



The Islamic Banking vs. Conventional Banking Regulation: A Comparative Study of Middle East and North Africa (MENA) Region

Author 1: Nehal Ahmad, LLM Candidate (Business Laws), NLSIU, Bangalore

Author 2: Nusrat Sultana, a Lawyer Based in Bhagalpur

Abstract: Since the Islamic banking system has heralded a new era in the field of commerce and industry by providing an efficient alternative model for sustainable development and reaching to those who are unreached. Some necessary amendments in the banking laws of the different countries like Malaysia, UAE, Egypt and Turkey is the need of the hour. It goes without saying that the countries like Malaysia, UAE, Turkey and some of the European countries as well have performed well. In this paper, I will deal with the fundamental concepts of Islamic Banking. What are the reasons for the growth of the Islamic Banking in the Middle East and North Africa (MENA) region? How the Islamic Banking has acted during the Covid-19 crisis? Finally, I suggested some necessary measures which are necessary to be taken for an inclusive and sustainable development of the Islamic Banking.

Index Terms – Riba, Musharakah, Mudarabah, Murabahah, Ijarah

I. INTRODUCTION

The very foundation of Islamic banking rests upon the premise of the *Holy Quran* and *Hadith*. The commencement of the Islamic Banking could be traced from the time of Prophet Mohammad (s). His conduct of the business is an exemplary and ideal method for banking taking into consideration the Sharia model. However, the credit goes to Egypt for formally introducing the Islamic Banking in the year 1963. It is essential to keep in mind that sometimes one could not find the provision pertaining to Islamic Banking in Quran and Hadith. Thus, it is the jurists and *faqeeh* who would derive the solutions in the light of *Ijma* (the consensus of opinion) or *Qayas* (the analogical deduction).

Some of the basic differences of Islamic Banking from the conventional banking could be elaborated in this way that Islamic banking belongs particularly to equity whereas the conventional banking system has the concept of debt which is totally different from each other. In addition to this, there is no any existence of leverage in Islamic Banking system as compared to the conventional one. It is indispensable between the parties to maintain a high level of transparency and accountability as per the provisions mentioned in Sharia. Above all, the risk sharing is an inseparable part of Islamic banking. Without which, the concept of Islamic banking is incomplete.

On the contrary note, the conventional banking system many a times has collapsed due to its heavy debt and lack of transparency and accountability in the system. Lehman Brothers in the US is an unprecedented example in this regard. With the expansion of the global economy, there has been an extensive development in the establishment of the Islamic Banking system across the globe. The current research of the *Islamic Finance Development Report 2019* shows that the Islamic finance industry's assets has increased to US\$ 2.5 trillion in 2018 from US\$ 2.4 trillion in 2017, a rise of 3% in the Islamic Banking system.¹

As far as the rules and regulation of the Islamic banking is concerned, some necessary amendments in the banking laws of the different countries like Malaysia, UAE, Egypt and Turkey is the need of the hour. It goes without saying that the countries like Malaysia, UAE, Turkey and some of the European countries as well have performed well. In this paper, I will deal with the fundamental concepts of Islamic Banking. How Islamic Banking regulation is totally different from conventional banking system? What kinds of challenges does the Islamic banking face on regulatory measures? What are the reasons for the growth of the Islamic Banking in the Middle East and North Africa (MENA) region? How the Islamic Banking has acted during the Covid-19 crisis? Finally, I suggested some necessary measures which are necessary to be taken for an inclusive and sustainable development of the Islamic Banking.

¹ Islamic Banking and Finance Report, 2019 <https://icd>

[ps.org/uploads/files/IFDI%202019%20DEF%20digital1574605094_7214.pdf](https://icd.org/uploads/files/IFDI%202019%20DEF%20digital1574605094_7214.pdf) (accessed on 26.11.2020).

RESEARCH METHODOLOGY**Research Problem**

This paper tries to analyze the fundamental concept of Islamic Banking and its contemporary regulations. It argues the fact that at that time of global financial and economic crisis, the Islamic banking system undoubtedly is an unprecedented model for providing economic justice.

