

Islamic Business and Finance Series

ISLAMIC FINANCE IN THE FINANCIAL MARKETS OF EUROPE, ASIA AND AMERICA

Faiza Ismail



Islamic Finance in the Financial Markets of Europe, Asia and America

Among international financial centers (IFCs), London is known as the ‘Western hub of Islamic Finance’, on account of its well-developed legal infrastructure. However, Brexit has threatened London’s status and consequently, the financial services industry is moving to Dublin to continue operating in the Euro region. Similarly, Islamic finance (IF) service providers in the UK are also looking to Dublin for expansion of this niche area in euro member states.

This is the first book to be written about Islamic finance operations in the Eurozone. The book offers an in-depth description of International Financial Centers and the growth of Islamic Finance, compares the growth of Islamic finance in London, Dubai and Kuala Lumpur, outlines the implications of Brexit for financial service providers in London in general and Islamic investors in particular and also presents a case study of Ireland to establish the latter as the most appropriate country to promote IF in the Eurozone.

The time is particularly right for a book exploring the potential of Ireland to emerge as a Eurozone hub of Islamic finance, as a result of Britain’s exit from Europe. The book will cater to the needs of readers studying IF in the disciplines of economics, business, law, and religion. A secondary market includes practitioners, such as policymakers, lawyers, fund managers, accountants, regulators and international investors, who will be interested in exploring the benefits that the UK and Ireland have to offer the Islamic finance industry.

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Islamic Business and Finance Series

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Faiza Ismail

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Contents

<i>Acknowledgement</i>	ix
Introduction	1
1 International Financial Centers and Islamic Finance	4
<i>London as an International Financial Center</i>	5
<i>An Analysis of the UK Regulatory Framework</i>	10
<i>New York as an International Financial Center</i>	11
<i>The US Regulatory Approach</i>	16
<i>Singapore as an International Financial Center</i>	20
<i>The Initial Stimulus</i>	21
<i>The Contributions of the Monetary Authority of Singapore (MAS)</i>	21
<i>The Singapore International Commercial Court (SICC)</i>	23
<i>Crisis 2008</i>	25
<i>Engagement with the Islamic Finance Industry</i>	26
<i>Hong Kong as an International Financial Center</i>	29
<i>Stock Market Crash 1973</i>	30
<i>Beginning of Regulations</i>	31
<i>Global Financial Crisis of 2008</i>	33
<i>Regulatory Response</i>	34
<i>Tokyo as an International Financial Center</i>	35
<i>Period of Economic Growth Up Until the 1970s</i>	35
<i>Liberalization and Deregulation</i>	36
<i>The ‘Bubble Economy’ and the Subsequent Burst</i>	39
<i>Islamic Finance in Dubai</i>	40
<i>Establishment of DIFC</i>	41
<i>Regulatory Framework of DIFC</i>	41
<i>Regulatory Framework of Islamic Finance in Dubai</i>	42
<i>Challenges to Islamic Finance in Dubai</i>	44
<i>Islamic Finance in Malaysia</i>	48

The Initial Phase of Development 49
Islamic Banking Act (IBA) 1983 and the BAFIA 1989 49
Bank Islam Malaysia Berhad (BIMB) 50
The Skim Perbankan Tanpa Faedah (SPTF)/Skim Perbankan Islam (SPI) Scheme 50
Regulation of the Banking Industry: Central Bank of Malaysia 51
Development of Islamic Capital Market 52
Shariah Advisory Councils (SAC) 54
Jurisprudence on Islamic Finance 56
Conclusion 60
Notes 61
Bibliography 81

2 English Commercial Courts and Islamic Finance Disputes 88

English Courts on the Commercial Law 88
Islamic Finance Developments in the UK 98
Islamic Finance Disputes in English Courts 105
Impact of the English Court's Approach toward Islamic Finance Disputes 110
Brexit and Islamic Finance in the UK 111
Conclusion 113
Notes 114
Bibliography 127

3 Islamic Finance Developments in the Republic of Ireland 131

The Finance Act 2010 131
Islamic Finance Products 132
Islamic Finance Products Addressed in the Finance Act 2010 133
Double Taxation Agreements 134
Irish Stock Exchange 134
Islamic Banking in Ireland 135
Absence of Dispute Resolution Mechanism in the Irish Jurisdiction 135
Choice of Law in Irish Courts 138
Brexit and IF in Ireland 139
Notes 142
Bibliography 149

4 Standardization and Irish Policy Makers	152
<i>Need for Standardization in the Islamic Finance Industry</i>	<i>152</i>
<i>Challenges to Standardization</i>	<i>153</i>
<i>Global Islamic Finance Standard-setting Bodies</i>	<i>157</i>
<i>AAOIFI as a Global Standard-setting Body Addressing Challenges to Standardization</i>	<i>158</i>
<i>Standardization and Financial Services Industry</i>	<i>160</i>
<i>International Swaps and Derivative Association (ISDA)</i>	<i>161</i>
<i>Contribution of ISDA to the Global Derivatives Market</i>	<i>162</i>
<i>Recommendations</i>	<i>164</i>
<i>Conclusion</i>	<i>167</i>
<i>Notes</i>	<i>168</i>
<i>Bibliography</i>	<i>173</i>
5 Islamic Finance in International Commercial Arbitration and International Investment Arbitration	176
<i>Islamic Arbitration</i>	<i>176</i>
<i>International Commercial Arbitration</i>	<i>178</i>
<i>Challenges</i>	<i>178</i>
<i>Recommendations</i>	<i>181</i>
<i>International Investment Arbitration (IIA)</i>	<i>185</i>
<i>Bilateral Investment Treaties (BITs)</i>	<i>185</i>
<i>UK Sovereign Sukuk</i>	<i>189</i>
<i>Dispute Settlement Mechanism Included in the Sukuk Certificates</i>	<i>190</i>
<i>Additional Protection to Sukuk Holders under International Investment Law (IIL)</i>	<i>190</i>
<i>UK's Concerns about Protection to Foreign Investors under the IIL</i>	<i>191</i>
<i>Conclusion</i>	<i>191</i>
<i>Notes</i>	<i>192</i>
<i>Bibliography</i>	<i>199</i>
6 Irish Financial Regulators Regulating Shariah Supervisory Boards	202
<i>Shariah Risk and Shariah Arbitrage</i>	<i>203</i>
<i>Transparency and Disclosure</i>	<i>204</i>
<i>Competence</i>	<i>206</i>
<i>Competence under UK Regulations</i>	<i>207</i>

viii Contents

*Fit and Proper Tests for the Approved Person as Specified in
Ireland* 208
Conflict of Interest 210
Liability 210
*Collaboration between Islamic and Conventional Standard-setting
Bodies* 212
Conclusion 213
Notes 213
Bibliography 219

Conclusion 222

Index 224

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Introduction

The regulatory system largely defines the success of a financial system. The history of financial regulations in five big financial centers broadly reveals two approaches, i.e., strict supervision and light supervision – Regulatory approach defines the success and failure of International Financial Centers (IFCs).

The UK is an excellent example of a regulatory framework that developed gradually from no-regulation to self-regulation to statutory supervision. The gradual development of the regulation has happened with the balanced strategy to ensure innovation and protect commercial interest. It has been reflected in the journey which started with the Banking Act 1979 and has reached to the Financial Services Market Act 2000.

The Bank of England (BoE) used to exert light supervision to regulate banks. It was an informal mode of supervision that promoted the cooperation between banks and the BoE. Bank failures such as JMB, BCCI and Barings revealed BoE could no longer supervise banks effectively. Thus FSMA 2000 set up Financial Services Authority (FSA) to regulate the UK's financial industry. Finally bank run of the Northern Rock led to extensive regulations regarding bank insurance schemes. It also resulted in a split of FSA into FCA and PRA. Nonetheless, innovation has always been encouraged and never punished in the UK. This is the reason why the Islamic finance (IF) industry has grown to the extent that London is known as a western hub of IF.

The reason why London is the only IFC among the top five IFC's known as the western hub of IF lies in its regulatory approach and legal system. Even New York which is known as second most prominent IFC cannot compete with London in this regard. The history of banking regulation in the US comprises of ups and downs in the regulatory approach. The great depression led to strict regulations such as the Glass Steagall Act (GSA) whereas by 90s a wave of deregulation had completely overcome the strictness of the GSA. De-regulation led to the financial crisis of 2008 which rattled all four IFC's and the global economy. Consequently, Sarbanes Oxley Act 2010 was enacted which led to strict regulation of the financial industry. There existed enormous criticisms of the Sarbanes Oxley Act 2000 which resulted in the Economic Growth, Regulatory Relief, and Consumer Protection Act

2 Introduction

(EGRRCPA) 2018. Fluctuation of regulatory approach along with distrust on financial institutions, punitive and rule-based nature of law, and a fragmented legal system are the causes of IF industry being almost non-existent in the US.

Tokyo as an IFC has a history of an emerging economy that could not sustain pressures of liberalization. Although liberal policies aided Japan's economy to stabilize, pre-liberalization the economy was fully protected. Japanese policymakers protected the domestic economy such that when the Japanese market was opened to foreigners, the domestic economy collapsed. The Japanese economy is still recovering from the consequences of liberalization to revive Tokyo's status as an IFC. Thus, there remains no room for promoting innovations such as IF.

Hong Kong is an emerging IFC with a huge influx of Chinese investment. Securities and Futures Commission (SFC) and Hong Kong Monetary Authority (HKMA) are regulating the market well but it lacks years of experience in financial markets and a strong legal system that can back innovations like IF. Similarly, Singapore with its Monetary Authority of Singapore (MAS) and commercial court has developed a stable IFC. It has also promoted IF in the country. However, Singapore also lacks the depth of regulatory and legal system which characterizes London's financial market.

London being a western hub of IF is not in competition with the rest of the IFCs. In this regard, London is competing with global hubs of IF, i.e., UAE and Malaysia. UAE has promoted IF in the Dubai Islamic Financial Centre (DIFC). In order to attract investment from the entire world, DIFC has established DIFC courts which is a transplantation into the UAE's legal system. DIFC court resolves disputes based on common law jurisdiction, whereas UAE's legal system is derived from Sharia and civil law traditions. Judges sitting in DIFC courts are mostly appointed from the UK and US. DIFC clearly lacks the stability and support that London offers to the IF industry in terms of supervision and dispute resolution.

Malaysia however has established a global Islamic capital market. Kuala Lumpur is known for its sukuk market which ensures a flow of liquidity to Islamic banks. Malaysia's success is largely reliant on the regulatory and legal support it has crafted for Islamic investors. Nonetheless, London has an edge over Kuala Lumpur, i.e., long-established regulatory and legal culture.

The scope of the UK in the IF industry is huge. At the moment there are five fully Sharia-compliant banks operating in the country. This is in addition to two sovereign sukuk that the UK government has successfully issued. The first sovereign sukuk has been fully redeemed and redemption of the second sovereign sukuk is in its way. To top it, all English commercial courts (ECCs) are the preferred choice of jurisdiction for Islamic financial institutions.

In [Chapter 2](#), the historical development of ECCs is explored. It contains an interesting story of the parallel development of equity and law along

with mercantile law. The history of the development of ECC reveals that English common law is a product of a compromise reached between the business community and stakeholders of common law. Even to date, English judges prefer to protect the interests of the business community while resolving commercial disputes. This is evident from the precedent, which has developed regarding IF disputes in English courts. Interestingly, English judges' approach to denying the interpretation of Sharia law to protect the commercial interest of the IF industry in the country had caused distrust among global IF stakeholders who consider that it creates legal uncertainty. Moreover, Brexit has created an additional layer of uncertainty for providers of financial services in the UK including IF service providers. Thus, the UK seems to be losing Islamic investors in the wake of the Brexit deal which has rendered the passporting facility ineffective.

At the moment, Dublin makes the most suitable destination for financial service providers in the UK. London no longer provides passporting facility whereby financial service providers could enter EU markets freely without any licensing or regulatory requirement. Dublin is an alternate center for service providers since on account of being a common law jurisdiction, English-speaking country, and being a eurozone member state, it facilitates free access to Eurozone member states. [Chapter 3](#) is an insight into Dublin as a eurozone hub of IF. Although Dublin will be an ideal place for UK-based IFIs to operate in Europe, the Irish legal system is no different than the English legal system.

Legal uncertainty in the global IF industry caused by the English courts can be overcome through standardized practices in the global IF industry. In this regard, we have a model in ISDA – ISDA played an instrumental role to standardize the most complex area of the financial services industry which is the derivatives market. There was a time when derivative trading was considered to be a purely speculative activity. ISDA clarified the purpose of derivatives to judges in the courts and financial regulators too. [Chapter 4](#) suggests AAOIFI plays the role for standardization of IF markets as ISDA did it for global derivatives markets.

Moreover, International Commercial Arbitration (ICA) and International Investment Arbitration (IIA) are alternate dispute resolution mechanisms that have the potential to overcome legal uncertainty for the global IF markets. Since standardization as suggested in [Chapter 4](#) will take a long time to accomplish, ICA and IIA are suitable dispute resolution mechanisms that have been fully examined in [Chapter 5](#).

Finally, legal uncertainty can be handled by regulatory reforms for SSBs. This author suggests the scholars of individual IFIs should be encouraged to take executive positions. Scholars working as executive directors will be in a position to address all the concerns, which have been identified in IF case law in English courts. [Chapter 6](#), therefore, recommends corporate governance reforms for IFIs to ensure scholars take up executive positions.

1 International Financial Centers and Islamic Finance

A comparative analysis of different jurisdictions reveals the diversity of actions that could be taken by the governments to build vibrant financial centers. This comparison allows one to identify and contrast certain salient features that have characterized the financial policy making and regulatory conduct of these jurisdictions. UK's financial regulations represent a receptiveness and accommodation toward innovative ventures which is lacking in the US. The historical progression of the financial institutions in both jurisdictions explain this contrast, with the UK having a system based on self-regulation as its point of origin, while the US having accepted a mistrust of big money as an *ipse dixit* in the post-depression period which remained deeply embedded in the ideological makeup of the country. Regulatory authorities played a very important role in navigating the financial trajectories of these jurisdictions for instance the Monetary Authority of Singapore (MAS) in Singapore and the Securities and Futures Commission (SFC) in Hong Kong. Major events, national or trans-national, also played a huge role in guiding the progression of these financial centers. 2008 crisis that shook major economies, including the US is one example. Other crises, such as the bursting of the housing bubble in Japan marking the advent of the 'lost decade', the Stock Market crash of 1987 called the 'Black Monday' in Hong Kong, and other such events had impacts but limited to their home ground. Regardless of the particular circumstances specific to these financial centers, every such crisis invited proactive government response to do necessary damage control and take effective steps for prevention in the future, leading to the sustainable growth of these IFCs. It is this tendency to act and embrace, that provided fertile ground to these IFCs for engagement with the Islamic financial industry, albeit to a lesser extent than possible. How the extent could have been broadened, is explained through the examples of Dubai and Malaysia, where Islamic finance (IF) was provided a parallel regime to operate. Dubai did this by establishing Dubai International Finance Center (DIFC), whereas Malaysia brought in a rigorous legislative overhaul to provide separately for the supervision of the industry. The dominant approach emanating from the combined analysis of

these financial centers provides a broader paradigm within which financial centers can aspire to achieve inclusive and sustainable growth.

London as an International Financial Center

The UK regulatory framework originated in an environment where the banking business was highly concentrated within a well-established elite network and with almost non-existent supervisory control. Interestingly, the great depression did not cause substantial damage to the UK's financial system – the British government therefore continued the informal supervision and regulation of banks.¹ Things started changing as the financial terrain became increasingly populated and more complicated. The realization of a gradual shift occurred through a series of crises. Johnson Matthey Bank (JMB)'s failure of the 1984, exposed weaknesses of the Banking Act of 1979, which was based largely on self-regulation, and the new Banking Act of 1987 that replaced it had some hints of regulation such as minimum capital requirements. The Bank of Credit and Commerce International (BCCI) crisis of 1990 exposed further weaknesses, and it was followed by the fall down of the Barings in 1995. These events catapulted financial regulatory reforms, which manifested in the Financial Services Act 2012 and Financial Services and Markets Act (FSMA) 2000 which introduced a new regulatory authority, the Financial Services Authority (FSA). The FSA marked a gradual shift toward regulation, however, a further crisis in 2008, the Northern Rock Bank run revealed a need for further regulatory reforms. This has resulted in the amendments to the FSMA in 2012, leading to a restructuring of FSA into Financial Conduct Authority (FCA) and Prudential Regulatory Authority (PRA). In this chapter, the author aims to explore this timeline, concerning every crisis, the regulatory response, and the overall impact the reforms have had on the move toward the adoption of a statute-based formal regulatory framework in the UK.

