

The possible inclusion of legal provisions in Islamic banking and finance

The case study of the Mozambican regulatory framework

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Abstract

Purpose – This paper aims to thoroughly examine the extent to which the current legal and regulatory framework is inclusive towards Islamic banking and finance (IBF) practices in the attempts to introduce IBF as a significant component in the Mozambique's financial system. This is achieved by providing a critical review on the Mozambican current legal and regulatory framework including the court and arbitration system, as well as the country's financial institutions law and regulations.

Design/methodology/approach – The methodology used in this study is the qualitative approach. The analysis made is based on descriptive and analytical approach whereby the study examined and critically analysed the banking regulations in Mozambique with the purpose of finding the legal gap in the existing legal and regulatory framework that allows the introduction of IBF in the country.

Findings – This study finds that whilst some legal provisions in the current legal and regulatory framework are conflicting with the *Shari'ah* principles such as the definition of loans and the concept of interest, there is also a certain number of enabling features that can be immediately explored, including deposits (with no interest), leasing operations, investment funds or venture capital.

Research limitations/implications – At present, to the best of the authors' knowledge, this is the first attempt ever made to assess the compatibility of the existing Mozambican commercial laws with the Islamic principles hence identifying the challenges that might arise due to the implementation of IBF practices in Mozambique.

Practical implications – This paper has several practical implications in the sense that it helps the financial market authorities in Mozambique to be able to foresee possible inclusion of provisions on Islamic transactions in the country's existing financial regulations.

Social implications – The contributions of this paper lie in the valuable recommendations made on the insertion of Islamic principles in the current regulatory framework as well as assisting in overcoming some of the conflicting aspects in medium to long term. Mozambique should explore and benefit from the experience and lessons learned by the neighbouring countries that have successfully adopted the IBF practice. It is recommended that the Central Bank should establish a "task force team", comprising of multi-skilled professionals and experts in Islamic finance from various internal areas ranging from licensing to supervision together with *Shari'ah* scholars and representatives from the Muslim Community, to study the required process for adoption of IBF in the country.

Originality/value – There is no other study on IBF in Mozambique, particularly on legal and regulatory aspects.

Keywords Mozambique, Islamic banking and finance, Legal and regulatory framework, Potential adoption

Paper type Case study



1. Introduction

Islamic banking and finance (IBF) is hitherto present in more than 50 countries worldwide, providing wide opportunities for Muslims to participate in mainstream business activities in *Shari'ah* compliant manners. Unlike its conventional counterparts, Islamic financial institutions (IFIs), although accepting depositor's money in the savings and investment account, do not offer loans to finance business activity. Instead, they provide financing facilities using several underlying Islamic transaction contracts, such as sale, leasing as well as joint ventures and business partnerships. In the spirit of ensuring economic and social justice, the IBF forbids any unjust accumulation of wealth while upholding the basic prohibitions in the Islamic commercial law including avoidance of *riba* (interest), *gharar* (excessive uncertainty and speculation) and *maysir* (gambling) as well as other prohibited elements, such as pork and alcohol-related business activities and *Shari'ah* non-compliant entertainment (Laldin, 2014).

In the African financial system, the IBF was successfully adopted by the majority of African countries, including Nigeria, Kenya, Uganda, South Africa, Malawi and Tanzania despite the existing legal settings of those countries that did not initially recognise the peculiarities of IBF transactions. This success story has inspired other African countries including Mozambique, which is the subject of interest of the present study, to introduce IBF practices in the country's financial and legal environment. This is indeed necessary as pointed out by Dr Michael Gondwe, the Governor of Bank of Zambia, that the majority of Muslims in African countries have to restrain themselves from using banking and finance products offered by the existing commercial banks as it is against their religious beliefs. Mozambique, as a member country of the Islamic Development Bank (IDB) since 1995, in the 39th Annual Meeting of the IDB Board Governors, accepted technical assistance from the IDB to facilitate the establishment of a financial and regulatory framework for IFIs in the country. This initiative includes the expansion of Islamic finance facilities to the private sectors especially small and medium enterprises (SMEs), which are in need of capital and liquidity to execute their business operations. It is worth mentioning that the country's current setting, including the hosting of the upcoming IDB's Annual Meeting, would likely bring more awareness and hence motivate the public, financial services providers, local government and other stakeholders of the country's economy in moving closer towards the adoption of IBF.

Despite this promising environment, there are serious questions as to whether the country's existing legal framework is inclusive enough to cover all aspects of IBF and the unique features and requirements of Islamic financial contracts. In answering this question, this paper aims to thoroughly examine the extent to which the current legal and regulatory framework are inclusive of IBF practices in the attempt to introduce Islamic finance as a significant component in Mozambique's financial system. This is achieved by providing a critical review of the Mozambican current legal and regulatory framework including the court and arbitration system, as well as the laws and regulations of the country's financial institutions with emphasis given to:

- the Central Bank Law (CBL; law no. 1/92 of 3 January);
- Law of Credit and Financial Institutions (law no. 15/99 of 1 November);
- Regulation of Credit Institutions and Financial Institutions (enactment 56/2004 of 10 December);
- Regulation of the Deposit Guarantee Fund (DGF; enactment 49/2010 of 11 November);

- Regulation for Establishment and Operation of Investment Funds (enactment 54/99 of 8 September);
- Regulation for Establishment and Operation of Venture Capital Investment Funds (enactment 56/1999 of 8 September); and
- Microfinance Regulation (enactment 57/2004 of 10 December).