Research Question

- What is the basic concept of Islamic banking?
- How the Islamic banking is different from conventional banking?
- How the Islamic banking has addressed the Covid-19 crisis?
- Why there is a need for robust and sound regulatory measures?
- What sort of Challenges does the Islamic banking face?

Hypothesis

Since the Islamic banking system has heralded a new era in the field of commerce and industry by providing an efficient alternative model for sustainable development and reaching to those who are unreached. The performance of the Islamic banking in the MENA region is a ratifying example. The misconceptions that it just belonged to Muslims need to be eradicated.

Research Methodology

The primary source of this article is secondary data. Various research papers, articles, books, web portals, the data of the government, think tank, law firms, periodical reports and the data of the different universities across the world have been collected and critically analyzed.

THE BASIC ELEMENTS of ISLAMIC BANKING

The following are the basic prohibitions of Islamic banking:

Riba (Interest): Riba or interest is totally prohibited in Islamic banking. There cannot be any dealings or transactions which contain interests. It is entirely illegal from the Islamic point of view. In other words, it is *haram* or null and void. There are many pious verses of the Holy Quran which talks about the prohibitions of the interest in its strict sense. "Trading is only like Riba (usury)," whereas Allah has permitted trading and forbidden Riba (usury)".²

Illegal (Haraam) business not allowed: it is pertinent to mention that investing in illegal business is undisputedly prohibited. For instance, pork, gambling, pornography, cinema come under the ambit of prohibition.³

Loss and Profit Sharing: one of the key elements of Islamic banking is the concept of loss and profit sharing when one acquires it from the venture. The fundamental aim of such provision is that the humanity should get benefited by such transactions or dealings. Hence, it is incumbent upon the parties to share the profit and loss which occurs in their business. In addition to this, the profits must be lawful in such kinds of business.⁴

COMMON TERMS USED IN ISLAMIC BANKING

"Musharakah" (Equity Partnership): the etymological meaning of the expression "Musharkah" is sharing. What usually happens in an equity partnership is that when there an agreement takes place between the two persons, the loss and profits must be shared by them. All the essential elements of a valid contract must be there in Musharkah.⁵ It is totally different from forms of contract because the financial institution does not just act as someone who participates in that particular venture but also as someone who facilitates or manages the dealings. In other words, it may be called as '*Shirkat-ul-Amwaal*'.

Mudarabah (Trust Financing): It is one of the important terms of Islamic banking which is based on profit and loss sharing. In such a case, a person agrees to give his money to another person for the purpose of making investment in a beneficial business. The person who invests in such business is called as "Rabb-ul-Maal". The person who is supposed to discharge the duty of a manager is called *Muzarib*.⁶ He is expected to act an entrepreneur. Meanwhile the *Rabb-ul-Maal* will act as a "sleeping partner". An active participation is very important in such business activities.

Murabahah (Cost Plus) at the very outset it is important to mention that *Murabahah* or "Cost plus Dealings" is completely different from differed payment method. For instance, there is a specific commodity which a seller is agreed to sale on a "margin price" plus the actual cost. For a consequence of this, it is the duty of the seller to let the buyer know the real price of the product. This is called as *Murabahah*. However, "the legality of this financing technique has been questioned because of its similarity to *riba*".⁷

Bai-ul-Muajjal (Delayed Payment): It is noteworthy to mention that in a differed payment, the payment of date should not be ambiguous at all. For a valid business transaction, the due date of payment should be crystal clear.

Ijarah (Lease) in day-to-day activities of Islamic banking, this concept of lease is quite prevalent. Lease is given for a specific period of time by the owner in terms of an immovable property. Nonetheless, the owner does not transfer the right of the property.

² Quran, Al-Baqarah, Chapter 2, Verse 275.

³ Narendra Kumar Bhasin, Anupama R. *Issues and Challenges in Implementation of Islamic Banking in India* Fifteenth AIMS International Conference on Management, available at <http://www.aims-international.org/aims15/15ACD/PDF/A197-Final.pdf> (last visited on 27.11.2020).

⁴ Nur Aqilah Zainordin, Monica Selvaraja, Ng Yee Man, Low Soon Hoong, *Challenges and Opportunities of Islamic Banking and Financial Institutions in Malaysia* South East Asia Journal of Contemporary Business, Economics and Law, Vol. 10, Issue 1 (Aug.) 2016. Available at https://www.seajbel.com/wp-content/uploads/2016/09/K10_21.pdf (last visited 27.11.2020).

