. Privilege (prioritized debt by law or contract)
4- The commercial code sets broader security rights in the same categories (e.g. mortgage on movable assets) and sets the order of secured creditors relative to unsecured creditors in bankruptcy.

Other laws set some limits on ownership of fixed assets, including:

1- GCC citizens can have very limited ownership rights on land, but traders can own and trade land if their commercial activity is permissible under GCC treaties.11
2- Foreign persons cannot own fixed assets, but they can have a right to usufruct. There are also situations where they can own fixed assets (in designated areas such as the Pearl). Lease is a real estate right and has to be registered, and can be subject to use, benefit/invest, and disposal/inheritance.[12]
3- The public debt law allows for Sukuk issuance to finance the government, but it sets no farther rules on the permissibility of foreigners to own assets represented by the Sukuk.13
4- The public properties law forbids public property from being subject to private ownership, and public property include public roads, bridges, and natural resources. This poses issues relating to asset-based Sukuk issuance to finance the government.[14]

There are other limits on foreign ownership of companies in Qatar, including:[15]

1- A 49% cap that can be broken in exception fields (agriculture, industry, health, education, tourism, natural resources, energy, mining, advisory, IT, sport, leisure)
2- Foreign ownership is not allowed in areas such as banking, insurance, agency, land brokerage.

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[11] Law No. 2 of 2002, regarding GCC citizens ownership of real estate

[12] Law no. (17) for the year 2004 Regarding Organization of Ownership and Use of Real Estate and Residential Units by non-Qataris

[13] Law No. 18 of 2002, regarding public debt and Islamic financial instruments

[14] Law No. 10 of 1987, regarding public and private properties of the State

[15] Law No. (13) of the year 2000 on Organization of Foreign Capital Investment in the Economic Activity

3- Joint-stock companies have a 25% cap, unless a higher threshold exists in the article of association.

The law is not detailed in setting the rules regulating securitization (e.g. SPV, guarantees, special taxation). In addition, Sukuk law doesn't exist in Qatar. Sukuk issuance can only rely on the civil code and the commercial code, which are not detailed enough.

4.1.2 Financial law

The banking and finance law relies on the civil code to build the legal basis of transactions, and the Commercial code specifically regulates commercial papers and a number of banking transactions. Commercial papers include Bills of Exchange, promissory notes, and Cheques.

4.1.2.1 Sharia Governance

It can be noted from various rules that the commercial code is drafted with sharia compliance in mind. First, the law avoids regulating interest, contrary to regional trends. Second, the definition of a cash deposit is similar to that of Qard (A344). Third, discounting securities is early payment of the monetary face value of a commercial paper, no more nor less (A400). Fourth, the code includes no apparent violations of Sharia.

4.1.2.2 Financial Infrastructure

Financial transactions that are referred to in the Commercial Code include:

1- Cash Deposit (A344-351)
2- Deposit of Securities (A352-361)
3- Rent of the Safe Deposit Boxes (A362-370)
4- Bank/Account Transfer (A371-379)
5- Simple Credit facilities (A380-385)
6- Letter of Credit (A386-399)
7- Discounted Securities (A400-405)
8- Letter of Guarantee (A406-413)
9- Current Account (A414-428)
10- Acceptance Credit (A429-431)
11- Credit Cards (A432-434)
12- Collection of Securities (A435-438)
13- Loan with the Guarantee of Securities (A439-446)

Despite the attempt of the Commercial Code not to violate Sharia, and because the original texts of the Commercial Code were intended for conventional finance, its treatment of financial transactions is not complete. It is particularly not specific about Islamic finance transactions. It can be argued that many of such transactions have already been defined in the Civil Code (e.g. Mudaraba), yet the Commercial Code does not do a good job integrating them for the purpose of finance. This is more evident in its treatment of deposits in a manner that does not account for the Mudaraba basis of saving deposits.

Based on the above, the private finance law in Qatar, as stipulated mainly in the Commercial Code, is not sufficient as financial infrastructure for Islamic finance. Specifically, the property rights and the transactions defined in the law need to cater for the nature of Islamic finance.

4.1.3 Company law

Company law is mainly regulated by the commercial Company law[16], but some other laws apply (e.g. Investment Funds law, civil code).

4.1.3.1 Sharia Governance

The Company law in Qatar is generally Sharia compliant, with few issues severely affecting Islamic financial operations. In addition, while company law regulates topics such as bond issuance, Qatar company law does not mention interest among the rules that regulate bond issuance, even though interest is an integral part of bonds (A169-A181).