Mozambique's civil framework is largely based upon Portuguese-Roman law with several reforms made in 1975, 1990 and 2004 including the shift from a single to multiparty political system and reinforcement of the individual rights and independence of courts. At present, to the best of our knowledge, this is the first attempt to assess the compatibility of the existing Mozambican commercial laws with the Islamic principles hence identifying challenges that might arise due to the implementation of IBF practices in Mozambique. This is important as it is believed that the successful inclusion of provisions on Islamic transactions into the existing conventional financial system will be dependent on, among others, the understanding of the existing legal and regulatory framework that governs the financial system (Muneeza *et al.*, 2010). This paper may have several practical implications in the sense that it helps the financial market authorities to foresee possible inclusion of provisions on Islamic transactions in the country's existing financial regulations.

The remainder of this paper covers the following: Section 2 describes the Mozambique's socio-economic profile and the Islamic finance development in Sub-Saharan Africa with a focus on the Southern African Development Community (SADC) region, Section 3 presents the description of the Mozambican Legal and Regulatory Framework and Section 4 includes the discussion and findings pertaining to the introduction of Islamic finance in the country.

2. Literature review

2.1 Mozambique's socio-economic and cultural aspects

The Republic of Mozambique is located on the southern tip of Africa, sharing borders with South Africa and Swaziland on the south; Zimbabwe, Zambia and Malawi on the west; Tanzania on the top north and Madagascar on the east separated by the Mozambique Channel. Mozambique is considered the 35th largest country in the world by land area of 799,380 km². The country is extensively rich with natural resources including water supply from plenty of rivers crossing the country, minerals and energy such as coal, gold, gemstones, titanium, bauxite and natural gas, hydroelectric facility and also a coastline of 2,500 km, containing an abundance of marine resources. Most of these resources are still currently untapped and not fully explored. However, it is expected that they will become significant contributors to the country's GDP in the future.

Mozambique has ten provinces with one capital city, namely, Maputo City that has a provincial status. The major provinces in terms of area and population are located in the north, Niassa province with 122,827 km² and Nampula province with 3,985,613 of the population, respectively. According to the 2007 Population Census provided by the National Statistics Agency, the country's total population was around 20 million people of which 28 per cent were Roman Catholic; 27 per cent were either Protestant, Pentecostal or Evangelical; 18 per cent were Muslims; 9 per cent consisted of small religious groups and approximately 18 per cent did not profess a religion. The more recent projection made by the World Bank suggests that there is a population of 26.47 million people in Mozambique in 2014 with an annual average growth rate of 7 per cent. It also indicated that, according to the 2009 National Poverty Lines, 54.7 per cent of the Mozambican population live in poverty and their life expectancy lies around 49 years, which is six years lower than that of the average Sub-Saharan over the same period.

Mozambique was colonised by the Portuguese Empire for almost four centuries, from 1505 till the country achieved independence in 1975. Two years later and for nearly 15 years, the country suffered from a devastating civil war that ended in 1992 after the United Nations (UN) managed to negotiate the peace agreement between The Front for the Liberation of Mozambique (Frelimo) and the rebels, Mozambique National Resistance (Renamo). Subsequently in 1994, the first multiparty national elections were held and gave victory to Frelimo, the present ruling party (after which won the next four consecutive elections in 1999, 2004, 2009 and 2014).

2.2 Mozambique's economic developments and key challenges

Astonishingly, as a low-income developing country that experienced only 20 years of socio-economic stability, Mozambique has been recently commended by the International Monetary Fund (IMF) after having displayed robust and stable economic growth and moderate inflation [International Monetary Fund (IMF), 2013]. It is also claimed that despite the struggles to recover from the 2013 floods, Mozambique still managed to achieve 7 per cent growth of GDP, which is higher than that of Sub-Saharan African and Middle Eastern and North African countries, which recorded below 4 and 6 per cent, respectively. This achievement was associated with the strong growth of coal mining, robust performance of the infrastructure (e.g. construction, transportation and communication) and highly effective financial services, therefore demonstrating a resilient economy against natural disasters [International Monetary Fund (IMF), 2014a, 2014b]. Despite that, Mozambique still holds one of the lowest GDP within the SADC region. Figures 1 and 2 illustrate Mozambique's GDP per capita in USD and its average GDP comparative to the Middle East and North African and Sub-Saharan African regions, respectively.

At present, one of the main GDP contributors is the agricultural sector, contributing on average 32 per cent of the country's GDP per annum and using 70 per cent of the population. On the other hand, with regard to the public finance, tax revenues account for approximately 25.9 per cent of the GDP, which covers only 4 per cent of the government expenditure, whereas the remaining amount is based on domestic financing (60 per cent),

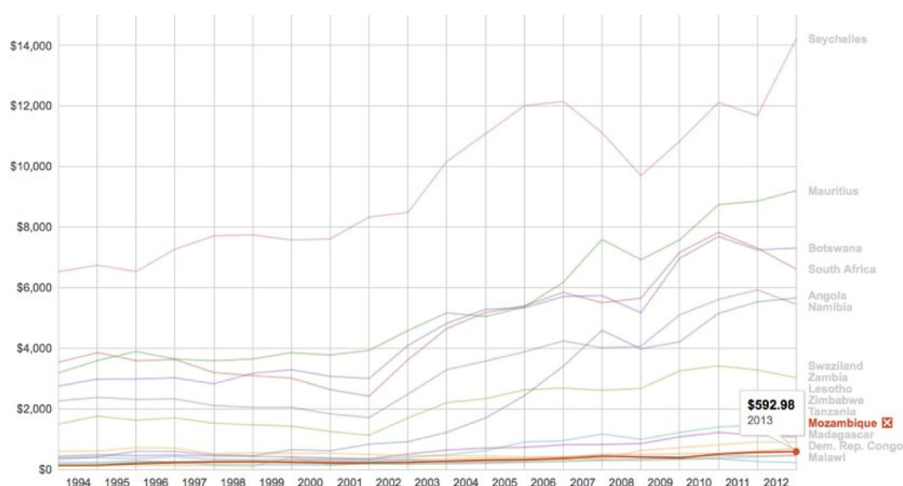


Figure 1.
Mozambique's GDP
per capita in USD

Figure 2.
Mozambique's
average GDP
comparative to the
Middle East and
North African and
Sub-Saharan
African regions



Source: World Bank

donations (13.2 per cent) and external loans (22.8 per cent) (Almeida-Santos *et al.*, 2014). In addition, the government debt reached 42.80 per cent of the GDP as at 2013.