London's profitable trading environment pushed forward its position as a stable financial center. The regulation surrounding financial services in London moved from a heavily politicized regulatory environment, mainly influenced by merchant lobbyists, to eventually providing it with enough regulatory autonomy to design a regulatory culture that is now grounded in the law.² The 1697 Stockbrokers Act was one of the crucial pieces of legislation that brought an idea of market welfare into play as opposed to self-regulated monopolies.³ Bank of England and Stock Exchange's privatization went a long way in shaping the current regulatory regime of the city.⁴ Despite the progressive nature of the Banking Act 1979, there existed significant political influence when the Banking Act 1987 was passed.⁵ Additionally, there was an introduction of statutory obligations upon the financial-services sector in 1986 with the Financial Services Act. It was termed as statutory regulation monitored by self-regulatory organizations recognized by, and under the surveillance of a self-standing Commission, which was a remarkable constitutional hybrid.⁶

Johnson Matthey Bank Crisis 1984

JMB was established in 1965 to engage in bullion trading and banking activities. The JMB got into trouble in 1984 on account of issues related to mismanagement of risk, credit, securities and bad debts. Particularly, the JMB's exposure to a handful of borrowers was kept understated. This exposure amounted to 120% of its capital. Reckless lending to two major borrowers turned into bad debts when both of them defaulted in their payments. These bad debts cumulatively reached a whopping \$300 million.

The Bank of England as a supervisory body remained accommodating to the JMB's auditors who failed to submit quarterly accounts. It was a time when regulatory control remained non-existent. The Bank of England used to promote self-regulation and relational relationship with banks. Thus, when JMB failed, the Bank of England intervened to bail out JMB.⁷ Failure of JMB was a challenge to the Banking Act 1979 and the supervisory authority of the Bank of England. JMB's failure led to the enactment of the Banking Act of 1987.⁸

The promulgation of the Banking Act of 1987 introduced, minimum capital and reporting requirement, i.e., when a single credit transaction exposure exceeded 10% of the banks' overall capital, it was required to be reported. The Act required coordination among Bank of England (BoE), external auditors and banks' management regarding banks' control systems and flow of information among them. It also introduced the requirement of an external audit. The Act abolished 'recognized banks' and 'licensed deposit takers' and merged them into a single category of 'authorized institutions'.

The BCCI Crisis 1990

The BCCI was registered in Luxembourg in 1972. Over time its operations spread in the entire world. When BCCI opened its branches in London, the Bank of America had 25% shareholding in BCCI. Though BCCI did not get authorization to operate as a bank in the UK, but it was authorized to operate as a deposit-taking institution under the Banking Act 1979 which was validated under the Banking Act 1987.⁹ In 1991, BCCI faced investigation for fraud and manipulation conducted by UK regulators.

It turned out that BCCI was engaged in hiding its losses, accumulating huge sums of bad debts, lending without security to clients, fraudulent and illegal transactions involving cartels, the narco-terrorist world and money launderers.¹⁰

BCCI was able to pull off the massive discrepancies on account of its unique organizational structure.¹¹ The BCCI was registered in Luxembourg and Cayman Island. It was operational in various parts of the world. Its operations in the UK branches became substantial overtime. There came a time when BCCI was fully operational in the UK. It felt like the UK was its main place of business. As per the Birmingham report, this is the point where the Bank of England's inadequate supervision became apparent.

During the process of getting authorization to operate in the UK, BCCI did not meet regulatory requirements to be recognized as a bank under the 1979 Act. It could only obtain a license to operate as a deposit-taking institution under the 1979 Act. At the time of granting the license, the BoE did not inquire about the BCCI's 'principal place of business'. As per Bingham report, the BoE assumed BCCI's principal place of business was Luxembourg where its registered office was located, although, correct interpretation of the phrase 'principal place of business' refers to the place where, mind and management of the company, its central direction, resided.¹² If the BoE at that time had inquired about its 'principal place of business' it would have been bound to conclude that BCCI's mind, management and central direction resided in London and certainly not in Luxembourg.¹³ This was a clear violation of Sec 3(5) and Sec 36 of the 1979 Act.¹⁴

Two elements rendered the BoE's supervision inadequate, i.e., absence of supervision and auditor's failure to report the discrepancies to the BoE. BCCI was able to avoid consolidated supervision of all its operations in different jurisdictions by shifting its assets between these jurisdictions and confusing regulators. Thus there was no superior who could examine and regulate the financial organization in its entirety and this allowed room for creating an asymmetry which in turn provided leverage for manipulation. An example of this is the shifting by BCCI, of the loans it made to gulf shipping group, from the UK to its Cayman Branch, to bypass the BoE's guidelines about exposure, since the loan was very much above the prudential limit and amounted to 60% of the total bank capital.¹⁵ Secondly, BCCI was able to avoid maintaining proper accounting records of its transactions and got away with it for so long, despite it being a requirement. In this, BCCI was aided by the lenient attitude displayed by both its auditors and the BoE which allowed these discrepancies to remain hidden. BCCI's auditors, despite having serious reservations about its functioning, failed to qualify their accounts such as their accounts of 1989, just two years before the closure was unqualified.¹⁶ Moreover, the Bank of England also failed to appoint an independent external auditor to trace these discrepancies and this laxity on their part was also a reason for such large scale fraud to remain hidden for so long.¹⁷

The inquiry recommended increased disclosure requirements, extensive external audit requirements, improved coordination and flow of information among the BoE, bank management and auditors.

The Barings Crisis 1995

Barings Brother and Co Ltd. was founded in 1890 to carry out banking business.¹⁸ In 1985, the Barings group was formed when Barings Plc obtained the Share Capital of BB & Co Ltd.¹⁹ The Barings failure started in Barings Futures Singapore (BFS) which was one of the many subsidiaries of Barings Securities Limited (BSL).²⁰ BSL was authorized by the BoE in the UK.²¹ BFS was operating in SIMEX operating under the MAS. SIMEX is a self-regulatory body

and BFS was one of its members.²² Thus BSL came under the direct supervision of BoE whereas BFS (which was registered with MAS in Singapore) came under the indirect supervision of BoE.²³

In 1992, Nick Leeson started working at BFS. The same year, account no. 88888 was opened as a client in BFS. Leeson was engaged in derivative trading in SIMEX. Over time BFS started generating huge profits which were supposed to be an outcome of Lesson's trading strategies. It was understood that BFS was engaged in risk-free trading which was exceptionally profitable.²⁴

It turned out that in fact, account no. 88888 was used to conceal enormous losses which Lesson incurred on account of his derivative trading activities.²⁵ The losses were worth many times more than the profits generated by BFS.

In 1995, Baring's management in London spotted weaknesses in internal controls and accounting of BFS. The management approached BFS to clarify issues of a shortfall of \$140 million. Similar reassurances were sought by SIMEX about ambiguities in BFS book-keeping.²⁶

Nick Leeson who was responsible for the derivative trading did not provide any clarification to the matters raised by the Barings' management in London. Instead, he disappeared leaving Barings Plc exposed to liquidation, and BFS went under judicial control.²⁷

An inquiry was conducted by the Board of Banking Supervision, BoE on an order passed by the House of Commons. The inquiry recommended that the BoE ought to improve on its understanding of the various risks associated with the bank's business, stringent requirements applicable to solo consolidation, effective coordination with other regulators, effective internal audit, on-site visits, the effectiveness of large exposure policy and quality assurance reviews. Interestingly, no substantial amendment was suggested to the Banking Act except legislation to ensure effective flow of information from banks to the BoE.²⁸

Self-regulation to Statutory Regulatory Framework

The BoE's informal supervision and relational approach to promoting self-regulation among financial institutions ended with the introduction of FSMA 2000. The FSMA 2000 put forth two actions that changed the direction of the UK regulatory framework.

First time in the history of UK financial regulation, the role of supervision was taken away from the BoE. FSA was setup to perform the functions of financial regulation and supervision.²⁹ The BoE's role was confined to performing the functions of a central bank which includes monetary policy.

Second, regulations were enacted to promote market confidence, public awareness, protection of consumers and reduction of financial crimes.³⁰ It marked the beginning of statutory regulation which ended the era of self-regulation in the financial markets of the UK.

This statutory regulatory system is based on principles instead of rules. Principle-based regulations ensure flexibility for financial entities which was

an essential feature of self-regulatory supervision. This leaves sufficient room for financial institutions to operate within the law without discouraging competition and innovation.³¹

Global Crisis 2008 – Northern Rock – The Bank Run!

Northern Rock (NR), a building society was converted into a bank in 1997. NR started its banking business with a specific focus on the residential mortgage market. NR's business model was predicated upon mortgage lending, securitization (mortgage-backed securities), and bank deposits. There came a time when the pace of mortgage lending substantially exceeded the growth of retail deposits creating a funding gap which was then met by 'securitization and borrowing in the wholesale market'.³²

Securitization was a crucial source of NR's funding. Interestingly, the BoE had already identified (in April 2007, four months before the bank acquired BoE's support) the increasing wholesale funding of banks as a potential risk if the market was to decline.³³ Global crisis of 2008 which started in the US was an outcome of reckless securitization and Collateral Debt Obligations (CDOs). NR's exposure to securitization led to over-reliance on the wholesale money market. Market turmoil in 2007 in the US exposed NR to liquidity risk on account of its reliance on international wholesale markets to meet its need for securitization.³⁴

Thus, too much reliance on funding from international markets and securitization caused liquidity risk which was aggravated by the 2008 turmoil in the US, leading NR into crisis.³⁵ Since liquidity risk was not covered under any regulatory requirement, therefore, NR did not have to comply with any liquidity requirement. It was a time when the financial regulators were concerned with ensuring banks are properly capitalized³⁶ instead of liquidity risk.

International financial markets froze on 9th August 2007. It was apparent that a prolonged closure of markets will land Rock into trouble. The problems were specifically severe for NR because its funding model required mortgage-backed securities and plain mortgages to be securitized and its next securitization was scheduled for Sept 2007.³⁷

Tripartite Committee comprising FSA, BoE, and the Treasury started considering supporting NR by way of short-term money market operation or finding 'safe haven' or a government guarantee.³⁸ Government guarantee was one of the primary options being considered to help NR deal with its liquidity crisis. On 13th September, BBC broadcast the news of the possibility of financial support from BoE to NR.³⁹

This led to a bank run which turned out to be historical. Government guarantee then had to be obtained and matters got worst. How the NR's liquidity crisis was handled raised concerns about the UK financial regulations particularly regarding the deposit protection scheme, insolvency laws and bailout mechanisms.⁴⁰

More Regulations – Prudential Regulatory Authority and Financial Conduct Authority

The Financial Services Act 2012 was enacted which substantially amended the FSMA 2000. The FSA 2012 set up the PRA and the FCA in place of the FSA. FCA deals with the conduct and affairs of all business entities that directly affect the economy and PRA boosts this role by conducting necessary prudential regulations. FCA and PRA are driven toward the protection of consumers and the economy. FCA and PRA work alongside the Bank of England to perform its duty to maintain financial stability and prudential regulation.⁴¹ This demarcation of functions is substantially driven toward efficient supervision of the financial services industry to ensure consumer protection, market integrity, competition and innovation and reduction in financial crimes.

An Analysis of the UK Regulatory Framework

Principle-based Approach

The principle-based approach is more concerned with outcome than compliance. It allows for a degree of discretion till the desired outcomes are achieved. It does not delve into the underpinnings related to the procedure, but rather identifies certain objectives which then define policy. The benefits of this approach are that growth is organic as it is in harmony with the objectives of both the regulators and the regulated, with the least possible cost of compliance. An example of this approach is the principle regarding drunk driving. The principle is that a driver must consume alcohol responsibly when driving on public roads. The principle aims to achieve an outcome, i.e., to prevent accidents resulting from drunk driving without setting any limit on alcohol consumption. This principle leaves the implementation to the driver's judgment as to what quantity of alcohol would make him a responsible driver. UK's financial regulatory approach toward regulation has been predominantly principle-based, which largely ensures self-regulation.

Informal Supervision

A principle-based framework goes hand in hand with light supervision. Light supervision takes place when the regulators do not approach financial institutions from a scrutiny-based perspective, but instead from a collaborative and guidance-based perspective. Such a supervisory mechanism ensures compliance through problem identification and rectification, instead of fault-finding and penalization. This allows for a regular flow of information between the regulators and financial institutions and the building of rapport and trust. Although this type of supervision has been criticized for being too lenient and causing moral hazards but it has nevertheless proved to be effective as despite light supervision, none of the crises led to a systemic failure in the UK financial services industry.

The approach to regulation in the UK is changing but the change is gradual. There is a specific direction that the UK has adopted and that direction does not reverse the original paradigm that was in place from the advent. The original paradigm was self-regulatory supervision, operating in a relational framework. After the JMB crisis in 1984, came the enactment of the Banking Act of 1987, which introduced minimum capital and reporting requirements as a measure to improve accountability. In 1990, the BCCI filed for liquidation which led to further inquiries and recommendations for stricter disclosure requirements and better banks management. The 1995 Barings crisis met with similar reports emphasizing harnessing the BoE's ability to assess risks, which in later years culminated into FSMA 2000 amid calls for improving accountability. FSMA 2000 codified the informal regulatory framework, however it ensured that it does not put in place a strict zero-failure policy nor hinder innovation. The final crisis happened in form of the bank run at Northern Rock, due to reckless policy-making and lack of proper assessment of probable risks. In its aftermath came the FSA 2012 which divided the FSA into FCA and PRA, both with specialized tasks to make their operations more effective. What is apparent and consistent in this whole timeline, is the adaptation in a way that does not compromise the basic anchors of the UK's policy framework, which is based on collaboration, rather than the US-like top-to-down paternalistic approach embedded with deep-seated suspicious of the financial institutions. The UK has, to a considerable extent, adopted formalism in its regulatory approach, but this formalism is a collective venture that has been brought about gradually, in a way that still upholds the first principles and thus has not led to a reversal in direction, but has only strengthened the framework already in place. Very briefly, some structures require change, some practices become redundant, and some approaches lose their significance. Realizing this, UK's move toward a more statute-based system was inevitable,⁴² but in becoming increasingly statute-based, it has not lost the British touch of light supervision.⁴³

New York as an International Financial Center

From the great depression and consequent Glass-Steagall Act through numerous crises leading to the crisis 2008, the US regulators had adopted strategies of either strict regulation or de-regulation. Post-depression, after identifying the dual function of banks in carrying out both commercial and investment activities, Congress promulgated the Glass-Steagall Act of 1933, which separated commercial banking from investment banking to eradicate and minimize the possibility of conflict of interest.⁴⁴ The purpose of this Act was, to restrict the use of bank depositor's money for speculative investment ventures, and to re-direct the same flow toward what the lawmakers deemed were more productive functions such as industry, commerce and agriculture.⁴⁵ However, it soon had a harsh reckoning that this separation of commercial banking and investment could not be sustained. More than 900 banks were reported to have failed, following which, Congress through an

amendment to the 1933 Act remerged both commercial banking and investment banking streams and allowed banks to carry out the dual function.

This radical paradigm shift, that reversed the policy direction, potentially in a nosedive, led many commercial banks to merge with investment banks. Lehman Brothers acquired many commercial and investment banks.⁴⁶ For instance, in 2003 and 2004, Lehman Brothers acquired, including BNC Mortgage and Aurora Loan Services, five mortgage lenders that specialized in Alt-A loans where loans are extended without full documentation. These acquisitions generated several enormous risks for the company which became detrimental during the financial crisis of 2008.⁴⁷

Amendment in Glass-Steagall Act began an era of deregulation which led to the merger of commercial and investment banking. The story of the US financial trajectory is filled with such re-alignments which rendered previous policy initiatives redundant. Banks operated freely during this era until the financial crisis of 2008 hit the country. The housing bubble was blown by financial engineering devised by banks. Thus crisis 2008 which rattled the global financial system was an outcome of deregulation, which surfaced by the amendment of the Glass-Steagall Act.

Financial Crisis 2008

The financial crisis of 2008 was primarily a result of the bursting of the housing bubble, in which lenders went bankrupt filing for liquidations and investors lost a lot of money, creating panic in the US economy and pushing it into a recession.⁴⁸ The seeds of the crisis can be traced back to the loose monetary policy, which encouraged people taking out loans to invest in housing.⁴⁹ This created a housing boom, which was fueled by increased borrowing from banks, which were backed by mortgages. Investors felt housing to be a lucrative market and started buying these mortgages from banks. As the investor's interest increased, these mortgages were consolidated into mortgage-backed securities and made accessible to a wide range of public. To increase the amount of these securities considering the keen interest shown by investors, the banks started to give out mortgage-backed loans to less credit-worthy customers, to increase the base and this created what is referred to as sub-prime mortgages.⁵⁰ In all this time, credit rating agencies kept giving AAA ratings to these mortgage-backed securities without realizing that these securities were purely speculative. All this led to the development of the bubble, and property prices increased astronomically, only to reach their peak. Housing became very expensive over time, and unable to pay the huge returns on loans, people defaulted on their loans and this started the process of the bursting of the bubble. The houses prices started coming down after reaching their peak, and the lenders could not recover their money by selling off the mortgages and many went into liquidation.⁵¹ Fall in housing prices led to a sharp decline in the mortgage-backed securities, and investors who had put in large amounts of money lost considerable sums.⁵² To further exacerbate

the panic, the insurance agencies that had sold credit default swaps,⁵³ which served as the fallback option in the event of defaults, found out that they did not have enough money to back these instruments and could not pay off their customers, which added to the strain on financial institutions.⁵⁴ All this led to recession and panic in the economy.⁵⁵ One of the major triggering episodes of this crisis was the fall of Lehman Brothers.