4.1.3.2 Financial Infrastructure

The company law states that any company that does not take the forms listed in the law is void (A5). However, the company law does not list Islamic finance companies, while the civil code does. The Civil Code allows for the establishment of Sharia-derived companies, such as Mudaraba (A513 of the Civil Code). This issue is more relevant for the Mudaraba Company.

The commercial register states that nobody shall practice commercial activities or set a business place without registration in the commercial registry (A7). This may have effects on some contracts (e.g. declining Musharaka, Mudaraba line of credit).[17]

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[16] Law No. 11 of 2015, promulgating the Law of Commercial Companies

The Investment Funds law is the main legislation regulating mutual funds.[18] The law gives three authorities regulatory powers: the central bank, the ministry of business and trade, and the securities exchange authority. This law is supported by the regulations issued by the minister. The regulations are more detailed in areas relating to the minimum standard to be observed by the fund and the persons dealing with it. The law is also supported by the central bank regulation on investment companies, and the central bank has the power to impose some penalties including withdrawing the license of investment companies.

4.1.3.3 Investor Protection

The mutual funds rules are compatible with international practices to an extent, and it deviates in some areas. One of the major differences is the concept of the founder. The founder in the investment funds law is supposed to be the same as the Sponsor. While the sponsor has very limited powers in other jurisdictions, the founder of a mutual fund in Qatar enjoys dictatorship powers in relation to the unit holders. Unit holders are considered shareholders in other jurisdictions, and have many of the rights of shareholders, including the right to decide and vote on major issues, similar to a shareholder of a company. The difference in power between investors and founders in Qatar is strange, and has implications on the performance of investment funds.

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[17] Law No. 25 of 2005, regarding the Commercial Registry

[18] Law No. 25 of 2002, regarding Investment Funds

4.1.4 Insolvency law

The Commercial Code regulates bankruptcy and the Companies law (and sometimes the Civil Code) regulates liquidation and winding up. The triggering event is defined as stopping to pay debt because of a balance sheet or credit issue (A606 of the Commercial Code). Bankruptcy can be requested by the debtor, the creditor, the public prosecution, or ruled by the court nevertheless. (A608) The court appoints an official to manage the insolvency (A676). Secured creditors are protected in a bankruptcy (A626-675).

4.1.4.1 Sharia Governance

The Commercial code does not regulate the issue of PSIA account holders in the case of bankruptcy of Islamic bank. However, the central bank law contains specific provisions for the insolvency and liquidation of financial institutions, and specifically states that IIFS Shall be liquidated in accordance with Sharia (A112). Although such rule needs subordinate regulations to lay the details of such liquidation, including the details relating to the treatment of PSIA, it is sufficient as the seeds for subsequent regulations by the Central Bank.

4.1.4.2 Investor Protection

The insolvency procedure may not be in line with the best practices around the world. Additionally, the bankruptcy of financial institutions is subject to other conditions as set out in the central bank law.

4.2 Public law

The Sharia governance framework in Qatar is comparatively satisfactory, but far from ideal. The central bank law relies on detailed guidelines on the SSB which have not been issued yet. The securities markets authority has no proper rules. The law does not set a national SSB.

4.2.1 Central Bank

Qatar Central Bank law [19] vests into the central bank the power to regulate all institutions offering financial activities, whether Sharia-compliant or otherwise, including banking, investment, and insurance (A77-113). This law is one of the least sharia-compliant laws in Qatar since it allows for Riba-based finance. However, the law is careful in limiting the use of the word 'interest' to a minimum:

- A1: Interest is first used in the definition of a deposit.
- A65: Interest is used as a benchmark for the penalty imposed on an institution.
- A70: the central bank has right to set the price for interest or profit for deposits
- A104: the goal of IIFS is providing finance that is not interest-based

Whereas such regulations regulate issues which are not Sharia compliant, such regulation is arguably necessary. The financial system in Qatar is mixed between Islamic and non-Islamic financial institutions. At least for the sake of monetary policy and

[19] The Central Bank and Financial Institutions Law No. 13 of 2012

financial stability, the central bank has to regulate the cost of finance born by micro economic units, whether it is called interest or profit.