2.3 Mozambique's present financial system

According to the 2014 African Economic Outlook, the financial sector in African countries is considered to be underdeveloped but is forecasted to experience a quick expansion and development in the coming years. Currently, there are 18 commercial banks operating in Mozambique with 85 per cent of the total banking assets concentrated on three major banks, namely, *Millennium Bim* (BIM), *Banco Comercial de Investimentos* (BCI) and the South Africa's Standard Bank. Also, there are 166 institutions registered at the Central Bank as microfinance or micro-banking institutions (MFIs), but as for now, only 65 are active with the majority located in rural areas. Concerning the domestic capital markets, the Mozambican Stock Exchange, BVM, listed only three private institutions though they represented 3 per cent of the GDP (Almeida-Santos *et al.*, 2014). Despite the efforts made by the Central Bank in reducing the standing lending facility, which is pre-determined to be at 8.5 per cent, and therefore encouraging lending to the economy, it is found that the commercial banks are still using high spreads (9.25 per cent on deposits and 10.75 per cent of lending), reflecting a weak monetary policy transmission [International Monetary Fund (IMF), 2014a, 2014b]. These financial institutions tend to defend their case by associating the high spreads with the credit risks and lack of collateral presented by their customers, especially SMEs and self-employed individuals. Next, financial inclusion is often argued to be one of the main drivers for poverty eradication in most developing countries through reduction of income disparities and increased economic growth (Doi, 2010). Sadly, both commercial banks and MFIs in Mozambique are found to play insignificant roles in promoting financial inclusion and hence have a minimal impact towards the achievement of poverty eradication.

2.4 Islamic banking and finance in Sub-Saharan Africa and Southern African Development Community region

Gelbard *et al.* (2014) documented that there were only 38 IFIs operating in Africa by end-2012, comprising commercial banks, investment banks and *takaful* operators. Out of these, 21 IFIs operate in North Africa, Mauritania and Sudan, and the rest in Sub-Saharan Africa. Figure 3 illustrates the geographical representation of Sub-Saharan African countries where IBF is present as well as highly potential areas for introducing IBF. Only 9 of 49 (18.4 per cent) Sub-Saharan African countries have implemented by the end of 2012. Moving forward to 2013, according to the EY's Word Islamic Banking Competitiveness Report 2013/2014, other Sub-Saharan African countries such as Nigeria, Kenya, Uganda, Malawi and Tanzania started to accelerate their efforts towards the adoption of IBF (Ernest and Young, 2014).

Meanwhile, the SADC[1] is determined to be the most significant region for Mozambique. As Mozambique is currently bordering more than 7 of 13 of its member countries, this region is observed to have more direct socio-economic and cultural impact towards Mozambique's economy. This is perhaps due to the SADC and African investors' understanding of the market including its potential return opportunities and future challenges. As a result, cross-border foreign direct investments in Africa, especially the SADC member countries are set to accelerate further as a large number of local firms seek for new markets.

In the context of IBF, the highly valuable experiences gained in the SADC region can potentially generate more confidence and motivation towards the local government's decision in adopting the IBF operations. For instance, in 1989, South Africa was the leading country with the establishment of Al Baraka Bank, the country's first ever full-fledged Islamic bank. Subsequently, this was followed by three conventional banks, namely, First National Bank, Absa Bank and HBZ Bank, by offering the IBF products through its Islamic "windows" as well as *takaful* products offered by Absa Bank. Moreover, following the Treasury of South Africa's decision to diversify the potential investors in their domestic markets since 2011, the first *ijarah sukuk* was then issued three years later on 19 September. This is the third issuance of dollar-denominated sovereign *sukuk* by a non-Muslim country (previously done by Hong Kong and the UK) and the largest *sukuk* issued in the Sub-Saharan Africa (Desai, 2016).

Mauritius set another example of a successful introduction to the IBF with the establishment of an Islamic cooperative credit union, Al Barakah Cooperative Society Limited. In 2007, the Banking Act was amended to include provisions on Islamic banking activities. This is to allow for the establishment of the country's first full-fledged Islamic bank, Century Banking Corporation, and also other banks such as HSBC Bank Mauritius to offer IBF products. In addition, the first *takaful* operator in the country, BAI Co. Ltd., was

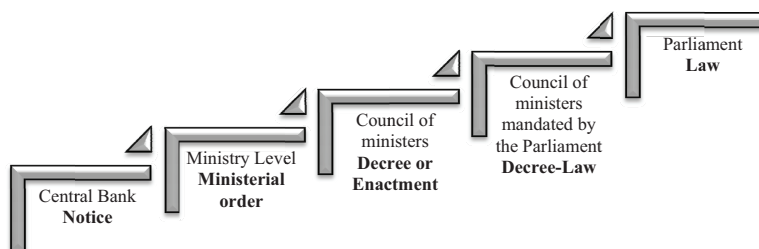


Figure 3. Types of laws applicable to Mozambique's financial sector

founded in late 2008, followed by the opening of a *Shari'ah* equity fund by India's Tata, namely, Tata Asset Management (Mauritius) Private Limited (TAMM). Meanwhile, Tanzania with the highest Muslim concentration in the SADC region started to adopt IBF in 2008 via Kenya Commercial Bank and later was joined by other four commercial banks, namely, People Bank of Zanzibar, National Bank of Commerce, Stanbic Bank and Amana Bank.