The Fall of Lehman Brothers

Lehman Brothers Holding Inc. was a US investment bank that dealt primarily in mortgage-backed securities. These securities were essentially bonds, through which a company buys a bundle of home loans from the banks. These bonds were very risky because if the borrowers defaulted on the mortgages, the securities were bound to become worthless. The housing boom in the US during 2003–2004 resulted in an over-abundance of such securities, and the Lehman Brothers were one of the major participants.

By 2003, the Lehman Brothers started doling out such mortgage-backed loans themselves. These loans were made to borrowers without proper scrutiny. With the huge investment in mortgages and mortgage-backed securities, there came a time when Lehman's debt to equity ratio was 31:1. This meant that any slowdown in the property market would further increase the debt-to-equity ratio.

In other words, the Lehman Brothers made huge investments in highly risky financial instruments (mortgage-backed securities) including the mortgages that were exposed to unguaranteed loans, and at the same time were operating on a very high leverage ratio. Thus, a slowdown in the housing market led to defaults on mortgages and created a credit crisis. Following this, the biggest competitor of Lehman Brothers, Bear Stearns failed and was bought out by JP Morgan chase in a deal backed by the Federal Reserve. This sent signals in the market that the Lehman Brothers was next, and its stocks started plummeting while its investors backed out. As soon as it came to the fore, that a potential rescue deal for the Lehman Brothers had fallen through, the company's stocks plummeted drastically, and it had to file for bankruptcy. Federal Reserve decided to let Lehman Brothers fall instead of bailing it out.

There were several reasons why the Lehman Brothers did not receive a bailout. One of the most obvious was the massive amount of debt that was owed, which was around \$619 billion. Another reason was that the Lehman Brothers was not a retail bank and the government felt that the fallout on the ordinary public would not be too great. The major reason was that the US government had already intervened by rescuing Bear Stearns, Fannie Mae, and Freddie Mac; hence the Federal Reserve decided to prevent moral hazard by letting Lehman Brothers go down.

In 2008, Lehman Brothers filed for liquidation. The damage included layoffs of 26,000 employees, around 80 insolvency proceedings of its subsidiary companies in eighteen different countries, and 66,000 claims on its real

estate.⁵⁶ The collapse of Lehman Brothers is attributed to factors including the merger of commercial and investment banking services, investment in real state, questionable management practices, liquidity issues and high leverage ratio. Due to the amendment in the Glass–Steagall Act, banks were permitted to carry out both commercial and investment banking. Lehman Brothers made huge investments in high-risk real estate and subprime mortgages, which when deteriorated threatened their survival. The practices of management were questionable, and the entity made use of repos 105 transactions to hide the firm’s financial conditions.⁵⁷ Although this was a violation of the Sarbanes–Oxley Act, but it went unreported. The company had assets, but they could not be liquidated immediately to meet the short-term obligation, which created a debt crisis.⁵⁸ Finally, the company was running on a high leverage ratio, and had indulged in excessive borrowing which shrank its equity.⁵⁹ This huge leverage ratio was difficult to sustain, and the global financial crisis triggered the downslide of prices and along with, increased interest rates and that dramatically harmed the financial standing of the entity. All these factors were responsible for the final demise of the entity, which had costly fallout.

The fall of Lehman Brothers shook the US economy, by crippling the entire financial system. The government introduced the Troubled Asset Relief Program intending to rescue the financial system by preventing the domino effect of the systemic failure, and the long-term response to the crisis came through the introduction of the Dodd–Frank Act of 2009.

The Troubled Asset Relief Program (‘TARP’)

At the beginning of the crisis in 2008, Federal Reserve adopted a policy to arrange bailout for the struggling financial institutions such as Fannie Mae, Freddie Mac and Bear Stern. Later, it let Lehman Brothers go bankrupt to avoid moral hazard. However, Lehman Brothers’ bankruptcy exposed the US economy to systemic failure. To protect the economy, Emergency Economic Stabilization Act 2008 (EESA 2008) was enacted to introduce the Troubled Asset Relief Program (TARP).

President George W. Bush signed the Emergency Economic Stabilization Act (EESA) 2008 that initiated thereunder Troubled Asset Relief Program (TARP) that today is also termed as the bailout legislation.⁶⁰ EESA prescribed that TARP would purchase the ‘troubled assets’ from financial institutions.⁶¹ It defined ‘troubled asset’ as residential or commercial mortgages and any securities, obligations or other instruments that are based on or related to such mortgages. Only if such instruments have originated or issued before or on the 14th of March 2008, they would qualify as ‘troubled assets’.⁶²

EESA vested in the Treasury Secretary the authority to make a decision regarding the purchase, hold and sell off troubled assets so that the costs of TARP to the taxpayer could be minimized.⁶³ The secretary also had to ensure that all financial institutions are eligible to participate in TARP.⁶⁴ Once troubled assets are acquired, the secretary is vested with the authority

to exercise any right received concerning the troubled asset; manage the troubled asset including its revenues and portfolio risks and sell the troubled assets or any portion of it.⁶⁵ EESA granted treasury departments funds of up to \$700 billion, as already discussed, to purchase, manage and sell troubled or toxic assets from financial institutions. The authority of TARP stood expired by October 2010.

The Dodd-Frank Act 2009

The Dodd-Frank Act 2010 was enacted to introduce financial stability through strict regulations for the financial industry. The Act considerably reshaped the financial regulatory framework of the US with the main focus on prevention of bailout, discouraging excessive risk-taking, increased disclosure and consumer protection. It aimed to protect the taxpayer by preventing bailouts, and consequently, discouraging the notion of 'too-big-to-fail'. It served the purpose of protecting consumers from abusive financial services practices.⁶⁶ It contained provisions relating to the mitigation of risk-taking by banks and non-banking financial firms and the liquidation procedure to be applied in future crisis.⁶⁷ The act imposed stricter regulations on banks that have total assets of more than \$50 billion. It justified this requirement on the basis that the collapse of a large financial institution would once again give rise to systemic risk.⁶⁸ It granted several federal agencies additional regulatory powers and almost regulated every aspect of the financial services industry.⁶⁹ In terms of disclosure, the act directed Securities Exchange Commission ('SEC') to require public companies to disclose the ratio of pay between the median employee of the company and the Chief Executive Officer ('CEO') of the company or any other principal executive officer.⁷⁰ This rule requires that the pay ratio, instead of being furnished, must be filed and shall be subjected to the certification of the CEO and CFO.⁷¹ However, it exempts smaller reporting companies, foreign private issuers and emerging growth companies from its application.⁷²

The Act led to the establishment of the Consumer Financial Protection Bureau⁷³ that is given the authority to formulate rules for consumer protection. This bureau is the primary supervisory and enforcement authority over consumer financial services companies and large depository institutions. It has achieved beneficial results in favor of consumers, as it is apparent from the fact that it successfully extracted billions in fines from big banks, for instance, in 2016, it extracted \$100 million from Wells Fargo for opening sham accounts that the customers did not ask.⁷⁴

The Act has been criticized for being overly strict. The Act has been subjected to criticism for its limited banks' ability to make profitable investments curtailing credit availability. Further, the act included a provision that prohibits Federal Reserve to provide emergency loans to a single firm, instead, it should be made available to an entire category of institutions termed as, 'broad-based eligibility'.⁷⁵ This restriction on the authority of Federal

Reserve, regardless of its commendable goal, has been criticized to expect- edly reduce financial stability and increase the moral hazard concern together with no positive impact on the economic growth.⁷⁶ The broad-based eligi- bility standard prohibits Federal Reserve to make emergency loans until the action can be justified for the entire class of institutions. Thus, the Federal Reserve will have to wait till the financial crisis gets worse or to ignore the spirit of the law, and lend emergency loans to a single firm

In response, Congress, in May 2018, passed Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA), which has considera- bly reduced restrictions imposed by Dodd–Frank Act. The enactment of the EGRRCPA is a move toward deregulation.

Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) 2018

The EGRRCPA is alarming for two major reasons. First, the Act 2018 has considerably reduced the Consumer Protection Bureau’s rule-making power, which results in weak protection for consumers. Second, the Act of 2018 has set the threshold of \$250 billion for the applicability of stringent require- ments for banks. Dodd Franks set a bar of \$50 billion which was criticized for being extremely strict and detrimental for banks. The new threshold of \$250 billion is too lower a regulatory bar which represents de-regulation.⁷⁷

The US Regulatory Approach

The US regulators either adopted strict regulations such as Glass–Steagall Act and Dodd–Frank or reverted to de-regulation as advanced by amendments in the law. This tendency leads to either enormous progress or global crises. Additionally, three main features obstruct innovation in the US financial sys- tem. The first is that the legal system is fragmented and there is a lack of har- mony between the agencies responsible for financial regulation, the approach to regulation is rule-based as compared to principle-based, which leads to rigidity, and finally that the regime is based on punitive supervision, which receives increased impetus after every crisis. It is important to understand all these features individually to appreciate the reasons for the non-existence of niche areas of finance, i.e., Islamic finance.

Fragmented Legal System

The US (and by extension New York) legal system is divided between federal and state courts. This structure allowed regulatory arbitrage in the market. Regulatory arbitrage is a corporate practice of circumventing unfavorable regulatory conditions by using the loopholes present in the laws. In other words, financial institutions could play around regulations to operate profit- ably without violating any regulations.

Two main types of regulatory arbitrage exist in the US financial markets on account of the fragmented legal system. The first one was by way of restructuring certain transactions in a way that gives favorable regulatory treatment to a business. An example of this was the Initial Public Offering of Blackstone in 2007, where it went public as a master limited partnership instead of a public limited company, to benefit from higher liquidity that going public brings while at the same time avoiding the higher taxes imposed on public corporations. Similarly, Blackstone also carefully took benefit of the legal definition by avoiding itself to be classified as an 'Investment Company' through skillful evasion, to retain tax benefits, it enjoyed. The second form of regulatory arbitrage that was very common on account of separate state and federal laws was 'geographical relocation' to states that had lax regulations and lower tax rates. Geographical relocation does not necessarily require a company to set up full operations in the state of registration, but only to set up an office as a means to getting lower taxes on profits that were shown to have accrued in that particular state. An example of such a state is Delaware, where businesses usually set up operations to benefit from favorable tax treatment, as Delaware has exemptions on State sales tax and State Corporate Income Tax. Such loopholes become very easy to exploit when the legal system is fragmented and there is a lack of certainty between the regulatory structures as to their jurisdictions.

Moreover, there was excessive overlaps in regulations of the financial institutions. For instance, the regulatory structure authorized Federal Reserve, Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation's (FDIC), and State Bank Supervisors to regulate various financial practices simultaneously such as the activities of depository and lending and consumer financial products.⁷⁸ All these agencies were responsible to regulate market at the same time, which leads to increased complications.

Post-crisis 2008, the complexity in regulations is maintained and instead of consolidating the agencies to eliminate overlap in jurisdiction and fragmentation, through Dodd-Frank, Congress found it convenient to absolve previous agencies and create new agencies.⁷⁹ To address the concerns of lack of coordination among agencies, Dodd-Frank assigns multiple agencies to draft rules and regulations jointly.⁸⁰ This has produced mixed results; this has led to increased friction among agencies and several congressionally mandated deadlines have been missed (Figures 1.1 and 1.2).⁸¹

Rules-Based Regulations – Impeding Financial Innovation

There are dominantly two approaches that the regulators adopt to govern the financial market: rule-based and principle-based. The rule-based approach necessitates the codification of detailed rules and regulations that define and encapsulate all financial market practices. This approach ensures certainty and predictability in the market.

The US relies primarily on a rules-based approach toward financial regulations. The rules-based approach allowed certain Citigroup traders to violate

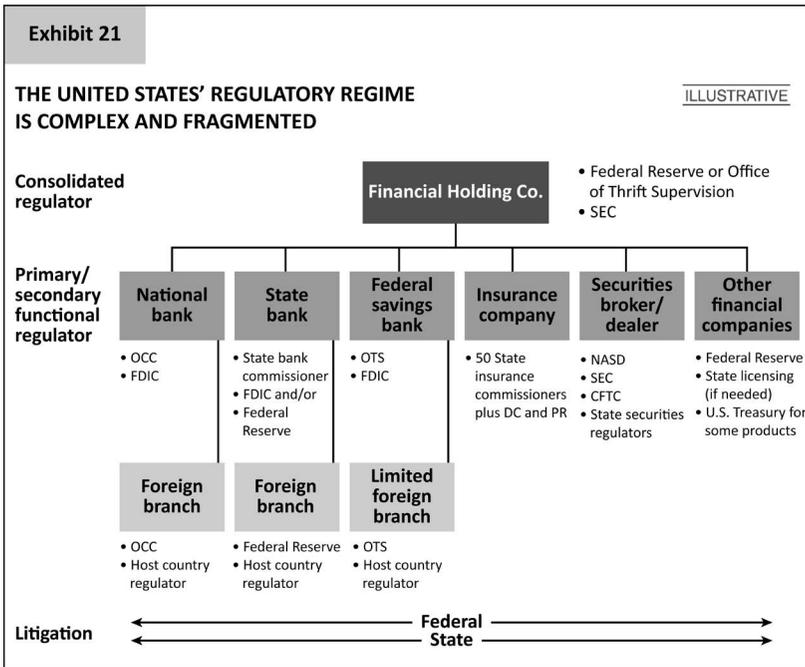


Figure 1.1 Fragmented Regulatory System of the United States

Source: Michael R. Bloomberg and Charles E. Schumer, 'Sustaining New York's and the US' Global Financial Services Leadership' 2020 The United States Senate < http://www.nyc.gov/html/om/pdf/ny_report_final.pdf>

Depository and Lending Activity	Federal Reserve	OCC	FDIC	State Banking Supervisors
Consumer Financial Products	CFPB	State Banking Supervisors		
Securities and Bonds Products	SEC			
Derivatives Products Exchange Based	CFTC			
Derivatives Products Over-the-Counter Based	SEC	CFTC		
Insurance Products	State Insurance Regulators			

Figure 1.2 United States' regulatory framework after Dodd-Frank Act

Source: Martin Neil Bailly and others, 'The Impact of the Dodd-Frank Act on Financial Stability and Economic Growth' (2017) 3(1) The Russell Sage Foundation Journal of the Social Sciences, p 37 <<https://www.jstor.org/stable/10.7758/rsf.2017.3.1.02>> accessed 26 April 2021. Neiman and Olson (2014, 49–50).

the spirit of the trading rules when it exploited the weakness incumbent in the Italian-based MTS electronic bond market.⁸² On 2nd of August 2004, Citigroup placed sell orders worth 11 billion Euro in a span of 2 minutes, through the automated system of MTS electronic bond market. This amount was equivalent to a full day's trading volume at MTS. As soon as the sell orders were placed, the supply increased and the market gave the signal to the traders to cover their position and sell because it is the basic rule that when supply increases, the market goes downward. The panic that was created, and the signals sent out, led to a drastic reduction in prices and as soon as the prices fell, Citigroup re-entered the market and bought back the same orders at drastically lower rates, making exorbitant profits on the transaction.

Although this was not a violation of any rule, it was the unethical practice that led to huge losses for others, and seven of the Citigroup traders were indicted for market manipulation. As a precaution, the MTS system set a limit on the maximum amount of transactions one dealer could push through the market. The above example illustrates how the rule-based system is vulnerable to such activities which do not expressly violate any rule but destabilize the market.

The rule-based regime has also led to a dramatic rise in costs of compliance that are reported to be 'duplication of examinations, regulations and supervisory actions'⁸³ and also hinders innovation.

An example of this is the Sarbanes-Oxley Act of 2002, which sought to create a risk-averse atmosphere in the US, and as result, it stifles growth.⁸⁴ New York lost and significantly got abated the innovative edge that it had in creating and trading derivatives when during the 1990s, London, under the government of Blair, played a key innovative role in conceptualizing and executing complex financial structuring under the public-private partnerships (PPP) of private finance initiative. This innovation of London added to the financial versatility of the region, and at the same time, challenged the dominance of New York among IFCs.⁸⁵

Punitive Supervision

The punitive nature of supervision is a distinctive feature of the US financial regulations. For instance, Martin Act empowers the New York Attorney General to bring criminal charges against the perpetrator of securities fraud without proving the existence of mens rea, i.e., intent to fraud are essential elements of a crime.⁸⁶ This view has led the courts to hold that 'a belief that a transaction was proper is not a defense', as the Act is 'directed at acts or practices, and not at any particular mental state on the part of the actor'.⁸⁷ New York State has generated \$6.61 billion in settlement fees from federal and state actions against domestic and foreign banks, and by extension, New York legal system is also considered as unpredictable. Similar attributes could be found in both the Sarbanes-Oxley Act 2002 and the Dodd-Frank Act 2010, as discussed in the earlier part of this chapter.