On the other hand, the 2012 law took a step forward by introducing a chapter on the regulation of Islamic finance institutions. The main provisions of the chapter include:

1- Islamic finance institutions
    a. 104: Goals
    b. 105: permission to practice what is necessary
    c. 109: central bank powers in Islamic finance
        i. deposit in Islamic banks
        ii. Islamic banks deposit in central bank
        iii. Implementing netting and settlement system
        iv. lender of last resort for IIFS
        v. trading financial securities with IIFS
        vi. issuing Sukuk
2- 110: supervision rules shall set
    a. liquidity
    b. capital adequacy
    c. risk management ratios
    d. maximum exposures
    e. maximum investment in companies
    f. maximum exposure to single project
    g. maximum credit per client
    h. maximum investment abroad
    i. required reserve
3- 111: converting conventional to Islamic
4- 112: liquidation in accordance with sharia
5- 113: the law and by-laws applies as far as it doesn't conflict with sharia

The law is elaborate in granting the necessary powers to the central bank, but many of the powers rely on details to be set by the central bank in subordinate regulation. While some of the needed regulations have been issued, other areas are being covered continuously. In addition, some areas relating to Islamic finance are covered based on working instructions which were later integrated into the central bank code of regulations. The regional and global market, technological, financial innovation and regulatory environment is rapidly changing and the central bank is working continuously to offer the required support. An example of the central bank approach can be illustrated in the Tawarruq, which was regulated in a circular as follows:[20]

1- Based on many fatwa, reverse Murabaha deposits are prohibited by the central bank
2- "Regulated" Tawarruq is accepted subject to certain conditions, and "organized" Tawarruq, which is not accepted.
3- banks should:
    a. avoiding reliance on Tawarruq in general
    b. refrain from organized Tawarruq and its finance products
    c. use organized Tawarruq in very exceptional cases, and in accordance with the SSB rulings in cases including:
        i. purchase of conventional debt to convert customers to Islamic banks
        ii. financing essential consumer needs
        iii. financing government projects which can hardly be financed otherwise

[20] Instructions to Banks 2030 Chapter 7 Part 1

iv. liquidity management

4- Each SSB in a bank needs to set detailed rules on Tawarruq.
5- The commodities used must
   d. be bought by the consumer, and not by the bank as an agent, and in such way that the bank bears responsibility.
   e. not include securities in Qatar exchange
   f. not include metals of international metal exchanges, unless necessary and with the approval of SSB.

Areas for further continuous improvement include:

1- application of AAOIFI standards.
2- Profit distribution to PSIA holders.
3- Risk management of Islamic banks and their products.
4- Clarity of instructions concerning binding or non-binding nature of promise-based contracts.

Sharia Governance

A number of Sharia governance articles were introduced in the latest Qatar Central Bank law.[21] According to the law, each institution shall have a Sharia Supervisory Board (SSB) of no less than three persons appointed and removed only by General Assembly (A106). They have to avoid conflict of interest (A107) and their tasks include sharia audit on operations, and opinion on sharia compliance (A108).

[21] The Central Bank and Financial Institutions Law No. 13 of 2012

Subsequent regulations of the central bank elaborated more on Sharia governance.[22] The corporate governance guidelines dealt more extensively with the requirements of SSB and added ex-ante regulation for a number of decisions relating to SSB members and their work. In addition, the regulation required the establishment of internal Sharia audit units. While the central bank does not have a central SSB structure, its approach to Sharia governance seem to be in line with best practices, such as the ones recommended by IFSB (IFSB, 2009).

Financial Infrastructure

Due to the Islamic context of the legal system in Qatar, and to the drafting of the central bank law, the central bank law and regulation are causing no major issues relating to the costs of information, transaction, or enforcement as it relates to Islamic finance. While the central bank could do better in decreasing such costs, this is an issue of implementation of law, not of law itself.

Financial Development

The law of the central bank grants it the power to license banks and financial institutions, including IIFS. Therefore, there are no major laws that prevent the development of the Islamic finance market.

[22] Circular No 68 of 2015

Financial Stability

The central bank law paid attention to the unique nature of risks in IIFS, and granted the central bank the necessary powers to ensure the stability of the financial system in light of the special needs of IIFS. The central bank has also issued regulations based on the IFSB recommendations in this regard.[23] Therefore, the central bank is filling the gaps.

Investor and Consumer Protection

The central bank law paid due regard to consumer protection. Among the regulated areas are transparency, misleading advertisement, and quality of service. Of particular interest to Islamic finance the requirement that there is a pre-approval requirement for products, in addition to a requirement of transparency and the need to reveal all terms and conditions to the consumer at the time of signing.

While consumer protection is generally useful, it is of particular utility for Islamic finance because of its complexity and the vulnerability of its consumers. The central bank law grants the central bank the necessary powers for the purpose of consumer protection. However, more elaborate subordinate regulations are needed for the purpose of protecting Islamic finance consumers in particular.

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[23] Circular No 6 of 2014

4.2.2 Securities Exchange Supervisor

The Qatar Financial Markets Authority law[24] is the financial markets supervisory law in Qatar.