Finally, it is worth mentioning that the approaches taken in introducing the IBF differ from one country to another. For example, while South Africa started with the establishment of a full-fledged Islamic bank and later followed by the setting up of Islamic "windows" by conventional banks, the IBF practice in Mauritius began with the establishment cooperatives followed by amendments made to the existing banking and commercial laws to allow for Islamic banking and *takaful* products to be offered in the market. Based on the abovementioned country examples, Mozambique needs to evaluate the pros and cons of different approaches and to decide the best one depending on the country's urgent needs for IBF and the openness of the country's legislations in accepting IBF practices.

3. Critical review of Mozambique's banking laws and regulations

3.1 Overview of the legal framework for the financial sectors in Mozambique

The Mozambican legal system experienced a series of reforms since the country gained its independence in 1975. The constitution had at least three major modifications (the latest happened in 2004) with several revisions ranging from changes in the party system (from single to multiparty system) to reinforcement of the individual rights and independence of courts. The civil regulatory framework is largely based on the Portuguese-Roman Law, wherein the most relevant feature is the fact that its primary sources are codified and referable laws.

With regard to the highest regulatory authority in the financial sector in Mozambique, the Central Bank is deemed responsible for providing main supervision to the financial system in Mozambique. In carrying out its duties, the Central Bank has the right to issue notices to any financial institution that has legal effects on its operations, affairs and business activities. The other important regulatory bodies in the Mozambican financial system are the Minister and Council of Ministers that may issue the ministerial order and the decree or enactment respectively. Finally, the parliament is the higher authority and has the power to issue a law pertaining to the country's financial system. The above Figure 3 is also illustrated in hierarchical order that, in the case of disputes, determines the type of law that has the most legal effect. For example, the Decree order has more priority against the ministerial order or notice but has a lower position when compared to a Decree-law or the law issued by the parliament.

3.1.1 Mozambique's court system. The 1992 Organic Law of the Judicial Courts governs the Mozambican court structure and defines it in the three layers of judicial courts, namely, administrative court, the constitutional council and the judicial courts. The judicial courts comprise superior courts and lower courts at both district and province levels. The latter can be further divided into the first- and second-class courts at both district and province levels, which can hear both criminal and civil matters. The size of the claim will determine where the civil matter will be heard. For instance, claims that are worth above approximately US \$15,000 (100 times the minimum salary) are addressed by the provincial courts. Normally, any dispute regarding a breach of contract will often take more than two years before a judgement can be obtained from the Mozambican courts (Clifford, 2014). Furthermore, this study also observed that, at present, if Mozambique were to start off its IBF activities, there is no specific reference available addressing the issue of where the related matters to IBF

would be heard. Hence, amendments to the existing laws must take place to address this concern.

3.1.2 The arbitration centres in Mozambique. In terms of dispute resolution system, the primary law governing arbitration in Mozambique is the Law on Arbitration, Conciliation and Mediation (Law no. 11/99 of 8 July 1999), which is mostly supported by the International Commercial Arbitration Model Law 1985[2]. Currently, Mozambique has only one local arbitration centre, the Centre for Commercial Arbitration, Conciliation and Mediation (CACM), which has several delegations in Maputo province (south) and Beira province (centre). It is important to mention that the Arbitration Law (Law no. 11/99 of 8 July 1999) gives the possibility for private arbitration to be established in Mozambique. With regard to the enforceability of the arbitration proceedings, any award given by the local arbitration has the same strength as the Mozambican courts, whereas for foreign arbitral awards, it is subject to the Mozambican supreme court's endorsement. The Arbitration Law applies to all matters, except that the judgements and arbitral awards may not be implemented against certain state-owned assets of a public nature as stated in the Mozambican Civil Procedure Code (Decree-Law no. 44129). Knowing that the current arbitration centres are not able to cater to Islamic financial matters, the present study, therefore, has urged for the establishment of an alternative local arbitration centre for IBF in Mozambique.

3.2 Laws and regulations abiding the Mozambican financial institutions

Two main market authorities regulate the Mozambican financial sector, namely, the Central Bank of Mozambique (CBM) or *Banco de Moçambique* and the Insurance Supervision Institute of Mozambique or *Instituto de Supervisão de Seguros de Moçambique*. Apart from the insurance operators, the CBM, under the Law no. 1/92 of 3 January, is responsible for regulating and supervising all licensed financial institutions. According to the Article 132 of the Constitution, the CBM's operations are based on their laws and certain international laws to which the Republic of Mozambique subscribes.

In this section, we present a brief description of regulatory instruments that governs the CBM and the Mozambican financial institutions, which are placed under the CBM's surveillance. The discussion has been narrowed to the laws and regulations that are highly relevant to the establishment of IBF in Mozambique, which may be divided into:

- the general level which covers the ones that are applicable to all financial institutions, such as the CBL and the Law for Credit and Financial Institutions; and
- the activity level which covers the ones that enable the establishment and govern the operations of other types of credit and financial institutions.

The latter to some extent can be related to the IFIs. It is notable that these laws and regulations include a concise description for numerous terminologies, such as the concept of branch, authorisation, currency exchange houses, discount houses, venture capital companies, factoring companies and much more. This includes the description of the types of institutions, summarised in [Table I](#) below. These financial institutions are found to have a high level of significance to the adoption of IBF, either they are in line with or completely contradictory to the Islamic principles.