⁵ Jahfar Puthan Peediyekka, *Islamic Banking in India: Prospects and Challenges* International Journal of Research in Engineering, Science and Management Volume-2, Issue-1, January-2019, available at https://www.academia.edu/38639170/Islamic_Banking_in_India_Prospects_and_Challenges (last visited on 27.11.2020).

⁶ Islami Tijara, India's Premier Islamic Finance Magazine, available at <http://www.islamitijara.com/glossary/islamic-finance-terms.aspx> (last visited on 28.11.2020).

⁷ GLOSSARY OF ISLAMIC FINANCE, p.226 available at <https://onlinelibrary.wiley.com/doi/pdf/10.1002/9781118670460.oth2> (visited on 28.11.2020).

This is something which the Transfer of Property Act 1882 deals with.⁸ Interestingly, there is no difference as such between the Conventional banking regulations in relation to lease and the Islamic banking.

Salam and Istisna (Forward Sale)⁹ the followings are the essentials for a sale to be valid:

- a. The commodity or the product must be there in a physical form.
- b. The seller must be the owner of that commodity.
- c. He must a capacity to sale the same product as per the Sharia compliance
- d. Mere ownership of such contracted products is insufficient for the purpose of a valid sale.

Apart from the abovementioned provisions, in a “Salam Contract¹⁰” the delivery of the goods takes place at fixed date in future but it is necessary to pay the price of such goods on the spot. In case of such failure, the sale will not be deemed to take place. In case of istisna, it is the moral responsibility of the producer to produce the goods in a time bound manner. Hence, the transfer of the products is sine qua non irrespective of the fact whether it has taken its physical shape or not.

HOW ISLAMIC BANKING REGULATIONS ARE DIFFERENT FROM CONVENTIONAL BANKING?

The question is that whether the Islamic banking system could be considered as an effective risk free banking model? The answer of this question contains both the expressions positive and negative. The positive expression is that it provides an effective alternative banking system in the time of global financial crisis. More so, at a time when the present banking and financial systems are collapsing due to heavy burden of debt or the housing crisis, the Islamic banking undoubtedly seems to be incredible in terms of providing socio-economic development and a perfect model for “social justice”. Subsequently, there is a negative answer as well for the abovementioned question. The Islamic banking system is full of risk and uncertainties. But one of the distinctive features of the Islamic banking is that the risk as mentioned earlier is shared by the venture provider whereas in the conventional banking system the burden of risks rests on the shoulder of the entrepreneur.

The financial flow and productivity one of the main differences between the conventional banking and Islamic Banking system because there is an involvement of the real economy not just for the benefits of the entrepreneur but also for the profits of the depositors and the bank concerned.¹¹ There are many differences as such between the conventional and Islamic banking. One of them is risk sharing. The risk in terms of profit and loss must be shared between the parties taking into consideration the fact that it does not contain any debt (Riba) at all. Hence, Islamic banking is “interest-free banking”.

THE ISLAMIC BANKING REGULATIONS: A COMPARATIVE STUDY

It goes beyond any reasonable doubt that a sound and robust legal mechanism plays a pivotal role in the overall development of any banking institution. As of now the rules and regulations of the Islamic banking are more or less based on the conventional banking regulations. However, the efforts of the Gulf Cooperation Council (GCC) should be appreciated for introducing the laws for the regulation of Islamic banking. The Central Bank of Kuwait (CBK) has made certain amendments for the oppression of Islamic banking system in a more effective manner. The United Arab Emirate has tried to bridge the gap between the Islamic banking and conventional banking system by providing a comprehensive regulation in the form of “Federal Law No. 6 of 1985”¹². A similar regulation has also been introduced by the Central Bank of Bahrain (CBB). Most importantly, the certain robust regulations have been incorporated in the United Kingdom by the Financial Service Authority (FSA) for the regulation of the Islamic Banking system.¹³ The “UAE Civil Code” provides a uniform mechanism and standard framework for regulating the affairs of the Islamic banking thereby promoting the social and economic justice.