The basic reason for which punitive measures are seen to be detrimental is the fact that the growth and success of a corporation lie in innovation and risk-taking. Punitive measures discourage risk-taking. Thus, the jurisdictions that have non-punitive regulations have a more vibrant financial market. The second reason is that punitive rules attempt to remove the corporate veil and create liability for employees. This personal liability for a company's employees is a huge deterrent in its decision-making. Particularly, the Martin Act, which circumvents the ordinary procedure of pinpointing mens rea and thus creates strict liability, explains why corporations would readily avail other options if they are on the table.

The US system is fragmented and represents a lack of harmony and consolidation in the working of regulatory agencies, the system is rule-based and not principle-based, which results in rigidity and unwanted formalism, and lastly, the regime is guided by the ideology of punitive supervision, which represents a deep mistrust of the system and its stakeholders. It is not wrong to say that the Great Depression made ripples in the US economy, which never really stopped hitting its shores and defined the pattern for US bank regulations, which have persisted forever. The effects of the great depression were further accentuated by the domestic political currents of the time, arising from the progressive movement, which had, at the core of its ideology, a deep-seated suspicion and hostility toward big money-making institutions. The great depression became the catalyst for allowing this suspicion and mistrust to be put into a policy framework, bringing in a structure that has constrained the US regulatory responses within well-defined contours, i.e., deregulation and strict regulation. It is this contrast in approaches to supervision that explains why Britain has been the place of preference for financial stakeholders, and the US being vice versa. Although efforts, sometimes fruitful, have been made to break out of these confines imposed by the great depression, the successful political appeal of the old ideology had thwarted these efforts by and large.⁸⁸

Singapore as an International Financial Center

Singapore's separation from the Federation of Malaysia in 1965, and the introduction of the Asian Dollar Market (ADM), which served as a conduit between the US and the European Markets, placed it very favorably on a path to becoming an IFC. The keen interest was shown by the government to catapult financial growth and the efforts of both the rules-making and rules-implementing bodies in making it possible further harnessed its potential to become an IFC. The efforts of the law-making bodies were manifested through several acts such as the Banking Act and the Foreign Exchange Act 1970. Meanwhile, the law implementing body, the birth child of MAS Act 1971, the MAS served as both a financial regulator and the central bank and made immense contributions to the growth of the financial market in

Singapore. The MAS effectively catered, with utmost tenacity and adaptability, to both the banking sector of the economy and the securities market. Another body, which had a great role to play in resolving of disputes that arose, was the Singapore International Commercial Court (SICC), which went out of the way toward accommodating all domestic and foreign stakeholders. An important testament to the stewardship of Singapore's government of its economy was its damage control after the watershed global financial crisis, which sent ripples that hit shores around the world. Singapore's efforts to bring its economy out of the ravages of this crisis through its stimulus package and its effective engagement with the growing Islamic finance industry provide a model for other similar jurisdictions.

The Initial Stimulus

The government of Singapore has actively participated in guiding it to become an international financial center. The government shaped the trajectory of Singapore from starting as a cheap consumer goods manufacturer to a stronghold provider of financial services.⁸⁹ It lent its political will to invite foreign investments through creating an open and friendly environment.⁹⁰

After separating from the Federation of Malaysia in 1965, Singapore laid down the foundation of the ADM that served as a conduit between the US and the European market.⁹¹ The market held the time-zone advantage; it filled the gap between the close of US market and the reopening of European Market. The state, to exploit the opportunity, introduced fiscal incentives to attract investment in the market.

For instance, to incentivize foreign banks and financial institutions, in 1968, the government removed the 10% withholding tax levied on non-resident foreign currency deposits.⁹² The government of Singapore also enacted the Banking Act and the Foreign Exchange Act 1970 to encourage foreign financial institutions to operate and invest in Singapore.⁹³

The government consolidated the local banks of the country to increase their competitiveness. This includes the consolidation of the Development Bank of Singapore (DBS), United Overseas Bank (UOB), and Overseas Chinese Banking Corporation (OCBC) as the three major local banks of Singapore.⁹⁴

The Contributions of the Monetary Authority of Singapore (MAS)

In 1971 MAS Act was enacted and set up the MAS. The MAS served as the financial regulator and the central bank. It was also made responsible for the regulation and promotion of the financial services sector.

It administers the Banking Act 1970, Exchange Control Act 1953, and Finance Companies Act 1967, and grants licenses to the financial institutions.

In the 1997 strategic review, the MAS shifted its approach from the one-size-fits-all, i.e., rules-based approach, to a rather flexible risk-focused supervision.⁹⁵

The examination of the risk profile of banks for the grant of a license, rather than focusing on specific regulations, provided a higher level of flexibility to these financial institutions. This allowed the MAS to strictly regulate the financial institutions that hold weaker risk profiles and leave a greater business latitude toward those whose risks are well-managed. The risk-focused approach, termed as smart regulation, comprised a mix of regulatory standards wherein its implementation was varied and resulted in flexibility based on the risk profiles of the institutions. Furthermore, the MAS adopted an inclusive approach in developing strategies to promote Singapore's role as an international financial center. In doing so, it developed strategies in collaboration with the private sector.⁹⁶

MAS and the Banking Sector

Till 1970, Singapore had the category of fully licensed banks, but a year later, MAS introduced two more categories, i.e., restricted license and offshore license banks.⁹⁷ This step allowed the operations of international banks and money brokers in Singapore's financial market.

A full license bank is authorized to perform all bank activities. It means that given they have an Asian Currency Unit license, they may accept deposits and may grant loans in foreign currencies.⁹⁸

The banks falling under the category of restricted license banks with some restrictions can perform all types of banking activities. The restrictions involve a minimum capital requirement of S\$250,000 to accept any deposit and limit to operate saving accounts.⁹⁹

The third category of Offshore license banks are not allowed to accept Singapore dollar deposits from other banks unless they are made through other banks or approved financial institutions.¹⁰⁰

In 1999, Singapore introduced several reforms to its banking laws, which included wide-ranging changes in the operation of financial and commercial banks in Singapore, including full license banks, restricted license banks, and offshore banks. Singapore realized that the limitations setup on the restricted license banks were for acceptance of any deposits, and they had to meet a burgeoning minimum capital requirement, which hindered them from approaching the average customer and accepting deposits from them. So, in response to these concerns, the government announced to award five more restricted licenses.¹⁰¹ In these reforms, MAS also delineated the criteria to obtain new licenses or privileges. The criteria included the past three years' credit and legal support rating, the compliance record with financial regulations, and setting up of internal control mechanism.¹⁰²

Furthermore, previously there existed a 40% limit on the foreign ownership of a bank.¹⁰³ The bank reforms of 1999 eliminated any such limit and

allowed the local banks to form strategic alliances together with the foreign banks or else, pay for overseas acquisitions in exchange of shares. Even in these circumstances, Singapore prioritized its national interest and stipulated that Singapore citizens or permanent residents must form the majority of the Board of Directors of local banks.¹⁰⁴

MAS, to ensure that the banks confirm the overall national interest of Singapore, setup the requirement that banks must appoint a nominating committee to confirm if the banks operate in a manner consistent with the national interest. The appointment of the nominating committee was subject to the approval of MAS.¹⁰⁵ This policy allowed the government of Singapore to put focus on the local banks so that the country's long-term interests are preserved.¹⁰⁶

MAS and the Securities Market

In 1973, the Stock Exchange of Singapore was established to create a deep and liquid capital market.¹⁰⁷ MAS has a substantial role to play when it comes to regulating and administrating Singapore Exchange (SGX). It holds the power to issue directions to and frame regulations for the SGX. It also holds the authority to call companies' statutory annual reports and is obliged to grant licenses to the market participants. In case any company violates the Securities and Futures Act, MAS can also charge such listed companies with civil penalties and may also settle the matter out of court.¹⁰⁸

If the company is generating profits or avoiding loss through violating the statute, MAS may award a civil penalty of an amount three times of the profit generated or the loss avoided along with a minimum penalty of S\$50,000 (individuals) and S\$100,000 (corporations).¹⁰⁹ Thus MAS serves the dual function of the rule-making authority and the civil prosecutor, to whom all the market participants are answerable.

MAS established the Financial Promotion Department that focused on promoting the financial activities in Singapore.¹¹⁰ Moreover, in the budget of 1992, there was a further reduction in the corporate tax, and a double tax deduction was introduced against the expenses incurred by the banks.¹¹¹

The Singapore International Commercial Court (SICC)

Singapore laid the foundation of the SICC on 5th January 2015 and became a dispute resolution hub. The SICC is a division of the Singapore High Court that deals with commercial disputes. SICC's jurisdiction arises when

- 1 Parties have pre-determined SICC as a choice of forum in the initial agreement, or
- 2 Parties chose SICC as a choice of the forum at a later stage through mutual agreement, or
- 3 The High Court of Singapore transfers the matter to SICC.¹¹²

Constitution of Republic of Singapore 1965 was amended to allow the president to appoint international judges to the SICC.¹¹³ The Supreme Court of Judicature Act 1969 was amended to make the SICC a division of the High Court of Singapore, and amendments were also introduced to the Legal Profession Act 1966 to authorize the participation of foreign lawyers in the proceedings before SICC.¹¹⁴

Thus, foreign councils, who are registered with the SICC, may appear on behalf of the parties and can participate in the proceedings.¹¹⁵ By 2021, there are 87 foreign councils (from the US, the UK, Hong Kong, Malaysia, and India) are registered with the SICC.¹¹⁶

Furthermore, the SICC's decisions are enforceable in entire Singapore. To setup enforcement of SICC judgments internationally, Singapore has entered into reciprocal enforcement conventions, treaties, and agreements with 44 countries.¹¹⁷ If the judgment involves the payment of sums of money, the payment can be collected by way of an action for debt/recovery suit following the normal procedure adopted for same, in common law jurisdictions.

To ensure fair and transparent procedure, the proceedings before SICC are held in open court, and the decisions are published¹¹⁸; however, parties to a dispute can also request the court to hold proceedings before a camera and seal the documents. Through an agreement, the parties may further request the court to follow and apply the evidential rules of another jurisdiction.¹¹⁹ The decisions can be appealed before the Court of Appeal of Singapore. Furthermore, the judges (appointed from various international jurisdictions such as the US, UK, France, and Australia) are experts and well-versed in the field of commerce and finance.¹²⁰ This allows the judges to swiftly handle international-cum-commercial matters involving different legal traditions and complex issues of law.

The attributes specified above as evident from SICC's first decision in the case of *BCBC v. PT Bayan Resources*.¹²¹ The parties in this dispute sought from SICC the relief of damages for the alleged breach of contracts, guarantee, misrepresentation, negligence, and inducement to enter the joint venture. The parties consisted of companies from Australia and Indonesia, together with associated companies in Singapore. On account of the international nature of the dispute, the High court transferred it to the SICC.¹²²

The matter involved a joint venture project that concerned the production and the sale of upgraded sub-bituminous coal. Under the rules applicable, the parties were required to disclose all the documents relevant to the suit that are in their possession, including the documents which can adversely impact the party's case. Before the SICC, however, these rules were modified to require the disclosure of documents which either the parties were intending to rely on, or which the parties had requested to be disclosed.¹²³

In this matter, the allegations of fraud were in place, the High Court of Singapore, before it transferred the case to SICC, on the request of the defendant, ruled in favor of applying the general regime of discovery. The court also conducted the proceedings of the requested matter before a camera

and thereon, based on the request, sealed certain documents relating to the financial reports and technical drawings, and witnesses.¹²⁴

Crisis 2008

As a result of the 2008 crisis, Singapore became the first country in the East Asian region to fall into recession. Singapore primarily relied on the export of manufactured products, and the financial crisis invited a decline in exports because Singapore's partners abroad were ailing.¹²⁵

The crisis also impacted Singapore at the front of labor productivity. To attend to the matter, wage cuts and retrenchments became the solutions.¹²⁶ As an aftermath of it, the country faced a sharp decline in consumption because of the ongoing wage cuts and retrenchments. MAS moved to ease its monetary policy, which led to the devaluation of the Singaporean dollar, which made its exports cheaper and thus more competitive in the international market, preventing the export rate from falling. Moreover, Singapore also faced an increase in inflation of nearly 6.5% by 2008.¹²⁷

The global financial crisis in the west opened the state-owned holdings of the countries like Singapore to a threat. The wealth these state-owned holdings accumulated allowed them to make risky investments, even where the investment by the respective government is perceived as strategically sensitive.¹²⁸

Temasek Investment

Temasek Investment, the holding chaired by Ho Ching who was the wife of the then-acting Prime Minister Lee Hsien loon, controlled Asia's most prominent firms¹²⁹ and has a reported record profit of more than 18 billion Singapore Dollars, which is approximately USD 12 billion. Citigroup Global Market has also ranked Temasek Investment as the leading and the largest wealth fund in the world.¹³⁰

The holding purchased stakes in the leading financial institutions in the US and Western Europe, specifically, a billion-dollar stake in the US bank Merrill Lynch. It continued to build up stakes in the Merrill Lynch, Barclays, and Standard Chartered. Disregarding the earlier signs of problems in the global banking sector in the first half of 2008, it continued to expand its financial service industry portfolio to a huge 40% in total.

Temasek Investment suffered significant losses of up to \$2 billion when these global financial institutions were hit by the crisis.¹³¹ The holding bought the stakes for an average of \$23 a share, which, after the crisis, dropped to less than \$12 a share.¹³² Temasek purchased the stakes in Merrill Lynch worth the cost of \$5 billion, which, after the crisis, dropped to \$2.7 billion resulting in a loss of nearly 45% investment.¹³³ When Merrill Lynch was taken over by the Bank of America in 2009, the holding further sold its 3.8% stake and further lost \$1.3 billion.¹³⁴

Government of Singapore Investment Corporation (GIC)

The second sovereign wealth fund of Singapore, the Government of Singapore Investment Corporation (GIC), which was managed by the former Prime Minister Lee Kuan Yew, also suffered significant losses during the global crisis 2008. It was estimated that the GIC's foreign reserves accounted for SGD 550 billion and if it suffered the approximate losses to that of Temasek's, it had lost around SGD 170 billion.¹³⁵ The MAS also admitted that the financial crisis and global recession severely hit its assets, culminating the total losses of more than SGD 9.2 billion or 3.5% of the bank's average assets.¹³⁶

The Stimulus Package

The MAS and the Ministry of Finance (MOF) announced that the government will setup SGD 150 billion to provide a guarantee to all the bank deposits in the city-state till the end of 2010.¹³⁷

It announced a bail-out package of amount SGD 20.5 billion, which was 8% of the city-state GDP.¹³⁸ This was the largest package ever announced by the government in the Asia Pacific region. The bail-out package aimed at preserving jobs and stimulating the financial sector. The package included reduction of corporate income tax from 18% to 17% (costed SGD 400 to 500 million); SGD 5.1 billion to help companies retain their employees; SGD 2.6 billion to support low-income households; SGD 2.6 billion to enhance cash flow and competitiveness of businesses; SGD 5.8 billion to help free up lending; and limited to one-year 20% rebatement of income tax.¹³⁹ Since the crisis primarily hit the financial institutions, which employed mainly graduates and diploma holders, they formed the majority who lost their jobs, the government announced a subsidy to the recession-hit banks and financial institutions that employed the new graduates.¹⁴⁰

Engagement with the Islamic Finance Industry

Minister of Trade and Industry, Mr. Lim Hung Kiang said that our aim is not to establish ourselves as an Islamic financial center, but we want the industry to be an extension of our financial service center.¹⁴¹ By 2013, Singapore was home to various financial institutions and banks offering Islamic financial services, including the Islamic Bank of Asia, OCBC, Standard Chartered, CIMB, Maybank, Tokio Marine Re Takaful, Daiwa Asset Management, Arcapita Bank, and Emirates NBD. Middle Eastern banks in Singapore have also started opening Islamic banking windows for their corporate clients. Additionally, the city-state offers favorable prospects in terms of ease of doing business and enjoys strong strategic connections to the world's economic giants such as Hong Kong and London.¹⁴²

The MAS is to be credited for ensuring a level playing field for Islamic finance. Shariah-compliant banking services were available in Singapore

since 1995, in the form of window facilities, and takaful products.¹⁴³ In 2003, the MAS joined the Islamic Financial Services Board (IFSB) as an observer member and became a full member by 2005.¹⁴⁴

Singapore has by being a member of the IFSB adopted several recommendations of the IFSB, which included its recommendations on capital adequacy standards for Islamic banking and financial products as set out in its guidelines, IFSB-2.¹⁴⁵

The first major obstacle or hindrance in the effective operations of the Islamic finance industry and its competitiveness with its conventional counterpart was excess taxation, which was concomitant to the structured financing arrangement on which most Islamic products and transactions depended. The Singapore government realized that the Islamic finance industry was at a disadvantage in terms of taxation. This is because most Islamic products and transactions are backed by procedures that either includes buying and selling of underhand assets; thus the taxation policy automatically added cost to each transaction. The taxation policy therefore was aligned to the needs of the industry, by providing concessions that effectively brought the taxes paid on these transactions to the same level as that of conventional banking transactions.¹⁴⁶

MOF announced several changes in the 2005 and 2006 budgets. In 2005, Singapore waived the imposition of double stamp duties on Islamic finance transactions. Similarly, a 5% concessionary rate was introduced for income derived from Shariah-compliant funds, lending, insurance, and re-insurance.¹⁴⁷ The FTSE SGX Asia 100 Shariah Index was launched in 2006 at the Singapore stock exchange (SSX) comprising 100 Shariah-compliant Asia-Pacific stocks.¹⁴⁸ MAS also granted approval to banks to engage in non-financial activities, such as commodity trading, to facilitate murabaha transactions.¹⁴⁹

Further efforts to encourage and perpetuate Islamic finance came when the DBS Bank launched the first Islamic bank in 2007, the Islamic Bank of Asia, after receiving official approval from MAS for a full bank license.¹⁵⁰

In 2009 first sukuk was issued, jointly arranged by the Standard Chartered Bank and the Islamic Bank of Asia.¹⁵¹ It was a landmark facility that allowed Islamic financial institutions (IFIs) the highest credit quality investment option, which was considered safe and risk-free, and the IF could tap the liquidity of MAS whenever required.