3.2.1 General level.

3.2.1.1 The Central Bank Law 1992. Mozambique's Central Bank Law 1992, also referred as the Law 1/92, was issued on 3 January 1992 by the Parliament. The primary objective of the Law is to outline the nature, objectives and roles of the CBM (Subtil, 2013). In Article 1 of the Law, the CBL defines the Central Bank as a legal person governed by the public law, with administrative and

Table I.
Descriptions of the
types of financial
institutions in
Mozambique

Types of financial institutions	Description
Credit institution	An organisation that receives deposits and other reimbursable funds from the public and perform the following: credit operations, including providing guarantees and other commitments; payment operations; issuance and management of payments mechanisms including credit cards, travellers cheques and letters of credit; transactions in precious metals, as provided by the exchange legislation and; selling insurance contracts
Financial institution	Listed entities, which do not hold a licence of the credit institution and must perform at least one of the following activities: credit operations and advisory (including guarantees and other commitments), stock trading or administration and management of securities
Bank	In addition to the activities performed by credit and financial institutions, banks may decide to incorporate one or more specialised activities such as factoring, leasing, investment banking or credit cards. Hence, they would have to comply with the norms and instructions from the Central Bank and to create special units so that it would allow an adequate supervision
Micro bank	An organisation that practices restricted banking and its operation is mainly revolved around microfinance. Microfinance activity involves the provision of financial services, primarily to low- and medium-sized operations
Credit cooperative	Credit institutions that are set up as cooperative societies which returns and benefits are channelled exclusively to their members
Investment company	Involves the provision of credit and related services that are applicable under certain laws and regulations such as the Enactments 54/99 of 8 September and 56/1999 of 8 September for investment and venture capital companies, respectively
Factoring company	Those companies have the principal purpose to provide financial factoring contracts whereby one party acquires the other's short-term credits, derived from the sale of goods or the provision of services to a third person (debtor)
Leasing company	In addition to the activities already defined by the Law no. 15/99, the leasing company can also perform the following: sell, lease or make other management activities

financial autonomy and with the public company nature. It is also described in Article 3 of the CBL that the main role of the CBM under the government's strategic planning is to be responsible for promoting the correct implementation of the monetary and credit policies to enhance the development of the country. In addition, the CBM has to discipline banking practice in the country, manage resources related to payment mechanisms and facilitate international trade. To support the abovementioned operations, the Central Bank can use the following resources:

- deposits from the government and financial institutions (including prudential deposits); and
- loans granted by natural or legal persons, foreign or international entities as stated in Articles 4 and 5.

Utilising the prudential deposits, however, can be subject to remuneration. Furthermore, Article 16 stated that the function of the CBM among others is to regulate the activities under the money, capital and foreign exchange market. As mentioned in Articles 21-27 with regard to the monetary policy, it is important that the CBM has ultimate power and authority to define interest rate, commissions and other remunerations. This has important impacts on the IBF products. As for the supervision of financial institutions, with the exception of the insurance companies, the CBL prescribes in Articles 37-39 that the CBM is responsible for the approval of requests regarding creation, merging and cessation of any

institution but not limited to, their subsidiaries, branches or any form of representation locally and internationally, as well as reviewing their guidelines for operation and supervision. In addition, all financial institutions that are subject to the Central Bank's supervision must submit regular reports on their operations and business activities in a fair and truthful manner.

Based on the review, the present study concludes that despite the absence of specific provision or clause on Islamic financial transactions in the CBL, there is room for the Central Bank to review and approve alternative forms of remuneration other than interest, including the profit rate offered by IFIs. This could instigate deposit taking and provision of financial services based on *Shari'ah* principles.

3.2.1.2 The laws on credit and financial institutions 1999. With the exception of insurance and pension funds, the Law on Credit and Financial Institution (CFIL) 1999, also referred to as the Law 15/99 was issued on 1 November 1999 and further amended by the Law 09/2004 of 21 July and the regulations provided by the enactment 56/2004 of 10 December, is applicable to all licensed financial institutions in Mozambique. The CFIL clearly outlines several requirements to be met by an organisation to be deemed as either a licensed credit institution or financial institution. In Article 2 of the CFIL, a credit institution is defined as the ones which their activity consists of receiving deposits from public or others sources and to use, on its account, into credit operations. A deposit is defined as a contract by which an entity receives funds from another and has the right to dispose of their business while taking responsibility to repay as much, with or without interest, within agreed period or at the request of the depositor. Whereas, credit operation is defined as the act whereby an entity, with the expectation of a remuneration, makes funds available to another entity against a promise or a guarantee to return on a specific due date. In contrast, financial institutions in Article 4 of the CFIL refers to those listed entities which do not hold a license of credit institution and must perform at least one of the following activities:

- credit operations and advisory (including guarantees and other commitments);
- stock trading; or
- administration and management of securities.

Meanwhile, other credit and financial institutions can only perform activities that are allowed under specific legislations. Finally, the law emphasises in Articles 55 and 57 that the responsibility of supervision of credit and financial institutions, either local or foreign, operating in Mozambique is given to the Central Bank. This includes setting up the general principles on prudential measures and supervision, comprising but not limited to liquidity, solvency, exposures, administrative and accounting procedures and internal control.

3.2.1.3 The regulation of credit and financial institutions 2004. In late 2004, the Regulation of Credit and Financial Institutions 2004 (enactment 56/2004 of 10 December) was enacted by the Council of Ministers in response to the amendments made in the Revised CFIL dated 21 July 2004. Once again, all credit and financial institutions are subject to the rules, regulations and procedures defined under this regulation, with the exception of credit cooperatives and micro banks, which are subject to the microfinance regulation (enactment 57/2005 of 10 December). Among important aspects highlighted in the Regulation include the legal definition of each type of credit and financial institution, such as banks (Articles 31-32), leasing (Articles 33-47), factoring (Articles 48-55), electronic money (Articles 56-60), financial societies (Articles 61-107), exchange houses (Articles 108-113), discount houses

(Articles 114-115) and credit card issuers and managers (Articles 116-120), license approval process and requirements, registration, statutory changes, opening of branches and matters related to breaches of law. In respect of payment of fines and penalties, the regulation in Article 29 specifies that the notified institution has to make the payment within 15 days or otherwise would be subject to penalty or interest charges. These rules are indeed against the Islamic principles that prohibit compounding interest.