In Bahrain, if anyone wants to avail the benefits of Islamic banking, it is the Central Bank of Bahrain which will grant license in order to get the person entitled to utilize the resources of Islamic banking as a licensee. There are three important conditions for being a licensee of the Islamic banking. The first condition is to accept the Sharia money deposits and the second is to manage and administer the sharia profit sharing account and the third one is to provide the sharia financing contract.¹⁴ If all the above-mentioned conditions are being fulfilled by the individual concerned, he will consequently be granted the license. In short, the role of the “Internal Sharia Board” could not be ignored for regulating the affairs.

Interestingly, the “Sharia Governance” model maintains a high level of transparency and accountability in order to acquire the utility of the banking service. It provides an absolute protection to the investors and stakeholders. As far as the Islamic banking regulations in Malaysia are concerned, it has witnessed a revolutionized change or sort of revamp in the Islamic banking industry after the enactment of the “Islamic Financial Services Act (IFSA) 2013”. It was formulated to deal with the better governance and regulatory structure for maintaining the Islamic banking and conventional banking industry. Another milestone was achieved in 2017 in the field of the Islamic banking by introducing “Value-Based Intermediation” (VBI).¹⁵ As I have mentioned earlier that the Central Bank of Kuwait regulates the Islamic Banking institutions in Kuwait under the “Central Bank of Kuwait Law (Act no. 32 of 1968) pertaining to the currency”. The CBK law was amended in 2003. It incorporates the scope of the Islamic banking activities under section 10 of the Article 86.¹⁶

⁸ Sec. 105 of the Transfer of Property Act, 1882.

⁹ Academy for International Modern Studies (AIMS) available at <https://aims.education/> (last visited on 28.11.2020).

¹⁰ Salam Contract in Islamic Finance, available at <https://islamicmarkets.com/education/salam-contract-in-islamic-finance> (last visited on 28.11.2020).

¹¹ ISTVÁN EGRESI, Ph.D., RAUF BELGE, *Development of Islamic Bank in Turkey*, Annals of the „Constantin Brâncuși” University of Târgu Jiu, Economy Series, Issue 6/2015.

¹² The United Arab Emirates' Government portal. available at <https://u.ae/en/information-and-services#/> (accessed on 29.11.2020).

¹³ Shafiqul Hasan, *An Empirical Investigation of Regulatory Framework for Islamic Banking System in Saudi Arabia*, International Journal of Innovation, Creativity and Change. www.ijcc.net Volume 7, Issue 3, 2019, Available at <https://www.researchgate.net/publication/341741568> (last visited on 28.11.2020).

¹⁴ Eleanor Clot, *The legal and regulatory framework governing Islamic finance and markets in Bahrain*, The Law Reviews.

¹⁵ Apnizan Abdullah, *Malaysia a global leader in Islamic banking*, Feb.07.2019, New Straits Times, <https://www.nst.com.my/opinion/columnists/2019/02/458228/malaysia-global-leader-islamic-banking> (last visited on 29.11.2020).

¹⁶ Suapi Shaffai, *“Islamic Banking Law in Kuwait”*, <https://islamicfinanceupdates.wordpress.com/islamic-banking-laws>.

THE CHALLENGES IN ISLAMIC BANKING REGULATIONS

There are not just legal and regulatory challenges which the Islamic banking industry is facing rather there are many other challenges as well. Lack of transparency and unaccountability, dearth of Islamic insurance, debt and equity imbalance, insufficient credit rating agencies, scarcity of Islamic financial experts and scholars¹⁷, unawareness among the public at large and misconceptions about the Islamic Banking system are some of the hurdles which needed to be tackled in order to create a conducive environment for the Islamic banking consumers. One of the greatest challenges that the Islamic banking system is facing in the 21st century is that they lack the latest technology and innovation.