At the same time, an added benefit with these sukuk was that because they were of the highest credit quality; these sukuk certificates also counted toward the calculation of liquidity and capital position of the institutions, which were required to maintain a particular threshold of liquidity, and capital deposits.¹⁵²

Singapore also hosted the 6th IFSB Summit in May 2009, which was attended by more than 300 delegates from Asia and the Middle East.¹⁵³ Singapore Management University established an International Islamic finance and law center, while HSBC Insurance launched a takaful training program catering to Singapore's Islamic religious teachers.¹⁵⁴

Singapore's Minister for Trade and Industry said concerning Islamic finance, 'We don't set out with [a] clear target that we want to establish ourselves as [an] Islamic financial center or ask ourselves what we can do. We see this as an extension of our development as a financial services center'.¹⁵⁵

Singapore's approach toward Islamic finance was one of adapting its existing conventional banking regulations to facilitate Islamic banking and promulgating new regulations where necessary. It has taken a piecemeal approach toward Islamic finance, which comprises adding and amending legislation and introducing subsidiary legislation wherever necessary, to enable Islamic finance to operate side-by-side with conventional banking. These regulations are, however, couched in secular language and betray no religious underpinning. Thus, the main legislation governing Islamic finance in Singapore is the Banking Act 1970 and the Securities and Futures Act 2001. No legislation specifically caters to Islamic banking.¹⁵⁶

The Banking Act, through Sections 30 (1) (d) and Section 78 (1), has granted MAS the authority to amend its rules and regulations to make timely adaptations to changing market currents. This authority allowed MAS to introduce regulations facilitating Islamic banking and finance. An illustration of this flexibility was the permission given to banks to engage in non-financial activities, i.e., trading, to facilitate Islamic banking products like murabaha.¹⁵⁷

In cases where such products or transactions can fit within the existing framework, parties are allowed to apply that framework. For example, a musharaka transaction can easily be carried out under Singapore's Business Registration Act or can also be managed under the Business Trusts Act, Limited Liability Partnership Act, and Limited Partnership Act, and thus is allowed to be registered under these.¹⁵⁸

Regarding the advisory mechanism, consumers are expected to rely on the guidance provided by the in-house Shariah advisory bodies of the financial institutions. The conventional banks have to obtain Shariah rulings from individual Shariah advisors to give backing and legitimacy to their Islamic banking and finance products. Therefore, in Singapore, the issue of whether a financial product offered is compliant with Shariah standards is left to the discernment of consumers and the reputation of the financial institution's Shariah advisory board.¹⁵⁹

Finally, Singapore has Shariat courts that were established under the Muslims Ordinance of 1957. A year after Singapore's independence from Malaysia in 1965, the Muslims Ordinance was replaced in 1966 with the Administration of Muslim Law Act (AMLA)¹⁶⁰ in response to proposals made by the Muslims gentry.¹⁶¹ However, the AMLA restricts the powers of the Shariat courts to matters about marriage, divorce, the disposition of property upon divorce and inheritance.¹⁶²

AMLA provides for court presidents to be appointed,¹⁶³ it does not mention any specific qualification for this appointment, because of which the eligibility criteria for becoming judges/president of the Shariat courts are also shrouded in secrecy.¹⁶⁴

There is no effort to develop the jurisprudence of these amateur courts in areas such as Islamic finance, and this is highlighted by the fact that there is not even a proper selection criterion of judges to these courts; nor are these judges provided any training. All this reflects that although Singapore wants Islamic finance to flourish, it wants this to happen in a strictly secular manner.

In summary, it can be said that Singapore has managed to create a highly organized and technical regulatory regime that the secular courts can easily interpret when disputes arise, and which does not require the assistance of any over-arching Shariah advisory body. Thereby, they have managed to introduce Islamic banking and finance and create an effective structure for it to operate in the country, without specifically referring to Shariah in its regulatory framework.

The chronological timeline of Singapore's rise as an international financial center presented in this chapter manifests the eager economic reforms that made Singapore a favorable and preferred destination for investors and other stakeholders. The efforts of the MAS provided the required direction to the banking sector and the securities market. On the banking side, the introduction of new categories of banking institutions, such as restricted license banks and offshore license banks, provided an astronomical boost to the banking industry and opened space for new actors. Similarly, on the securities side, the creation of the SGX and its management by MAS to ensure strict regulations and compliance with the Securities and Futures Act allowed for sustainable growth and increased investments in the securities market. The role of SICC in terms of dispute resolution was also pivotal as it provided for the much-needed adaptability and inclusivity that an IFC needs, by providing for foreign councils and foreign judges to be a part of the court. The fair and transparent procedure adopted by these courts, and the enforcement mechanism provided for effective resolution of disputes in an expeditious and just manner, bolstered the confidence of all stakeholders. The global financial crisis of 2008, leading to a loss of billions of dollars, especially in the state-owned companies such as the Temasek Investment and the GIC, proved to be a litmus test for the Singaporean economy. However, Singapore displayed its capacity to deal with unprecedented situations by the introduction of the stimulus package that proved crucial in bringing the economy back on track. The flexible interaction with the relatively nascent Islamic finance industry in the aftermath of this crisis displayed Singapore's ability to adapt to difficult situations while making its way toward becoming an international financial center.

Hong Kong as an International Financial Center

The journey of Hong Kong toward becoming an international financial center was mired with booms and busts but the government displayed commendable stewardship. The pivotal stock market crash of 1973 unveiled the vulnerabilities of the financial regime, but it became a catalyst for renewed regulations, in the form of the protection of the Investor's Ordinance, and

the Securities Ordinance in 1974. The effectiveness of these regulations was once again called into question with the Stock Market Crash of 1987, also referred to as the Black Monday. However, the government took it as a stimulus for new reforms, and a new securities committee was established to propose reforms. This culminated in the introduction of the Securities and Futures Commission Ordinance, which marked the beginning of a single strong regulator, the Securities and Futures Commission. The SFC, through a series of inquiries and investigation, made its best efforts to tighten the noose around the culpable elements in the regulatory structure responsible for creating instability in the market, and was quite successful in this venture. However, its efforts fell short of preventing the stultifying impact of the global financial crisis of 2008, but Hong Kong did its best to recover. Further reforms were initiated, which included the formation of a Taskforce on Economic Challenges (TFEC) to identify proposals to deal with long-term issues, and the regulatory regime was strengthened through the crisis response strategy.

Stock Market Crash 1973

From the 1950s onward, Stock Markets started to gain momentum and made their way to the radar. The Hong Kong central bank took the immediate step, of increasing its overdraft rates,¹⁶⁵ to prevent borrowers from taking loans to invest in the stock market. This had a short-term effect, but the market kept escalating. Stock turnover reached its highest levels, and share prices doubled between 1959 and 1961.¹⁶⁶ However the boom was halted in June 1961 due to restrictions on borrowing placed to halt speculation.

The market got fresh momentum after a political rift was successfully dealt with. This renewed stability attracted a flood of new issues and right issues,¹⁶⁷ causing the market to climb and the nominal value of turnover tripled from HK \$305 million in 1967 to HK \$944 million in 1968.¹⁶⁸ This new interest in the stock market led to the opening up of new exchanges. These exchanges exposed the stock market, to a whole new range of companies both large and small (even when many did not even meet the listing requirements) and also to a wide range of new investors with fresh interest in the rising stocks, both large and small.¹⁶⁹ All this resulted in a boom, which was exacerbated by huge lending by the banks. There came a time when the bank lending to the stock market grew from 0.5% to 4%. By 1973, it was clear that the competition among exchanges further lowered the standards leading to instability in the stock market.¹⁷⁰ The banks also had started to become nervous by 1973 for the huge debt financing ratio and started calling in the loans they had doled out along with increasing the interest rates to reduce further borrowing for speculative purposes.¹⁷¹

At the same time, there were developments in the international market that made investors lose confidence in stock markets. The Bretton woods systems had collapsed after Nixon introduced drastic measures one of which was to

disallow the conversion of dollar to gold. These measures were referred to as the 'Nixon Shock', and there was the subsequent devaluation of the dollar under the Smithsonian Agreement.¹⁷² This complicated situation coupled with the oil crisis that occurred due to Arab countries placing an embargo on the export of oil to certain countries had an impact on the market in Hong Kong.¹⁷³

During international monetary crisis, the stock exchanges restricted their trading activities, banks increased interest rates further dampening the market, and the last straw came with the discovery of several forged and fraudulent shares floating in the market, sending chills down the market.¹⁷⁴ In other words, the combination of tighter money, end of the property prices boom that had been a catalyst for rising stock prices, government warnings and measures, and discovery of fraudulent shares coupled with the international monetary crisis gave way to a stock crash, which brought the Hang Seng Index down from 1800 points to 300 points.

Beginning of Regulations

It started with the enactment of two key statutes, i.e., The Protection of Investors Ordinance, and more importantly, the Securities Ordinance, both of which came into effect on 1st March 1974.

The two statutes aimed to ensure investor protection and disclosure requirements, to prevent fraud, market manipulation, and discourage the establishment of new stock exchanges.

Investor protection was ensured by requiring financial service providers to avoid fraudulently and negligently inducing people to make investments. Civil as well as criminal liability under contract and tort law was created, which made such practices an offense punishable with a fine of 1 million HK dollars and seven years of imprisonment.¹⁷⁵ This remedy was independent of the criminal remedy, which included personal liability for directors where the crime had been committed by a corporation.¹⁷⁶ To ensure transparency, it was made mandatory for stock exchange dealers to make complete disclosure to their customers for example, while making recommendations of investment, in particular securities, the dealer should disclose if he has any interest in the transaction.¹⁷⁷

Part 2 of the Securities ordinance brought the stock exchanges under strict scrutiny intending to discourage the setting up of new exchanges.¹⁷⁸ Approved exchanges were required to maintain daily records of all dealing in the stock market, and to make such records publicly available.¹⁷⁹ Approvals were revoked or suspended for misconduct, and failure to comply with the requirements laid down in the Ordinance.¹⁸⁰ Furthermore, all alterations to approved stock exchanges' constitutions were subject to prior approval of the regulatory authority.¹⁸¹

The bulk of the provisions on manipulation and frauds dealt with the prevention of improper trade practices.¹⁸² Market manipulation included the

creation of a false market (whereby the market price of a security was raised, depressed, or pegged employing collusive schemes), tampered and fake trading, and fictitious transactions.¹⁸³ Civil and criminal penalties were introduced to ensure compliance. In the case of the involvement of corporations, personal liability was created toward directors.¹⁸⁴

Black Monday and SFC

The Stock Market Crash of 1987 was also referred to as the Black Monday. This crash caused a 50% decline in the Hang Seng Index.¹⁸⁵ Meanwhile, the Chairman of SEHK¹⁸⁶ and also the chairman and convener of the Listing Subcommittees, Ronald Li Fook Shiu was found guilty of accepting allotment of 500,000 shares in a Cathay Pacific Airways Limited, as a bribe for favorable listing decisions. He was convicted for violation of the Prevention of Bribery Ordinance.¹⁸⁷ This conviction was one of the reasons that the need for a strong regulatory authority was realized to scrutinize regulators' conduct.

Stocks had become overvalued, and it was inevitable for the market to correct itself. The crash turned out to be severe and sudden due to two factors: Computerized Trading, which accelerated the speculative activities, and the introduction of Port Folio Insurance, which was a recent phenomenon. The basic strategy of this Portfolio insurance was based on the premise that investors automatically would increase taking short positions in the futures market as the stock market declined. So when the stock markets declined on account of speculation, investors took short positions on the futures market, which added pressure on the stock market leading to a vicious cycle that took the market into a slump. Other subsidiary factors including trade deficits, inflation, and concerns about oil prices also contributed to the crash.¹⁸⁸

Responding to Black Monday, a new securities committee was appointed in 1987. The securities review committee submitted its report, which is known as the 'Davison report' in which it recommended major reforms including the establishment of a single independent statutory body to regulate and supervise the securities and futures industry.¹⁸⁹ As a result of this report, the Securities and Futures Commissions ordinance was passed in 1989, which marked the beginning of a single strong regulator, the Securities and Futures Commission.¹⁹⁰

SFC Actions against Companies and Directors for Market Misconduct

Hong Kong courts have also been supportive of the actions initiated by the SFC.¹⁹¹ An example of this is one case in which the SFC had sought an injunction from the Court of First Instance (CFI) against a hedge fund named Tiger Asia, to block use of what it alleged were proceeds from insider dealing. On a literal interpretation of the Securities and Futures Ordinance, the CFI denied its jurisdiction to hear the case and directed SFC to the

Market Misconduct Tribunal (MMT).¹⁹² This could have potentially stymied the pace of enforcement activities pursued by SFC, one reason being that the MMT is not formally a court in the Hong Kong judiciary. However, on appeal, the court of appeal¹⁹³ and the court of final appeal¹⁹⁴ both rejected the restrictive interpretation by CFI and held that SFC could take direct recourse to CFI. This removed a potential roadblock that could have slowed down the activities of SFC.

The range, scope, and reach of SFC cases have expanded rapidly over time. For example, in 2008, the SFC exercised a rather dormant power enshrined under Section 385 of the SFO, to intervene in a scheme of arrangement through which PCCW Limited (a company dominated by Richard Li, son of Hong Kong's wealthiest man, Li Ka Shing) sought to squeeze its public shareholders at a historically low price and delist voluntarily from SEHK. This scheme was approved by the CFI, but the Court of Appeals rendered it invalid, giving a judgment in favor of SFC.¹⁹⁵

The SFC has taken its work quite seriously. In 2009, a former investment banker of BNP was found guilty of insider trading and was expected to become the first jailbird in Hong Kong for insider trading. Between 2008 and 2009, the SFC initiated ten prosecutions for insider trading, resulting in ten guilty verdicts, dozens of convictions, and five jail sentences.¹⁹⁶ This depicts the gradual development of a very stringent and punitive regulatory regime in Hong Kong, which is a continuance of radical steps taken in response to market crashes.

Global Financial Crisis of 2008

The global financial crisis that shook the world with a severe economic shock had its impact recorded in Hong Kong. The filing of bankruptcy by the Lehman Brothers on 15th of September 2008, which was the climax of this crisis, had severe implications for the financial markets in Hong Kong so much so that the common public came out on streets to vent their frustration, leading to popular disquiet in the country. Lehman Brothers' liquidation impacted around 34,000 retail investors who had bought 'Mini Bonds' issued by the Lehman Brothers. These Mini bonds could not be directly liquidated but tied to a Lehman entity. The liquidation of the Lehman Brothers meant that most of the money invested in Mini-bonds, amounting to around 21 billion HK\$, were lost.

There were complex contractual provisions involved in the issuance of the Mini bonds, and these were triggered by the bankruptcy of Lehman Brothers, leading to an unwinding of the underlying financial structure, and consequently, the investors received only a fraction of their investments.¹⁹⁷

This fiasco brought to fore serious discrepancies in the regulation of the financial markets, especially bond markets; investigations revealed several banks being involved in dubious activities to make a profit from the distribution of these bonds while keeping investors in dark about the true nature of

the Mini bonds.¹⁹⁸ There was public outrage, people came to the streets, and there was a widespread realization of the need for further strict regularization.