3.2.1.4 The Regulation for the Deposit Guarantee Fund 2010. To promote the development and stability of the financial system, the Council of Ministers enacted the Regulation of Deposit Guarantee Fund 2010 (enactment 49/2010 of 11 November) which serves as protection for the deposits made by the participating banks. Although operating in harmonisation with the Central Bank, a DGF is deemed as a financial and administrative autonomous entity, as stipulated in Article 3 of the regulation. Participatory entities in Article 5 refer to all authorised credit institutions that take deposits and subject to prudential supervision by the Central Bank. It is clearly mentioned in Article 2 that the DGF is entitled to reimburse the deposits made by the participating institutions subject to the conditions and limits set by order of the Minister of Finance and other applicable legislation. Furthermore, the limit of guarantee includes the amount of capital and interest up to the date when the incapacity to return the deposit is declared. In providing the guarantee, the DGF is allowed to use the following resources: contributions from the government, participating institutions, income from the investment of resources, donations, fines levied institutions participating in the proportion defined by the Minister of Finance and amounts from other sources not prohibited by law.

3.2.2 Activity level.

3.2.2.1 The Investment Funds Decree 1999. The Investment Funds Decree 1999, also known as the enactment 54/99 of 8-Sep, was endorsed by the Council of Ministers with the objective to promote and develop the domestic financial markets by facilitating the participation of the international and local investors in the markets. As defined in Article 2 of the Enactment, investment funds refer to a set of values belonging to a plurality of persons designated participants, which result from capital investments made by them. It is determined that the funds' exclusive objective is to establish diversified portfolios of values, movable or immovable property, allowing the diversification of risks and profitability of applications. The final approval for the investment funds in Mozambique is given by the Ministry of Planning and Finance with the recommendation made by the Central Bank, which also acts as a regulating agent in defining the rules and reporting requirements. Based on the review, the Mozambican investment funds provisions do not contradict with *Shari'ah* principles and constitute an immediate platform for Islamic investment funds to be established in Mozambique.

3.2.2.2 The Regulation on Venture Capital Investment Funds 1999. The venture capital investment fund is very similar to the investment fund in general, with the main difference being that this type of funds would be allocated or directed to venture capital activities. Article 2 of the Enactment 56/99 of 8 September describes venture capital activity as the acquisition of shares of high-growth potential companies (entrepreneurs) with the objective to obtain profit from a subsequent sale of those shares (the return of funds applied and additional profit). The establishment of venture capital investment funds is subject to the prior authorisation of the Central Bank with a minimum start-up capital of 5 million Meticaís (approximately US\$160,000). The Central Bank of Mozambique acts as the regulating agent, which defines the rules and reporting requirements for the Mozambican venture capital investment funds. Like in other investment funds, the requirements for venture capital operations stated in the regulation seem not to conflict with the *Shari'ah*

principles and serve as a viable avenue to commence such initiatives to develop a market for Islamic venture capital investment funds in Mozambique without having to amend the legislation.

3.2.2.3 The Microfinance Regulation 2004. Upon the establishment of microbanks in Mozambique, the Council of Ministers passed the Regulation on Microfinance 2004, also known as the enactment 57/2004 of 10 December, aiming to provide detailed and comprehensive regulations that would cover not only the micro banks but also other licensed microfinance operators. The decree defines microfinance activity as any provision of financial services primarily in the form of low- and medium-sized operations. Varied in term of its microfinance activities, the regulation classifies the microfinance operators in Mozambique into the following four categories:

- (1) Category A (micro bank institutions) – microfinance operators that receive deposits from the public;
- (2) Category B (credit cooperatives) – microfinance operators that receive deposits only from their members;
- (3) Category C (micro-credit operator) – operators of microfinance that only grant credit; and
- (4) Category D (intermediaries of deposit taking) – operators of microfinance that intermediate deposit.

The regulation also prescribes two types of licences for microfinance operations;

- (1) the one for the microfinance operators that are subject to prudential supervision such as micro banks and credit cooperatives (category A and B) that require the authorisation to be granted by the Governor of the Central Bank; and
- (2) the one that requires the enrollment or registration and it includes operators that are subject to monitoring such as savings and credit institutions, micro-credit operators and deposit taking intermediaries.

Moreover, the regulation specifies that Categories A and B microfinance institutions are subject to prudential supervision by the market authority and the Central Bank can, but not limited to, determine the following:

- the minimum capital for its constitution and/or the minimum funds to be allocated to their activity;
- the credit and deposit limits;
- the interest rate regime and; and
- compulsory reporting and its frequency.

In relation to the credit cooperatives, each member of the cooperative must have a prior relationship or linkage by:

- having the same profession or occupation;
- becoming members of the same association or organisation with social, religious or other purpose; or
- residing on the same land area, rural or urban.

In addition, credit cooperatives must provide a legal reserve, to cover possible losses and a reserve for mutualism. The latter is allocated to finance self-help actions and mutual aids

required by their members or employees. Table II summarises different categories of microfinance operators according to their type of supervision, minimum capital and allowed operations.

Based on the review of the microfinance regulation, we have identified features that are aligned with the Islamic teachings such as the requirement to set up a mutual aid fund similar to the Islamic concept of *ta'awun* (mutual assistance). On the other hand, it would require that some amendments be made to enable the insertion of Islamic principles into the practice of microfinance in a holistic manner such as the encouragement to engage in trade and partnership rather than taking loans.

4. Findings

Based on the critical review of the present regulatory framework applicable to the credit and financial institutions, this section highlights the conflicting as well as enabling or similar features of the Mozambican financial laws and regulations in comparison to the Islamic transaction principles. This is highly important to assess the adaptability of the current Mozambican regulatory frameworks towards adopting IBF practices.