Globalization, technological revolution and e-commerce have rapidly increased the strength of the capital market.¹⁸ Hence, in order to remain efficient and constructive, the Islamic banking industry has to adopt latest communications, technological innovations and development. There are many other challenges like Sharia auditing, Sharia governance, building confidence in its depositors and operators, performing the local regulatory reporting and its requirement.¹⁹

THE ISLAMIC BANKING SYSTEM AND THE COVID-19 CRISIS

The Covid-19 has been the root-cause of the current global economic crisis by threatening the health of the people and aggravating the tension. This needs comprehensive and robust policies to protect the health of the citizens at minimum economic costs. The Nobel Laureate Amartya Sen opines, “*The current crisis might end up with a severe concentration of wealth and income and higher levels of poverty, adding to the already prevailing trends before the pandemic.*”²⁰

It is important to mention that Islamic Banking and finance provides two types of defense against this global economic and financial crisis. 1. “*The tight integration of finance with real economic activities and risk sharing the first line of defense against endogenous risks.* 2. *A strong social safety net is the main line of defense against exogenous risks.*”²¹

If these two abovementioned requirements are fulfilled, the world would in a better position to tackle this widespread pandemic along with the global economic crisis. The Islamic banking industry is not an exception from getting affected by this widespread pandemic and financial crisis. Nonetheless what distinguishes the Islamic banking from the conventional banking at the time of financial crisis is that there has been an incredible performance of the sharia compliance equities as compared to the conventional banking. In short, the Islamic banking regulation is addressing or accepting the three core elements which are considered as the fundamental pillars of the finance industry and those are “liquidity”, “capital” and “profitability”. That is why, since this model is based on the principle of the social justice, it has the potential to provide a better and efficient alternative to deal with the current global economic crisis.

CONCLUSION

Needless to say that Islamic banking has been progressing by leaps and bounds. It has been regulated for the benefits of society taking into consideration the marginalized and the deprived one as well. It has been building an amicable relationship between the buyer and the seller on the basis of humanity in the form of sharing loss and profits simultaneous. The Islamic banking system has proved to be more effective as compared to its counterpart. However, there are many challenges that the Islamic banking system has to overcome. One of the biggest hurdles is the legal and regulatory measures, the amendments of the certain provisions relating to banking, the lack of professional and sharia experts, the unawareness among the people and above all the misconceptions and misunderstandings regarding Islamic banking. The accessibility issues are also of the hindrances. Once we overcome the abovementioned challenges, the dream of an interest free banking could be even more real for the general public.

BIBLIOGRAPHY**BOOKS**

1. [Imam Abu Abdullah Imam Bukhari](#), Sahih Bukhari Sharif, Volume 3, (Darussalam Publication Global Leader in Islamic Books).
2. Mufti Mohammad Taqi Usmani, An Introduction to Islamic Finance, (Darussalam, 1998)
3. Quran, Al-Baqarah, Chapter 2, Verse 275.
4. R.K. Sinha, Transfer of Property Act, (Central Law Agency, 2017).

ARTICLES

1. Academy for International Modern Studies (AIMS) available at <https://aims.education/> (last visited on 28.11.2020).
2. Apnizan Abdullah, Malaysia a global leader in Islamic banking, February.07.2019, New Strait Times <https://www.nst.com.my/opinion/columnists/2019/02/458228/malaysia-global-leader-islamic-banking> (last visited on 29.11.2020).
3. Dipika, Islamic Banking in India: Opportunities and Challenges, International Journal of Engineering Research & Technology (IJERT), Special Issue – (2017).

kuwait/#:~:text=The%20Islamic%20banking%20institutions%20in,the%20Organization%20of%20Banking%20Business. (Last visited on 29.11.2020).

¹⁷ Dipika, “*Islamic Banking in India: Opportunities and Challenges*”, International Journal of Engineering Research & Technology (IJERT), Special Issue – 2017.

¹⁸ Muhammad Tahir Jan, *Will It Survive? Challenges Faced by Islamic Banking and Finance in Today's World*, Journal of Islamic Finance, Vol. 7 No. 1 (2018) 058–067.

<https://www.researchgate.net/publication/329933461> (last visited on 29.11.2020).

¹⁹ Muhammad Shaukat Malik, Ali Malik and Waqas Mustafa, *Controversies that make Islamic banking controversial: An analysis of issues and challenges*, AMERICAN JOURNAL OF SOCIAL AND MANAGEMENT SCIENCES.

https://www.researchgate.net/publication/265888667_Controversies_that_make_Islamic_banking_controversial_An_analysis_of_issues_and_challenges (visited at 29.11.2020).