Regulatory Response

SFC and HKMA produced reports regarding the incidents, especially the bankruptcy filed by the Lehman Brothers, leading to proposals for reforms.¹⁹⁹ These proposals called for strict reform and regulations, in five main areas including:

- 1 The regulatory regime
- 2 Conduct of business
- 3 Information and disclosure
- 4 Risk assessment in the context of both customer suitability and product
- 5 Dispute resolution and compensation.²⁰⁰

In addition, they also discussed a stringent accountability framework. Similarly, a task force was established in the aftermath of the crisis 2008; the task force is known as Task Force on Economic Challenges (TFECs) to identify proposals to deal with long-term issues.²⁰¹

The stock market crash was a decisive event in the recent history of Hong Kong in terms of the regulatory reforms. This crash was a mix of both internal inflationary pressures leading up to instability and uncertainty within the market and external factors such as the collapse of the Bretton Woods system and the Oil crisis. The renewed regulations in the form of the Protection of Investor's Ordinance and the Securities Ordinance were aimed primarily toward protecting investors from fraudulent and negligent activities by bringing the stock exchanges under tightened scrutiny. However, these regulations fall short of preventing another crash within one and a half-decade, which brought the Hang Seng Index down by 50%. This crash again was a result of an artificial increase in stock prices, which was not sustainable in the long term being based on speculative market tendencies. This crash led to a new thrust of regulations, the most prominent of which was the Securities and Futures Commissions Ordinance 1989, which designated the task of regulation to an independent single regulator, the Securities and Futures Commission. The commission pursued the perverse elements responsible for the market crashes, with great vigor and enthusiasm and through an interventionist approach, of which we see a glimpse in the SFC's intervention resulting in invalidation of the inequitable scheme of arrangement that PCCW Limited was using to squeeze its public shareholders. However, there was yet another crisis looming large, which was primarily a result of external pressures but it made a great impact on the Hong Kong financial market due to the heavy presence of the Lehman Brothers in Hong Kong, which went bankrupt in the crash and people in Hong Kong lost huge investments. This was the global financial crisis of 2008, and it led to renewed calls for stricter and tighter regulations it is in this backdrop that the TEFCs was formed

to present sustainable and long-term proposals to deal with these recurring crises. In all this, one can identify the pattern of damage control that has been adopted by the Hong Kong government and how after every crisis, the economy turned out stronger than before, harnessing its potential to become an international financial center.

Tokyo as an International Financial Center

The growth graph of Japan is very different from that of its contemporary IFCs. Japan's journey started from ruins, and it achieved too much in too little a period, but this also made its model very volatile and unsustainable. Japan reemerged from a country devastated by war to a world leader in exports. Japanese policy for creating a consumption economy coupled with industrial growth, allowed it to grab a great chunk of the world's exports in the high-end technological product. However, in doing so, Japan faced several problems, such as the stagnation of domestic demand in the late 1980s due to which the government had to constantly adapt by changing its goalposts and refocusing its direction. The late 1980s saw the period of liberalization and deregulation to boost domestic demand, through plans such as the Structural Development Initiatives, de-regulation of financial markets, the introduction of Gen-Saki transactions and impact loans, amendments in the banking and securities law, and, very importantly, the creation of a Japanese Offshore market allowing for capital to flow into the country. With this liberalization, however, came a series of scandals about frauds, market manipulations and a chain of failures, liquidations, and subsequent bailouts. This merry-go-round of constantly arising dilemmas insinuated that Japan's growth, though flexible, was not sustainable. This growth was dependent on artificial market impulses, which when lost, pushed the economy in a nosedive lasting a whole decade. This phenomenon was referred to as the bursting of the bubble, but it allowed Japan to restructure its economy on a more durable and stable growth model.

Period of Economic Growth Up Until the 1970s

Japan made a remarkable leap ahead in the 20 years that succeeded in the re-emergence of Japan from a war-torn country to an uprising industrial economy. This was a result of a two-pronged approach by the government which focused on consumption economy and industrial policy.

First, it directed efforts to build a consumer economy in Japan, which, among other measures, included the Income Doubling Plan of 1960 introduced by Ikeda Hayato.²⁰² As per the plan, the government provided social security, social welfare, vocational training, and education,²⁰³ all of which was directed toward inducing consumer-led growth in the economy.²⁰⁴

Second, an industrial policy was introduced by the Ministry of Trade and Industry in 1959 called the 'Industrial Policy of Japan', which focused on the production of high-end technological products designed for domestic

and foreign consumption. Additionally, essential industries for the production of heavy technological products, such as steel industry, coal, energy, and transportation were setup.²⁰⁵ The industrial developments made Japan a world leader in electronics, precision optical equipment, steel, automobiles, shipbuilding, and high technology.²⁰⁶ Consequently, Japan's share in world exports rose from 2.1% in the 1950s to 4.3% in 1963.²⁰⁷

The first shock to the Japanese economy came in the form of rising oil prices in 1973, and the oil embargo placed on the export of oil by the Organization of the Petroleum Exporting Nations (OPEC). Japan's economy was highly dependent on the import of petroleum for its industrial production, and the rising oil prices led to a decline in industrial production and economic growth slowed down sharply.²⁰⁸

Inflation increased with rising unemployment, causing the Japanese economy to go into recession.²⁰⁹ Major technological improvements globally resulted in a decline in global demand for Japanese tech products. Moreover, Japanese firms could not compete in international markets since their previous growth was stimulated by government protectionism, control of currency, and availability of cheap raw materials that allowed them to reduce cost.²¹⁰ By the 1980s liberalization domestically and internationally became unavoidable. This meant a shift toward deregulation of the financial system was needed.

Liberalization and Deregulation

By the late 1980s, domestic consumption was stagnating on account of rising prices, congested housing, traditional savings habits, and long working hours discouraged spending.²¹¹

Exports were rising, headed by automobiles, color television sets, high-quality steel, precision optical equipment, and electronic products, which grew far rapidly than imports, and Japan's merchandise trade balance with Western Europe and the US still steadily mounted in its favor.²¹²

Hence, the trade surplus was largely used to compensate for the domestic stagnation, but this created two problems that laid the foundation for liberalization.

- First, the surplus was injected into the reserve which was putting pressure on the exchange rate, because of controls on capital outflows which prevented it from being invested in foreign markets.
- Second, Japan was facing increasing friction with its trading partners mainly from the US for its protectionist approach.²¹³ Japan's mounting trade surplus was thus becoming a global issue.²¹⁴

Under this domestic and international pressure, the Japanese government undertook measures to finally 'open' the economy.²¹⁵ Japanese government drafted a policy for liberalization where it committed to a target of achieving

'a liberalization rate of 80% in three years'. It classified 104 commodities to be liberalized following different timelines of liberalization and removal of restrictions. The manufacturing industry was prioritized to be liberalized, whereas Japan moved slowly in terms of agricultural goods.²¹⁶ By the 1990s, agricultural goods were also being liberalized, rice being a major commodity to become exempt from tariff.²¹⁷

A study commissioned under Prime Minister Nakasone Yasuhiro in 1986 proposed the restructuring of the Japanese economy to make it rely almost entirely on domestic demand for growth.²¹⁸ This was because international trade was already a forte at this point, and it was the surplus from this trade that was being used to cover the deficit at home. Hence this policy was meant to reduce this reliance and shift toward stabilizing domestic growth, which was more reliable and stable as compared to international trade where fluctuations were probable, for example, the 1973 Oil crisis.

Plans for such changes were further taken up in the Structural Impediments Initiative (SII) in the late 1980s.²¹⁹ SII identified causes of decline, i.e., domestic policies and regulations, restrictive business behavior that ousted foreign firms from the economy, close inter-corporate relationships which prevented any penetration in the economy, and the distribution system where manufacturers were controlling wholesalers and retailers to not entertain any foreign company.²²⁰ SII aimed at dismantling the monopolistic structures and open the domestic economy to foreign firms to diffuse mounting pressure.²²¹

Deregulation of financial markets started with the introduction of Gen Saki transactions, i.e., interbank foreign currency transactions.²²² Shortly afterward, permission was granted to the banks to issue 'short-term' foreign currency loans to residents, which were known as 'Impact Loans'.²²³ This was extended in 1980 when foreign exchange banks were allowed to make 'medium and long term' impact loans as well.²²⁴ Significant amendments in the Foreign Exchange and Trade Control Act of 1949 were made to promote cross border transactions²²⁵ and encourage foreign investors to operate businesses from Japanese soil.²²⁶

The Banking Law of 1981 was drafted to maintain financial order and promote economic development by ensuring sound and appropriate bank management, depositor protection, and facilitation of financial transactions. The law designated MOF as the financial regulator responsible for authorizing and regulating banks.²²⁷

In 1988, three major amendments were introduced to the Securities and Exchange Law (SEL) of 1948, through which disclosure requirements were liberalized, regulation of insider trading was strengthened, and a legal framework for stock-index and other securities-related futures and options was established.²²⁸ In the 1990s, SEL was further amended to ensure market stability.²²⁹ Meanwhile, Financial Futures Law was enacted and the Tokyo International Financial Futures Exchange (TIFFE) was established.²³⁰

A very important culmination of this process of liberalization was the opening of the Japan Offshore Market, which loosened control on capital

inflows and allowed foreigners to bring in capital into Japan while enjoying tax exemptions. By the end of the decade, formal barriers to trade had been largely dismantled.²³¹

An offshore banking market, also called an Off-shore Banking Unit (OBU), became a crucial feature for the growth of an international financial market, as it facilitates non-residents to bring their excess capital into the country while taking advantage of lack of capital control and tax exemptions.²³² The establishment of Japan's Off-Shore market escalated the pace of liberalization that Japan had undertaken.²³³ There were challenges that came to Japan as well due to the establishment of the OBU.²³⁴ However, the benefits of the OBU clearly surpassed the challenges.

Initially, the MOF was responsible for regulating the financial services industry. In the 1990s, the Securities and Exchange Surveillance Commission (SESC) was setup. Responsibility for planning and legislation relating to the securities markets continued to rest with the MOF, with authority for the inspection of securities companies, the surveillance of the markets, and the investigation of criminal activity transferred to the SESC.²³⁵

Financial Services Reform Law was essentially a revision of laws including the banking law, the capital market, and the insurance law.²³⁶ The main thrust of the reform initiative was to foster competition by liberalizing Japan's financial systems.²³⁷ There were three main aspects of these reforms.

First, they sought to diversify the activities of each bank within Japan's banking industry to promote competition.

Second, it allowed financial managers increased independence from the paternalistic guidance of the MOF, reinforced the disclosure system, and introduced capital adequacy requirements.

Third, the MOF relaxed the boundary between the banking and securities industries by allowing each to have a subsidiary competing in the other's market, with the hope that this would encourage innovation.²³⁸ The third aspect was very radical and effective, as it allowed the breathing space they were demanding since last 40 years.²³⁹ Interestingly, liberalization came with a cost in the form of fraud, market abuse cases, and increased bad debts.²⁴⁰

Fraud and Market Abuse in Banking and Securities Industry

High officials in Fuji, Tokai, and Kyowa-Saitama were forging deposit certificates to serve as collateral for loans from other lenders.²⁴¹

In 1991, the presidents of Nomura Securities Ltd and Nikko Securities Ltd resigned amidst charges of paying improper compensation and having close ties to a large Japanese crime syndicate.²⁴² The other two of the so-called Big Four securities houses, Daiwa Securities Ltd and Yamaichi Securities Ltd were also charged with improper compensation payments. Thus, the payment of compensation was forbidden completely.²⁴³

In the summer of 1995, Daiwa, a major Japanese bank, reported fraudulent trading in its New York branch. Bank of Japan conducted a special on-site

examination of Daiwa Bank's New York Branch. MOF ordered Daiwa Bank to reduce its international operations, including the number of loans outstanding, the number of securities holdings, and market-related activities. This scandal forced the MOF and the Bank of Japan to strengthen their oversight over Japanese banks and overseas offices.²⁴⁴

Liquidations and Bailouts

The first series of failures started in 1994 when two urban credit cooperatives, Tokyo Kyowa and Anzen, failed. The bank of Japan in collaboration with private financial institutions created a new bank to assume the business of the two failed institutions. This bank was named Tokyo Kyoudou Bank (TKB).²⁴⁵

In 1995–1996, came what was known as the Jusen Problem. Jusen or housing loan corporations were non-bank financial institutions, which advanced home loans. They decided to move into real estate which led to huge losses. The government had to bail out the institutions and cover their losses. This was the first instance where tax money was used directly to cater to financial instability.²⁴⁶

By early 1997, the non-performing loans (NPLs) problem was triggered by a chain of failures and bailouts. Most prominent among them was Nippon Credit Bank (NCB). NCB was one of the three long-term credit banks in Japan. It had also been heavily exposed to real estate, and it was facing a huge NPL problem by 1996. The authorities opted for a bailout and arranged for a consortium of private institutions to inject capital into the bank. However, it was not enough so the Bank of Japan had to mobilize its pool to inject capital into the bank. This injection of capital only helped the bank to survive a year and a half long but did not increase its profitability. Hence finally it failed and had to be nationalized in 1988.²⁴⁷ The Bank of Japan played its role in crisis management as the lender of last resort on an unprecedented scale.²⁴⁸

One prominent failure of 1988 was that of the Long-Term Credit Bank of Japan (LTCB). As the banks started facing problems of liquidity, the authorities sought to arrange a merger with Sumitomo Trust which backed out due to its suspicion regarding the amount of NPL, and because it received bad signals from rating agencies and the stock market regarding this circle. Hence to deal with the problem, a significant piece of legislation known as the Financial Reconstruction Law was enacted that allowed temporary nationalization of the troubled banks. According to this, LTCB was nationalized and ultimately funded by the Bank of Japan.²⁴⁹

The 'Bubble Economy' and the Subsequent Burst

Liberalization fueled the supply of finance because banking regulations incentivize lending combined with a low rate of interest which made lending convenient and cheap. This led to the circulation of finance in the economy.²⁵⁰

Excessive availability of finance increased investment insecurities and the real estate market.²⁵¹ This boom was dependent on the crutches of continuous supply of finance, which started tightening up by the end of the 1980s. Bank lending declined considerably because of the non-availability of finance, which led to stocks and property prices declining sharply. Banks had given loans on real estate as collateral; the banks were not able to recover the loan, as the property market went down rendering the collateral worthless resulting in huge bad debts and defaults.²⁵²

With the bursting of the bubble, the period of 1992–1993 ushered in a period of weakening economic activity which converted into a deep recession, commodity and asset price deflation, bank failures, increased bankruptcies, and rising unemployment.²⁵³ With this crisis ensued a period that is referred to as the ‘Lost Decade’, which was characterized by a series of complicated, and prolonged economic crises which the Japanese policymakers seemed unable to deal with.

Japan’s post-war growth, whether how miraculous it seemed, was due to protectionism that could not be sustained. Japan’s move toward liberalization made these cracks prominent, and a collapse became inevitable which came in the form of the crisis of 1992–1993. What made this worst was the lack of preparation that accompanied it. A whole decade was lost in doing the necessary damage control. When Japan emerged out of the crises, it had lost its pace and in turn, Tokyo’s rise as a leading international financial center, which seemed so close at some point, now seemed quite far away. Nonetheless, on the plus side, this transition allowed Japan’s economy to shift its weight away from the weak crutches that it was hanging on, to a stable and durable foundation.

Islamic Finance in Dubai

From the plethora of options, UAE chose to create the Dubai International Finance Center (DIFC) to accommodate Islamic finance. The DIFC is approximately 110 acres of land located beside Sheikh Zayed Road in Dubai, which operates independently and free. UAE national laws are not applicable to DIFC, instead the DIFC runs on common law. The rationale behind its creation was to encourage foreign trade and investment facilitated by an independent legal framework running parallel to the UAE law. DIFC courts were established, with jurisdiction over all disputes arising out of DIFC operations. These courts offer conventional dispute resolution mechanisms derived from common law as well as arbitration. Previously, the access to these courts was restricted to disputes arising out of DIFC operations only, but it was widened to allow anyone to submit before the court’s jurisdiction through the opt-in method. All awards passed by the DIFC are enforceable throughout UAE, provided they are translated in Arabic and are final and executable. IF is being promoted to ensure DIFC develops into an IFC in the future. The two main laws that govern Islamic finance in DIFC include the ‘Laws regulating Islamic Financial

Business (2004)' and 'Islamic finance rules'. Institutions that intend to engage in Islamic finance can get a license from Dubai Financial Services Authority (DFSA) to operate either an Islamic window or IFIs. In both cases, they are required to have an Sharjah Supervisory Board (SSB), which is the final arbiter of Shariah compliance. The Islamic finance rules though provide for the formulation and constitution of SSBs but are silent as to what threshold should be followed to label a product as a Shariah compliant or vice versa. The requirement of an internal and external review is a regulatory check on SSBs. DFSA has the authority to ensure Shariah compliance by way of suspending the license of any firm not complying with IF rules and regulations, along with powers to impose civil liabilities for contravention of DFSA administered law.

Establishment of DIFC

United Arab Emirates (UAE) is a civil law jurisdiction that is predominantly influenced by Sharia law. Article 7 of the UAE constitution defines the role of Sharia in the UAE's legal framework, as it states that Sharia is a main source of legislation, but not the only source. The UAE government through an amendment in Article 121 of the Constitution exclusively empowered the federal government for the establishment of financial free zones, exempted from the rules and regulations of UAE.²⁵⁴ The Federal Law No. 8 of 2004 was enacted which allowed the establishment of financial free zone independent from all civil, commercial, and federal laws of the federation.²⁵⁵ A separate and independent authority in Dubai, Dubai International Finance Centre (DIFC) has been created under Federal Decree No. 35 and the Law of the Dubai International Finance Centre, No. 9 of 2004. DIFC is a financial-free zone having a specific regulatory framework based on the common law of England.