4.1 The conflicting features

4.1.1 *The use of Shari'ah non-compliant terminologies.* First, the conflicting features have mainly revolved around the inconsistency of the terminologies used in the laws with the *Shari'ah* principles. This may urgently need to be amended to ensure inclusivity to the IBF. It is worth pinpointing that the use of terminologies such as “remuneration”, “interest”, “profit” and “at cost” to refer to the proceedings of a financial transaction, be it the bank or customer side, may represent interest-based transactions which are clearly prohibited by the *Shari'ah*. For instance, in deposit products, the words “remuneration” and “interest” are used to refer to a gain that the capital owner would be entitled simply by placing his funds with the deposit taking institutions. This is explicitly mentioned in the CBL that all prudential deposits are subject to remuneration as well as in the CFIL that the financial institutions have the responsibility to return the capital, with or without interest, within agreed period or at the request of the depositor. Whereas, with regard to leasing contracts, it is stated in the CFIL and the Regulation of Credit and Financial Institutions that the lessor is entitled to remuneration due to a temporary allocation of an asset to the lessee. Furthermore, when defining the responsibility of the Central Bank, the CBL mentions that the Central Bank is the one who defines the interest rate, commissions and other remuneration alternatives for operations performed by the financial institutions. Despite the abovementioned conflict, the good side is that the broad concept and meaning of remuneration can be extended to not just interest and commissions but also alternative returns offered by Islamic finance such as profit rate. Therefore, the Central Bank may want to use its authority under the specified laws to include other remuneration alternatives that are compliant with the *Shari'ah* and not only limit to conventional interest and commissions. This study would also suggest that the above and other similar articles must be adjusted to a broader meaning (e.g. use only the word “remuneration”) to avoid inconsistencies and hence enable the operations of IBF.

4.1.2 *Concept of loan and credit.* We have also identified a potential conflict between the concept and features of the conventional loan and its Islamic counterpart in the present legislations. The remuneration and maturity date used in the conventional loan are deemed to conflict with the ideal characteristics of the loan as set by the religion of Islam, as observed in Article 2 of CFIL (Law no. 15/99 of 1 November) and also Article 1 of

Microfinance operators	Minimum capital	Allowed operations			
		Public	Deposit-taking Own members	Public	Credit Own members
<i>Prudential supervision</i>					
Micro banks					
General savings and credit bureaux	5.000.000,00 MT	Yes	Not appl	Yes	Not appl
Rural financing bureaux	1.200.000,00 MT	Yes	Not appl	Yes	No appl
Savings postal office	2.400.000,00 MT	Yes	Not appl	Yes	Not appl
Economic bureaux	1.800.000,00 MT	Yes	Not appl	No	Not appl
Credit cooperatives	200.000,00 MT	No	Yes	No	Yes
Monitoring					
Savings and credit organisations	150.000,00 MT	No	Yes	Yes	No
Micro-credit operators	75.000,00 MT	No	No	Yes	Not appl
Deposit-taking intermediaries	Not appl	Yes	Not appl	No	Not appl

Source: Central Bank of Mozambique

Microfinance Regulation (enactment 57/2004 of 10 December). Contrary to conventional finance, as mentioned earlier, Islam clearly prohibits interest-based transactions. Therefore, when granting a loan, the lender in return shall not request, charge or expect that the borrower grants him any extra benefit either in monetary form or in kind (Saleem, 2013). Certainly, this does not hold true in the conventional loan as the borrower is entitled to receive a pre-determined remuneration or interest. Another aspect to take into consideration in executing an Islamic loan (*qard*) is that due to its charitable nature, the majority of scholars are of the opinion that a repayment date must not be set. In the efforts towards adopting IBF in Mozambique, this study would suggest that the term “loan” needs to be changed to a broader and inclusive term such as “financing” which represents both the existing conventional practices and the newly incorporated financing alternatives brought by IBF, such as *murabahah* (mark-up sales), *ijarah* (leasing), *wakalah* (agency) and *mudharabah* (partnership).

4.1.3 Source and destination of funds. The main challenge for the IBF practice to penetrate the Mozambican financial markets is related to the source of funds to be channelled to financing activities. Unlike its conventional counterparts, IFIs must ensure that the source of funds as well as their investment are fully compliant with *Shari'ah* principles. In other words, the funds are not derived from non-*halal* activities or transactions such as producing, selling or distributing goods and services that are not lawful in the eyes of the *Shari'ah* and also engaging in a contract that involves *riba* (interest), *gharar* (extreme uncertainty) and *maysir* (gambling). This enters into a conflict with the Regulation of the Deposit Guarantee Fund where it is stated that the source of funds can be from the following:

- “Income from investment of resources” – This would attract interest payment or returns from non-*halal* sources.
- “Donations” – The sources of donations may not be limited to *Shari'ah* compliant.
- “Fines” – As defined in the *Article 29*, the Central Bank has the authority to charge penalty interest due to delay in payment.
- “Amounts from other sources, not prohibited by law” – which may consist of elements that contradict the *Shari'ah*.

Next, the Lender of Last Resort and deposit insurance schemes are the two significant mechanisms implemented by the market regulators including the CBM to mitigate stability risk and promote consumer protection. Due to the limited availability of liquidity management instruments that are compliant to *Shari'ah* (e.g. Islamic interbank money market), IFIs can be more prone to liquidity risk than conventional banking (Laldin, 2014). Therefore, if IFIs' operations were to start in Mozambique, *Shari'ah* compliant solutions including Islamic deposit insurance system based on *Kafalah bil 'Ujr* (guarantee with fee) and *takaful* (mutual guarantee) contracts are among the alternatives that should be explored. The authors are of the opinion that given its infant phase and under *maslahah mursalah* (interest of the public), the IFIs (taking customer deposits \investments) should be allowed to participate without being entitled to any interest and gradually adopt the alternative instruments that best suit their nature and business operations.