²⁰ <https://economictimes.indiatimes.com/> (visited on 29.11.2020).

²¹ *The Covid-19 Crisis and Islamic Finance, Response to the Islamic Development Bank Group* Sep. 2020, available at

https://www.isdb.org/sites/default/files/media/documents/2020_10/1.%20ISDB%20Group%20Report%20on%20Covid-19%20and%20Islamic%20Finance_FINAL.pdf (29.11.2020).

4. Eleanor Clot, The legal and regulatory framework governing Islamic finance and markets in Bahrai, The Law Reviews.
5. GLOSSARY OF ISLAMIC FINANCE, 226 available at <https://onlinelibrary.wiley.com/doi/pdf/10.1002/9781118670460.oth2> (visited on 28.11.2020).
6. Islami Tijara, India's Premier Islamic Finance Magazine. Islami Tijara, available at <http://www.islamitijara.com/glossary/islamic-finance-terms.aspx> (last visited on 28.11.2020).
7. Islamic Banking and Finance Report, (2019). https://icdps.org/uploads/files/IFDI%202019%20DEF%20digital1574605094_7214.pdf (accessed on 26.11.2020).
8. István egresi, ph.d., rauf belge, development of islamic banking in turkey, Annals of the Constantin Brâncuși University of Târgu Jiu, Economy Series, Issue 6 2015.
9. Jahfar Puthan Peediyekka, Islamic Banking in India: Prospects and Challenges, International Journal of Research in Engineering, Science and Management Volume-2, Issue-1, January-(2019). https://www.academia.edu/38639170/Islamic_Banking_in_India_Prospects_and_Challenges (last visited on 27.11.2020).
10. Muhammad Shaukat Malik, Ali Malik and Waqas Mustafa, Controversies that make Islamic banking controversial: An analysis of issues and challenges, American journal of social and management sciences. https://www.researchgate.net/publication/265888667_Controversies_that_make_Islamic_banking_controversial_An_analysis_of_issues_and_challenges (visited at 29.11.2020).
11. Muhammad Tahir Jan, Will It Survive? Challenges Faced by Islamic Banking and Finance in Today's World, Journal of Islamic Finance, Vol. 7 No. 1. <https://www.researchgate.net/publication/329933461> (last visited on 29.11.2020)
12. Narendra Kumar Bhasin, Anupama R. Issues and Challenges in Implementation of Islamic Banking in India Fifteenth AIMS International Conference on Management. <http://www.aims-international.org/aims15/15ACD/PDF/A197-Final.pdf> (last visited on 27.11.2020).
13. Nur Aqilah Zainordin, Monica Selvaraja, Ng Yee Man, Low Soon Hoong, Challenges and opportunities of islamic banking and financial institutions in malaysia, South East Asia Journal of Contemporary Business, Economics and Law, Vol. 10, Issue 1 (August) 2016. Available at https://www.seajbel.com/wp-content/uploads/2016/09/K10_21.pdf (last visited 27.11.2020).
14. Salam Contract in Islamic Finance, available at <https://islamicmarkets.com/education/salam-contract-in-islamic-finance> (last visited on 28.11.2020).
15. Shafiqul Hasan, an Empirical Investigation of Regulatory Framework for Islamic Banking System in Saudi Arabia, International Journal of Innovation, Creativity and Change. www.ijicc.net Volume 7, Issue 3, 2019. <https://www.researchgate.net/publication/341741568> (last visited on 28.11.2020).
16. Suapi Shaffaii, Islamic Banking Law in Kuwait, <https://islamicfinanceupdates.wordpress.com/islamic-banking-laws.kuwait/#:~:text=The%20Islamic%20banking%20institutions%20in,the%20Organization%20of%20Banking%20Business> (last visited on 29.11.2020).
17. The covid-19 crisis and Islamic finance, response of the Islamic development bank group, September 2020 https://www.isdb.org/sites/default/files/media/documents/202010/1.%20IsDB%20Group%20Report%20on%20Covid-19%20and%20Islamic%20Finance_FINAL.pdf (29.11.2020).
18. The United Arab Emirates' Government portal, <https://u.ae/en/information-and-services/#/> (accessed on 29.11.2020).