Regulatory Framework of DIFC

DIFC has a holistic structure that includes three main bodies supervised by the Higher Board of Directors: the DIFC Authority (DFCA), the DIFC Financial Services (DIFCF), and the DIFC courts.²⁵⁶

The Dubai International Finance Centre (DIFC) has the DIFC dispute resolution authority comprising the DIFC Court, the DIFC-LCIA (London Court of International Arbitration) Arbitration Centre, the DIFC Wills and Probate Registry and an Academy of Law.²⁵⁷ Another innovation under the DIFC was the establishment of Small Claims Tribunal in 2007 to provide justice in a swift and efficient manner. It has the jurisdiction to adjudicate matter related to not only the entities registered in DIFC or contracts involving DIFC where the amount of claim does not exceed AED 500,000 and are more than AED 100,000.²⁵⁸

The DIFCA is the legal representative of the DIFC and regulates non-financial entities operating in DIFC, the DIFCF is the independent regulator of financial and additional services conducted in or from the DIFC.²⁵⁹ The powers, procedures, and administration of DIFC courts are regulated by the Dubai Law No. 12 of 2004. The DIFC also has commercial and civil laws called Law on the Application of civil and commercial laws in the DIFC, financial services and market regulators and the DIFC Islamic Finance Advisory Council, which advises on Islamic finance.²⁶⁰

The DIFC courts have absolute jurisdiction over any commercial or civil matter arising out of the DIFC operations and any claims referred to them in writing by the parties.²⁶¹ The governing law for the DIFC courts should be the DIFC Laws and Regulations until the parties explicitly choose that another law will govern the dispute.²⁶² The DIFC courts have two-tier court system: the court of the first instance and a court of appeal.²⁶³ The decision of the court of appeal is final. With the creation of DIFC courts, there are now two parallel, alternative judicial systems in UAE.

The DIFC also offers an arbitration system. The arbitration law which is based on the UNCITRAL model was enacted through the DIFC Law No. 1/2008. Like DIFC courts, the DIFC arbitration law also allows entities not registered with the DIFC to submit their disputes to the DIFC arbitration system. An award recognized by the DIFC Courts is enforceable in the entire Emirates without any further review by the Dubai Courts, provided that it is translated in Arabic and is final and executable.²⁶⁴ The DIFC court's jurisdiction to hear arbitration cases at its start was limited because there was a prerequisite that there must be a direct connection to DIFC courts physical jurisdiction.²⁶⁵ However, the jurisdiction was expanded through an amendment in 2011²⁶⁶ by allowing an opt-in option for anyone seeking to have their matter arbitrated in DIFC courts. It basically allowed the parties through a contractual agreement between them to choose DIFC courts as their jurisdiction for any civil or commercial dispute.²⁶⁷

Regulatory Framework of Islamic Finance in Dubai

Islamic finance in DIFC is primarily governed by the Law Regulating Islamic Financial Business (IFB) 2004 and the Islamic Finance Rules, which are applicable in the jurisdiction of DIFC and is administered by DIFCA. The Islamic Finance Rules is applicable to the entity that carries on or holds itself as carrying on financial service in or from the DIFC as in accordance with Sharia.²⁶⁸

There are two ways prescribed by the IFB for a provider of Islamic Financial services to get itself recognized as Shariah compliant. They need to obtain a license or license endorsement from the DFSA as either an Islamic Window or IFI.²⁶⁹ IFI is an authorized firm whose entire business operations are conducted in accordance with Sharia, whereas an Islamic window is where a part of the business is conducted under Shariah law as part of its overall

business operations.²⁷⁰ Interestingly, under the DIFC Islamic finance law the requirement to obtain a license or license endorsement is applicable to only those entities which seek to promote their business/products as being Sharia-compliant. Any firm or entity which does not hold out to its customers that the product or services offered by them are Sharia-compliant, even though it is structured in a way that is Sharia-compliant, there is no restriction to obtain the license.²⁷¹

Moreover, regardless of an entity being registered as IFI or Islamic window with DFSA, it is bound to appoint a Shariah Supervisory Board (SSB).²⁷² The SSB is a committee of Islamic jurists that can issue a fatwa about whether or not a particular transaction or activity complies with Shariah.²⁷³ This is the interesting aspect of IF in Dubai because the Islamic Finance Rules do not state or prescribe as to what activities are or are not Shariah compliant. It is rather the job of per entity-level SSB to monitor the activities of the entity and issue the fatwa regarding its compliance with Shariah.²⁷⁴ The DFSA's focus is on regulating the process for determining sharia compliance rather than the outcome of such a determination. Along with this, the registered entities have to abide by the policies regarding Sharia compliance,²⁷⁵ rules to prevent any conflicts in the SSB,²⁷⁶ and perform internal reviews of Sharia compliance in line with international standards.²⁷⁷

The formation of SSB is an integral component of IF in DIFC. The Islamic Finance Rules set out the basic requirements for the running of the SSB and its management. The authorized entity must ensure that the:

- a the Shari'a board has at least three members
- b the members appointed are competent to perform their functions as Shari'a board members
- c any appointments, dismissals or changes in respect of members of the SSB are approved by the governing body of the authorized firm; and
- d no member of the SSB is a director or controller of the authorized firm²⁷⁸

To ensure transparency and stability, the Islamic Finance Rules (IFR) also obligate the authorized firms to document their policies regarding appointments dismissals, changes to be made in SSB, the process to consider the suitability of the SSB members and their remuneration.²⁷⁹

Accordingly, the authorized firms should maintain their records for six years of its assessment of the competency of the SSB members and the agreed terms of engagement of each member of SSB.²⁸⁰

Finally, to evaluate the extent to which the authorized firms are complying with the fatwas, rulings, or guidelines of their SSB, the IFR requires a firm to perform internal Shariah reviews and external Shariah reviews in accordance with AAOIFI Governance Standards for IFIs and publish periodic reports.²⁸¹ Also, the authorized firms are required to make complete disclosure to their client regarding details of the members of the SSB and any

marketing material communicated must state that the SSB has reviewed the products or services the material offers.²⁸²

The compliance of the entities to the laws is the responsibility of the DFSA. The DFSA has the power to suspend or withdraw the license of any firm not complying with the rules and regulations,²⁸³ can commence an investigation if there is an apprehension that a law has been violated²⁸⁴ or can also impose fines and other sanctions for breach of law.²⁸⁵ These all powers are along with the general power of the DFSA to impose civil liabilities arising out of any contraventions of DFSA administered laws.²⁸⁶

Furthermore, the PIIB provides general prudential regulations for the services offered in DIFC. The prudential regulations are like a framework for financial safety. Thus, like many other authorized firms registered in DIFC, the prudential regulations of the Islamic finance are also governed by [Chapter 3](#) of the Prudential Investment, Insurance Intermediation and Banking Business Module of the Authority's Rules (PIIB). PIIB regulates as to how the IF businesses should control the activities that arise from its IF business, ensure their compliance with the Shariah, the basic and ongoing capital requirements for IFI.²⁸⁷

Challenges to Islamic Finance in Dubai

An important issue of the DIFC courts being a separate jurisdiction is that a decision of the DIFC court to be enforced outside DIFC, has to be ratified by an executive judge of the Dubai courts.²⁸⁸ One of the cases which highlighted this issue was the *Daman Real Capital Partners Co LLC v Oger Dubai LLC*.²⁸⁹ In the Daman Real Partners case, the proceedings started in both the DIFC court and the local Dubai courts. The issue as to which court will now have jurisdiction came before the Dubai-DIFC judicial committee.²⁹⁰ The Committee ruled that in such cases where legal proceedings are brought simultaneously in both separate jurisdictions, the Dubai courts will have the jurisdiction and the conclusive authority. This ruling was reinforced in *Dubai Waterfront LLC V Chenshan Liu*²⁹¹ by the Court of First Instance (CFI) of Dubai International Finance Centre Court.

Similarly, DIFC courts' independence face issue while enforcing arbitral award under the *Convention on the Recognition and Enforcement of Arbitral Awards* ('*New York Convention*'). The reason is that for enforcement the award must be treated as being made in a contracting state²⁹²; however since only states can be contracting parties to the convention, it is UAE rather than the DIFC, which is considered as the contracting party under the *New York Convention*.²⁹³ Thus, the DIFC requires ratification of its decisions from Dubai domestic courts in order to be enforced. Fortunately, the Dubai CFI in *Macsteel International LLC v Airmech Dubai LLC*²⁹⁴ while enforcing two arbitral awards was of the opinion that the role of local courts is restricted to ensure that there is no conflict between the Federal Decree under which UAE became a party to the convention and the arbitral award.²⁹⁵

Moreover, another significant impact on IF in Dubai could have been caused by the Dana-Gas case. The Islamic finance market was in disarray when in June 2017, Dana-Gas, a natural gas company, announced that due to changes in Shariah interpretation, its sukuk instrument based on *mudharabah* is no longer Shariah compliant. Thus, the sukuk issued are unlawful in the UAE and the company is hence under no obligation of fulfilling its payment under the sukuk, and they will be doing a restructuring of the instrument. It was a shock to the sukuk holders, they appealed against this decision of the company before the court of the UK; however, the Dana-Gas approached the UAE court. This conflict of jurisdiction as to which court had the authority to hear the issue was the result of the fact that the sukuk document was governed by the United Arab Emirates laws but the ‘Purchase Undertaking’, which was part of the contract was governed by English law.²⁹⁶

After prolonged litigation in the UK court, the court held that the Purchase Undertaking is enforceable and hence the Dana-Gas has to fulfill its payment obligations to the sukuk holders. The court reasoned their decision with the principle that the English courts would apply the law which governs a contract when deciding on questions of validity and enforceability. Thus, since the Purchase Undertaking was governed by the English law, the court can enforce that part of the contract within the sukuk structure.²⁹⁷ However, the UAE court, directed that only the instructions given by the UAE court should be followed and the orders of the UK court should not be followed. The court opined that the question of whether the sukuk are Shari’a compliant or have ceased to be so is to be decided by the Sharjah court itself and not by the English court. Thus, there was a standstill situation due to the conflicting decisions of the two courts, but an out-of-court settlement was reached between the parties before any final decision could come from the UAE courts.²⁹⁸

The case could have set an important precedent regarding the relationship between sharia compliance and credit risk, however, the out-of-court agreement eventually reached with sukuk holders left these issues unresolved. Hence, the issue that can the UAE stop the enforcement of a decision by the UK court in this instance is still unanswered.²⁹⁹ However, following Dana Gas’s 2018 restructuring, creditors have become more prudent and cautious and started inclusion of enhanced warranty and waiver clauses in sukuk documentation aiming to prevent debtors from challenging the sukuk enforceability on Shariah grounds.³⁰⁰ Also, if the English High Court has ruled in the favor of the Dana Gas or that the UAE court has the sole authority to address this issue, it would have been havoc for the Islamic finance market. It could provide an option for issuers to back out on payment on their existing Islamic financings on the rationale that those financings are no longer Shariah compliant, thus forcing creditors to restructure on terms favorable to the issuers.³⁰¹

Moreover, the case of *Meydan Group LLC v Banyan Tree Corporate Pte Ltd* reinforced the point that the DIFC is nevertheless a separate and independent

jurisdiction, but the jurisdiction is exceptional and limited. The Banyan Tree obtained a DIAC arbitration award against Meydan and invited the DIFC courts for its enforcement. Both the court of the first instance and the DIFC court of appeal found that they had jurisdiction to hear the case and ruled for its enforcement. The Meydan Group moved to the Dubai courts seeking an annulment on the grounds that neither the Meydan Group nor Banyan Tree had any office, activities or assets within DIFC, the underlying contract and hotel management agreement was governed by the Dubai law and hence the seat of arbitration should be Dubai rather than DIFC. The Dubai CFI agreeing with the claims of Meydan Group nullified the decisions of the DIFC courts and held that Article 5 of the Judicial Authority Law gives the DIFC courts exclusive jurisdiction only in cases involving the DIFC, its bodies and establishments, contractual disputes performed or executed in DIFC, incidents in the DIFC or where contracting parties 'opt in' to the jurisdiction of DIFC in writing. Besides these circumstances, the Dubai courts will have the jurisdiction.³⁰²

Enforcement of DIFC Decisions

The enforcement of judgments outside DIFC means that the enforcement which has to be done outside the physical boundaries of the DIFC's operation. DIFC is an area of approximately 110 acres located beside Sheikh Zayed Road in Dubai. For enforcement outside of this physical boundary, e.g., in Dubai but outside DIFC the law states that the judgment of the DIFC court to be enforced in Dubai must be ratified by an executive judge of the Dubai courts.³⁰³ It is sort of a formality which requires translation of the order in Arabic and that the judgment is final and appropriate for enforcement.³⁰⁴

Interpretation of Shariah

The rationale for the establishment of DIFC was to provide the parties with an opportunity to an independent legal framework, without the concern of Shariah law. Keeping in view this intent, the DIFC created laws and regulations which are based on common law principles. The DIFC laws obligate each entity registered as an Islamic Finance Institution with the DFSA for the establishment of SSBs.³⁰⁵ The SSB has the sole authority to issue a fatwa if the product or service of the registered company is Shariah compliant.³⁰⁶ The DFSA does not hold any power or authority to determine whether a product/service is Shariah compliant, and it has obligated external and internal reviews for each SSB to ensure that the fatwas of SSB are not given arbitrarily.³⁰⁷

Moreover, the parties can choose Shariah law as the governing law under Article 6 of Law No. 12 of 2004.³⁰⁸ Similarly, Article 30 of the DIFC Law No. 10 of 2004 states that in exercising its powers and functions, the DIFC court shall apply such law as is agreed by the parties.³⁰⁹ The DIFC laws and

regulations do not mention anything explicitly as to what procedure or as to how the courts will apply it. However, Article 8 of DIFC Law No. 3 of 2004, on the application of civil and commercial laws, states that in determining any dispute, the court shall apply the following, in order:

- a The mandatory provisions of any DIFC law or any other law in force in the DIFC.
- b The law of any jurisdiction other than that of the DIFC expressly chosen by any DIFC law.
- c The laws of jurisdiction as agreed between all the 'relevant persons concerned'.
- d The laws of any jurisdiction which appears to the court or the arbitrator to be the one most closely related to the facts of, and the persons concerned in the matter.
- e The laws of England and Wales.³¹⁰

Article 8 of the DIFC Law No. 3 of 2004 could allow the courts to apply sharia-based legislation, except for any provision contrary to any mandatory rule of law in force in the DIFC. However, when both Article 6 of the DIFC Law No. 12 of 2004 and Article 8 of the DIFC Law No. 3 of 2004 are read jointly, it is unclear whether the non-national principles of Shariah (distinct from the UAE's national Shariah-based legislation) can be applied.³¹¹

Dubai catered to Islamic finance in a very different way, as compared to other jurisdictions. It created a separate entity by the name of DIFC, where Islamic institutions could operate in an independent financial zone, under a common law-based regime. For the effective resolution of disputes, DIFC courts were given jurisdiction to cater to all issues arising out of DIFC. In order to ensure Shariah compliance, all IFIs, either operating windows of Islamic finance or performing full-fledged functions, are required to have SSBs. Although the Islamic finance rules did not provide guidelines of deciding upon the Shariah compliance of products, the effective check was created on the SSB by mandating an internal and external Shariah review annually to be carried out in line with the AAOIFI Governance standards, and also to publish a periodical report on such review. This allowed for ensuring that the fatwas as to Shariah compliance of products are not arbitrary. Apart from this, it was also made mandatory that all activities and actions taken in regard to SSBs have to be documented so as to be amenable to inspections. Despite all these efforts, several hindrances have occurred in Dubai becoming a hub of Islamic finance.

The primary root of these hindrances is the conflict between the DIFC and regular Dubai law, as interpreted by courts. The jurisprudence that has evolved in response to these conflicts manifests a lot of fault lines and disconnects. First, the importance of DIFC has been undermined by it having to ratify all arbitral awards from local courts, before them becoming enforceable under the New York Conventions. This issue though has been resolved by the decisions where it was held that the job of local courts is

only to ascertain whether the award is in line with the Federal decree under which UAE became a party to the conventions. Second, it has been held that in cases where issues are brought simultaneously before the DIFC and the Dubai Courts, the latter will have jurisdiction which further curtails the authority and jurisdiction of DIFC. There have also been instances where Islamic products such as sukuk were declared non-Shariah compliant by parties to wriggle out of payment obligations. Resultantly, creditors have become more cautious and have started including warranty and waiver clauses in sukuk documentation. All such challenges need to be effectively dealt with before Dubai could achieve its true potential as a hub of Islamic finance.