4.2 The enabling features

4.2.1 The arbitration system. Despite several conflicting features in the present legislations, there are a number of areas that are facilitative to the IBF practice. The

strongest point in these areas lies in the arbitration system. Indeed, Mozambique has a modern arbitration system, and although it has only one arbitration centre, it allows the creation of another local arbitration that can be privately owned. Also, resolutions from the local arbitrator are bound as court judgements. This is doubtless an enabling factor considering the fact that changes to the statutory law would be a lengthy and a costly process, found by previous studies conducted in civil law countries (Grassa and Gazdar, 2014). Moreover, due to the lack of expertise and competence to resolve disputes arising from Islamic transactions, even if the contracting parties agree to use Islamic contracts, the courts and judges may not be able to interpret and hence enforce the judgement. Therefore, in line with the provisions of the current arbitration law, we suggest that the feasibility of the following shall be explored:

- The contracting parties may agree and make reference to an arbitration centre, be it local or international, such as the International Centre for Reconciliation and Commercial Arbitration, Dubai International Arbitration Centre and Abu Dhabi Commercial Conciliation and Arbitration Centre, which understand the nature of IBF and are capable of dealing with related disputes.
- The establishment of a centre for Islamic alternative dispute and reconciliation should be explored. The Kuala Lumpur Regional Centre for Arbitration can be taken as a good example to follow. Despite the presence of the well-established International Islamic Centre for Dispute Resolution[3], which Mozambique can have access to and benefit from, it is more preferable to have one at the domestic level as it would be less costly and laborious, as the proceedings from a local arbitrator will be given same weight as the civil court's rulings, but not to international resolutions.
- In the event a local Islamic arbitration is absent, to make the dispute resolution process less expensive and more efficient, the IFIs' *Shari'ah* Advisory Board shall be allowed to act as an arbitrator for the investors or shareholders but limited to a modest amount such as up to US\$10,000,000 (Colón, 2011). A similar approach was adopted at the time of creation of the Al-Amanah Islamic Investment Bank in Philippine.
- In drafting a contract, make reference to the well-established and recognised International *Shari'ah* Standards whereby the contracts would be governed in term of *Shari'ah* matters, for instance, the Accounting and Auditing Organisation for Islamic Financial Institutions guidelines which cover standards concerning Islamic transactions better than any national system.

4.2.2 Leasing, investment funds and venture capital operations. From our review, the financial institutions' products and services such as leasing, investment funds and venture capital are defined in the laws in a manner that does not contradict with the principles of the *Shari'ah*. Hence, this can be the starting point for operators who are willing to undertake Islamic finance operations. It is noteworthy that, in a leasing product, the financial institutions would not be able to charge any penalty due to late payment.

4.2.3 Microfinance regulation. We have also noticed that the Regulation on Microfinance, with regard to the characteristics of credit cooperatives, outlines two conspicuous features of these institutions that correspond to the *Shari'ah*. First, Article 42 of the Enactment states that members must have a prior link, which, among other types, can be in the form of a religious group (e.g. Muslims society). Furthermore, apart from the statutory reserve for capital adequacy, a cooperative must create a reserve for the purpose of mutual aid according to Articles 51 and 52. This concept of mutual aid fund ties directly with the

Islamic concept of *ta'awun* (mutual assistance) that derives many other practices of IBF including *takaful* (Islamic insurance).

5. Conclusion

Undoubtedly, several lacking areas that need to be further explored through a series of field studies to facilitate the successful implementation of IBF in Mozambique. In contributing to that, this research paper, despite representing a limited perspective, certainly paves the ways for future studies and initiatives to be made to encourage both decision makers and policymakers and other stakeholders of the Mozambican financial system to appreciate and hence become more inclined towards the adoption of IBF. This study has demonstrated that while some legal provisions in the current legal and regulatory framework are conflicting with the *Shari'ah* principles such as the definition of loans and the concept of interest, there is also a certain number of enabling features that can be immediately explored, including deposits (with no interest), leasing operations, investment funds or venture capital. The contributions of this paper also lie in those valuable recommendations made by the insertion of Islamic principles in the current regulatory framework as well as to assist in overcoming some of the conflicting aspects in the medium to long term. As a way forward, Mozambique should explore and benefit from the experience and lessons learned by the neighbouring countries, which have successfully adopted the IBF practice. In addition, we would suggest the Central Bank establish a "task force team", comprising of multi-skilled professionals and experts in Islamic finance from various internal areas ranging from licensing to supervision together with *Shari'ah* scholars and representatives from the Muslim Community. This team must be given the mandate to supervise the entire process of adopting the IBF since the inception stage and form the advisory board for the Central Bank.

Notes

1. SADC countries: Angola, Botswana, Democratic Republic of Congo, Lesotho, Madagascar*, Malawi*, Mauritius, Mozambique, Namibia, Seychelles, South Africa*, Swaziland*, United Republic of Tanzania*, Zambia* and Zimbabwe* (*countries with direct borders with Mozambique).
2. UNCITRAL Model Law on International Commercial Arbitration (1985), with amendments as adopted in 2006. UNCITRAL is the core legal body of the UN system in the field of international trade law. A legal body with universal membership specialising in commercial law reform worldwide for over 40 years, UNCITRAL's business is the modernisation and harmonisation of rules on international business. www.uncitral.org
3. Located in Dubai and set up by Islamic Development Bank as the centre is a non-profit international organization and one of the largest infrastructures that supports the development of Islamic Finance worldwide by managing, in an independent manner, the Islamic Finance disputes.

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