Sharia Governance

On the level of the securities markets authority, the regulations are rather passive and insufficient in setting strong Sharia governance. Attempts in this direction include:

1- Fatwa is only required for Sukuk issuance. [25] The fatwa has to include the name and qualification of Scholars and the fatwa in full. The regulations say nothing about regulating other securities (e.g. investment funds, stocks).
2- The Sukuk and Bonds offering and listing Regulation defines the SSB as the committee that ensures the Sharia compliance of the Sukuk.
3- The Corporate Governance Regulation includes nothing about Sharia Governance.

Relevant considerations include:

1- Sukuk definition
    a. The law considers Sukuk a financial instrument (A1)
    b. The IPO and Listing Regulation (issued by the authority) defines Sukuk in a bad way: Sukuk are certificates that recognize debt on the issuer in accordance with Sharia. The issuer has to pay the holder some return, but

[24] Law No. 8 on 2012

[25] The IPO and Listing Regulation by QFMA

should not call it interest or fixed-income. (A1) This definition indicates that Sukuk are fixed-income only, and this is true despite no

c. The Sukuk and Bonds offering and listing Regulation defines Sukuk in a different way: Sukuk are those Sukuk which are issued in accordance with Sharia.

2- Trading in the market: the Secondary Market Listing Regulation imposes no restrictions on trading. So a Murabaha-based Sukuk is not prevented from being listed in the market.

3- Investment Funds: the Investment Funds Market listing Regulation sets limits to exposure of funds to parties and types of investments. This makes it difficult to issue investment or project-specific Sukuk under the investment fund form.

4.2.2.1 Public Finance

The latest public finance law in Qatar contains a number of provisions of relevance to Islamic finance.[26] It included "Islamic financial paper" among the instruments the government can seek to raise public finance, and makes all the necessary changes.

4.3: Dispute resolution

Since Qatar is a Muslim country, and given the Islamic source of its law, Islamic Finance Contracts are supposed to be enforceable provided that they comply with sharia. In addition, since the law forbids Riba, if a loan with interest contract goes to court, the interest part will be nullified.

[26] Law No. 2 on 2015 on Public Finance

The current provisions regarding arbitration in Qatar are sufficient but far from ideal.[27] They are sufficient to enforce Islamic finance contract arbitration awards. However, since the law is not based on the UNCITRAL model law on arbitration, the arbitration clause in each contract needs to be drafted with care and in a way that avoids the inadequacy in the law (e.g. a no-appeal clause).

The impact of private law enforcement on Islamic finance transactions is tremendous. The basic rule is that parties are free to contract, so Islamic finance contracts are permissible. However, some issues are mandatory by the private law of the state (e.g. the guaranteed return on a deposit). Parties may escape from this rule through choosing a different substantive law to govern the legal relationships, or add an arbitration clause.

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[27] CIVIL AND COMMERCIAL PROCEDURE LAW - Law No. 13 of 1990

CHAPTER 5 CONCLUSION

The discussion above can be summarized in Table 4 below. While it is not statistically robust, it is meant to translate the analysis into numbers so as to give an indication of the performance of Islamic finance law in Qatar. The areas of law that have been evaluated against each evaluation criteria are given a number from 1 (worst) to 10 (best) with 7 being the expected standard.

Table 4 Evaluation of Qatar Islamic Finance Law

Evaluation criteria →		Sharia governance	Financial infrastructure			Financial sector development				Investor and consumer protection			Financial stability
↓ Area of law			Information	Transaction	Enforcement	Depth	Access	Product range	Efficiency	Creditor	Shareholder	Consumer	
Private law	Contract	8		8				9					
	Finance	7		7				7					
	Company	8		7				7		7	7		
	Insolvency	8			6					7	7	7	7
Public law	Central bank	7	8	7		8	7	7	7	7	7	7	8
	Securities exchange	7	7	7		7	7	7	7	7	7	7	7
	Public finance	7	6	7									
Dispute resolution		7			6					6	6	6	

(Source: researcher's own template and assessment)

Based on the analysis above, the legal infrastructure for Islamic finance in Qatar can be considered more than good. The legal system is Sharia compliant and Sharia enforcing to a large extent. The financial infrastructure for the practice of Islamic finance exists to a great extent, and can be improved with better adaptation of Islamic finance transactions in the Commercial Code. The legal basis for Islamic financial sector development exists, and the proactive support of the financial regulator to utilize such legal powers offers a great opportunity in the ways forward. The legal basis for the protection of financial customers in general and Islamic finance customers in particular exists, although it needs farther details in the form of subordinate legislation. Investor rights are fairly good, yet the can be improved by meeting international standards. Financial stability for Islamic finance is also well catered for in Qatar.

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