Islamic Finance in Malaysia

The patronage that the Islamic finance industry has received in Malaysia is hardly matched by any other Islamic jurisdiction. Malaysian government manifested considerable stability and consistency in its approach to Islamic finance. The formation of the National steering committee on Islamic banking set the wheel in motion. The recommendations of the committee resulted in the enactment of the Islamic Banking Act 1983, and the establishment of BIMB, the first full-fledged Islamic bank. For the next decade, BIMB was allowed a competition-less environment to grow without hindrance. After gauging the viability and favorable prospects over this decade, Malaysia introduced the SPTD scheme allowing for the creation of the dual banking system, whereby conventional banks were allowed to operate Islamic banking windows. This scheme was later enlarged into the SPI scheme, whereby conventional banks were allowed to operate full-fledged Islamic subsidiaries, although operations of both had to be kept strictly separate. At the same time, the Islamic interbank money market was established to enhance the liquidity of Islamic banks. To ensure Shariah compliance, in 1997, Shariah Advisory Councils (SAC) were setup on a national level, to cater to both the banking and the securities industry. On the banking side, the SAC collaborated with the Central bank, and on the securities side, with the Securities Commission to facilitate Shariah adherence. The 2000s saw the establishment of the Islamic capital market in Malaysia which allowed for smooth flow of funds in the Islamic financial system. The capital market was regulated by the securities commission in collaboration with the respective SAC. To provide direction to its economy and to crystallize the government's objectives, Malaysia introduced comprehensive master plans for both sectors of Islamic finance. Financial Sector Master Plan (FSMP) of (2001–2010) and (2011–2020) catered to the banking industry and the Capital Market Masterplan of 2001 dealt with the securities industry. Despite these efforts, some discrepancies have arisen in Malaysia in court's dealing with the IF sector. There have been instances where IF transactions have been disgorged and simplified, or outrightly rejected by civil courts in Malaysia. The jurisdiction of Shariah courts has remained limited. However, steps have been taken to mitigate

this situation, which includes making it mandatory upon civil courts to refer Shariat matters to the SAC and the advice rendered to be binding.

The Initial Phase of Development

The first formal step toward the development of Islamic finance in Malaysia came in 1981, with the formation of a national steering committee to identify recommendations pertaining to all legal and financial aspects of setting up the Islamic financial industry in Malaysia. The council submitted several recommendations, including setting up an Islamic bank based on principles of Shariah, enacting new legislation to regulate the activities on the bank, appointing the Central bank of Malaysia as the regulator of the bank, and mandating the bank to appoint a Shariah advisory body to bring its operations in harmony with Shariah precepts.³¹²

Islamic Banking Act (IBA) 1983 and the BAFIA 1989

Based on these recommendations, Malaysia saw the introduction of the Islamic Banking Act 1983 (IBA), and the Takaful Act 1984, which officially marked the inauguration of the Islamic banking industry.

Though IBA 1983 was enacted primarily to govern Islamic banks, there was nothing specifically Islamic about this Act, except for where the Act defined Islamic banking to mean ‘banking business whose aims and operations do not involve any element which is not approved by the religion of Islam’.³¹³ No specific type of Islamic contracts or products such as *mudarabah*, *musharakah*, *ijarah*, *murabahah*, and *wakala* were defined. IBA was substantially modeled on the conventional banking statute of 1973. The main purpose this act served was to allow for the establishment of Islamic Banks. IBA’s counterpart on the conventional side was the Banking and Financial Institutions Act 1989 (BAFIA). Islamic banks though were established and allowed to carry out Islamic banking activities under IBA, they had to comply with the general banking provisions under BAFIA. Both IBA and BAFIA applied to Islamic banks, despite BAFIA dealing primarily with conventional banks. Comparatively, the IBA is a brief law as compared to the BAFIA but allows a broader scope of activities to be performed by Islamic banks.³¹⁴

The absence of a definition of specific banking activities in the IBA 1983 meant that Islamic banks were allowed to engage in anything not contrary to Shariah, which is that they were allowed to carry out ‘Universal Banking’,³¹⁵ involving a range of financial functions, for example, trading of financial instruments and foreign exchange, brokerage and investment management.³¹⁶ On the contrary, Section 2 of BAFIA limited conventional banking to three main businesses, which included receiving deposits, paying and collecting cheques and providing finance.³¹⁷ Section 32 specifically prohibited conventional banks from carrying out any trade whether retail or wholesale.³¹⁸ Similarly, Section 66 of the Act prevented conventional banks from being

involved in any investment activity.³¹⁹ Anything comparable to both of these latter sections was not found in IBA, thereby allowing a range of business activities to be carried out by Islamic banks.³²⁰

There were several discrepancies within the Act, which hampered the development of Islamic banks. One of the most notable discrepancies was that the Act limited the establishment of Islamic banks to only companies which possessed a license under the Companies Act 1965.³²¹ As a result, any company enacted under any other Act could not operate as an Islamic bank. This was the reason that Bank Kerjasama Rakyat Malaysia's attempt at becoming a full-fledged Islamic bank was stymied, despite its functions being de facto Islamic.³²² However, for divergence between IBA and the Companies Act 1965, Section 55 of the IBA clearly set out that in case of any conflict between the Companies Act 1965 and IBA, the latter shall prevail.³²³

Bank Islam Malaysia Berhad (BIMB)

In 1983, Bank Islam Malaysia Berhad (BIMB) was incorporated as a public company, and it became the first full-fledged bank to offer Islamic banking products and services.³²⁴ The bank was governed under the IBA 1983. Since it was incorporated as a company under the Companies Act 1965, which allowed the bank to carry out trading activities including owning of assets and dispersing them.³²⁵ During the decade forming 1983 to 1993, Islamic finance remained in its experimental stage, keeping itself an exclusive forte of the Islamic Banks. During this time, BIMB operated as a monopoly for 10 years during which it achieved tremendous growth, rapidly expanding throughout the country. Things started to change around 1993, when commercial banks were allowed to step into the field as well defeating the perception of Islamic finance being exclusive for Muslims only.³²⁶ This was done through the introduction of the SPTF scheme, which later transformed into SPI scheme, allowing conventional banks to first offer Islamic banking windows and later to operate full-fledged Islamic subsidiaries.

The Skim Perbankan Tanpa Faedah (SPTF)/Skim Perbankan Islam (SPI) Scheme

In 1993, an interest-free banking scheme, or the Skim Perbankan Tanpa Faedah (SPTF) was introduced. This introduced a dual-banking system allowing for Islamic and conventional banking systems to co-exist. Through this scheme, conventional banks were allowed to offer Islamic banking services and products through 'Islamic Windows'. It was highly successful as a greater number of the public, both Muslims and Non-Muslims started to participate and contribute to the Islamic banking industry.³²⁷ This scheme further allowed the Islamic banking industry to increase its share in the shortest time possible since the setting up of fully organic Islamic banks was an onerous and time-consuming task. At the same time in 1994, Malaysia also established an Inter-Bank Money Market, for the Islamic banking system to

function as a full-fledged banking system³²⁸ and to facilitate the provision of short-term capital between Islamic banks enabling them to balance their books daily.³²⁹

Further development to these banks offering both conventional and Islamic banking services, usually called the SPI banks came by way of an amendment made to Section 124 of the BAFIA 1989. Through this amendment in 1999, vide the BAFIA (Amendment) Act 1996, the interest-free banking scheme that allowed for Islamic windows in conventional banks, was fully formalized and legalized to be carried out by licensed institutions and six new provisions were added to govern and regulate the SPI banks. These provisions allowed SPI banks to formally carry out Islamic banking business with their conventional banking business, in consultation with the central bank. In carrying out their business, they were subject to the provisions of BAFIA. Section 124 (1) of BAFIA which allowed Islamic banking to be carried out by SPI banks,³³⁰ was in conflict with Section 32 and Section 66 of the same Act, which restricted trade and investment respectively,³³¹ whereas Islamic banking business involves both. To resolve this discrepancy, two orders, namely the BAFIA (Trading by Licensed Banks, Finance Companies, and Merchant Banks) Order 1994, and BAFIA (Acquisition and Holding of Shares and Interests in Shares) (Licensed Banks, Licensed Finance Companies and Licensed Merchant Banks) Regulations 1991, were passed to grant an exception to conventional banks to carryout strictly Islamic banking business and all activities ancillary thereof. Further, under Section 124 (3) (4), SPIs were required to seek advice from the Shariah advisory council established by the central bank, and if they did, the advice was made binding on them.³³² Despite all this, however, these SPI banks did not get the status of Islamic Banks as their structure was still conventional,³³³ and they were obligated to keep both Islamic banking and conventional banking functions strictly separate.³³⁴

Both the IBA and BAFIA were the prime statutes that allowed the banking industry, both conventional and Islamic to develop in a mutually sustainable way, but they were later replaced in 2013 by the Islamic Financial Services Act 2013 (IFSA) and the Financial Services Act 2013 (FSA), respectively. Similar to the previous linkage between IBA and BAFIA, the IFSA though is the main law dealing with Islamic Banking like IBA 1983, does not have an exclusive role. Financial Services Act 2013 also requires compliance by Islamic banks. Similarly, the arrangement where conventional banks can also provide Islamic banking services and products through opening Islamic banking windows, under the interest-free banking scheme is still in place, but such banks also have to comply with the regulations under IFSA.³³⁵

Regulation of the Banking Industry: Central Bank of Malaysia

The central bank of Malaysia also called the Bank Negara Malaysia, created in 1959, is the main body responsible to manage monetary policy and deals exclusively with the banking industry. In regulating the industry, the central

Bank was conferred with powers to regulate and govern the industry under the Central Bank of Malaysia Act 1958, and after 2009 under the Central Bank of Malaysia Act, 2009 which repealed the former.³³⁶ It was also conferred with powers under the Islamic Banking Act, 1983 and the Banking and Financial Services Act 1989, and later on under the Islamic Financial Services Act, 2013 and the Financial Services Act, 2013 which repealed the former two respectively.³³⁷ In relation to Islamic Banking, the central bank is also assisted by the Shariah Advisory Council, which is a unique feature of the Malaysian regime for Islamic banking. In 2001, Malaysia introduced the FSMP on basis of recommendations from the central bank, which aimed for 20% market share for Islamic banking and takaful by 2010.³³⁸ The FSMP focused on improving the legal structure of the country, providing a favorable tax regime, increasing the number of Islamic banks to stimulate competition, and other such plans for the development of the banking industry. Taking further the efforts of the SPI scheme to setup a dual banking system through the Islamic Banking Scheme of 1993 and to carry out financial liberalization of Islamic banks, the FSMP also entailed granting of licenses to qualified conventional banks to setup full-fledged Islamic banks.³³⁹ This FSMP pertaining to 2001–2010 was succeeded by another FSMP introduced in 2011, which focused on the internationalization of Islamic finance, achieving greater regional and international integration, and enactment of a comprehensive legislative framework for Islamic financial systems.

Development of Islamic Capital Market

The creation of the Islamic capital market and money market in Malaysia facilitated the smooth flow of funds in the Islamic financial system. It allowed for a variety of financial instruments to develop that provide for effective management of liquidity for IFIs.³⁴⁰

Islamic capital market is a very strong and crucial component of Islamic finance since it allows capital to be raised through Shariah-compliant shares and bonds, thereby acting as an alternative to conventional capital markets. The growth of Islamic capital markets worldwide has been accompanied by a corresponding regulatory regime. Malaysia has been a forerunner in the development of this regulatory regime, by creating a hybrid model of regulation, taking cues both from its common law heritage and principles of Shariah,³⁴¹ allowing for the development of a vibrant capital market.

The regulation of Islamic capital markets in Malaysia started in the 1990s and saw strong growth after Capital Market Masterplan was launched in 2001, which represented state policy toward Islamic finance. This master plan detailed the strategies for the development of an Islamic capital market in the country. It set out a ten-year strategy of the securities commission for capital market development and served as a catalyst for the growth of Islamic capital markets in Malaysia. This regulatory framework is a combination of common law and sharia. The Shariah element of this regulatory framework

consists largely of Quasi-legislative guidelines issued by the Securities Commission.³⁴²

On the common law side, Islamic securities are subject to disclosure requirements and shareholder protection regulations as conventional securities. Similarly, company legislation, listing requirements, and codes that govern conventional securities apply equally to Islamic securities, as they apply to conventional securities. These include the Companies Act 1965, equitable fiduciary principles drawn from English common law, the Malaysian Code on Corporate Governance 2012, and the Malaysian Code on Takeovers and Mergers 2010.³⁴³

The Securities Commission and its Shariah advisory council have a central role in the regulation of Islamic capital markets. The securities commission issues guidelines and rulings based on advice from Shariah experts, regarding the legitimacy of certain commercial transactions from an Islamic perspective. The main statute that deals with the capital market is called the Capital Markets and Services Act, 2007. This Act makes the Securities Commission responsible for guidelines to Islamic securities.³⁴⁴ The Act allows guidelines issued by the Securities Commission a quasi-legislative status and stipulates sanctions for non-compliance.³⁴⁵

Guidelines issued by the Securities Commission aim at tidying up the existing rules regarding the issuance of Islamic securities. The guidelines include definitions of securities, their purpose and promotion of innovative products. They include the Guidelines on the Offering of Islamic Securities and Guidelines on Unit Trust Funds for example. The Securities Commission while offering these guidelines also works closely in consultation with the Islamic industry to remove obstacles and keeps oversight to ensure Shariah compliance.³⁴⁶ This consultation has resulted in guidelines also being issued to facilitate the securities industry, for example, the Registration of Shariah Advisors Guidelines which took effect on 10th August 2009 made it easier for individuals and corporations to provide advice on Islamic capital market products and services. Under these guidelines, individuals and corporations can provide advice on all Shariah-based products and services through a single registration, which was not the case previously where a separate registration had to be made for every product and service.³⁴⁷

The amalgamation of both Shariah law and common law in the regulation of Islamic capital markets means that the regulations build on the foundation of corporate governance as established according to common law, with an added layer of ethics based on Shariah principles. These ethics include structuring investments to avoid interest, excessive speculation, gambling or other practices proscribed by Islam. Hence, these investments are often structured as for-profit sharing or sale and purchase transactions, while Islamic bonds (*sukuk*) are asset-based or asset-backed.³⁴⁸ To avoid jurisdictional conflict between common law and Shariah, the Capital Market and Services Act states that where Shariah matters arise before courts or arbitrators, these should be referred to Shariah authorities.³⁴⁹ Further on, the Act makes a ruling of the Shariah Advisory council binding on the courts.³⁵⁰

Due to the dedicated focus toward the development of the capital market by the Malaysian government and the effective regulatory regime that facilitates and garners the capital market, by 2004 the number of Islamic securities approved by the securities commission had grown to 80% of those listed on the National Exchange. More than a third of the bonds issued were Shariah compliant and it was estimated that half the world's Islamic capital market funds are located in the country.³⁵¹ The number of products approved by the Securities Commission has also increased greatly. From two Islamic unit trust funds established in 1993, today there are more than 60 Islamic funds available in the market with over 390,000 accounts opened.³⁵² The list of these products including sukuk, Shariah-compliant funds, warrants and futures contracts, etc. have continued to grow over time, offering investors a wide range of products which are viable alternatives to conventional products.³⁵³ The Commission has also reduced the processing time for approvals to launch a new fund by easing the application process.³⁵⁴

On the capacity-building side, in order to further facilitate the industry, the securities commission offers training programs for the industry to develop expertise, through its Securities Industry Development Centre (SIDC).³⁵⁵ In terms of taxation, the Federal Budget 2004, announced changes to address several tax anomalies that hindered the progress of Islamic capital markets. For example, in relation to real property gains tax and stamp duty, exemptions are given for the issuance of Islamic securities that involve the sale and purchase of underlying assets to achieve tax neutrality between Islamic and conventional instruments.³⁵⁶ To encourage the introduction of foreign expertise in the market, efforts have been made to liberalize the industry to bring foreign companies in the fund management and brokering business and allow foreign companies to offer Islamic products.³⁵⁷

Hence the Securities Commission has constantly made and is constantly making efforts on all levels and fronts, from regulation to development of expertise to removing hindrances, to allow the Islamic industry to flourish.

Shariah Advisory Councils (SAC)

In order to provide Shariah-based oversight to the banking and securities industry, National Shariah Advisory Councils were established in 1997.³⁵⁸ There are two National-level Shariah Advisory councils, one operating on the banking side in consonance with the Central Bank of Malaysia and the other with the Securities Commission of Malaysia. The role of these councils is to ensure Shariah compliance and to afford a sense of homogeneity and consistency to the Islamic finance industry. They are the final arbiters and judges in deciding Shariah adherence of products and transactions.

The Shariah Council dealing with the Banking industry derives its powers under the Central Bank of Malaysia Act, 2009 and is the sole authority for ascertainment of Islamic law in respect of Islamic financial services.³⁵⁹ Its purposes include ascertainment of Islamic law on financial matters, advising

the central bank on Islamic financial services and also rendering advice to the IFIs.³⁶⁰

The central bank, in furtherance of its functions, has to consult the Shariah Advisory Council in relation to matters that require ascertainment of Islamic law, and similarly, other financial institutions can also refer issues to the council to get its ruling.³⁶¹ Similarly, courts also have to refer matters requiring ascertainment of Islamic law to the council for a ruling or take into account the already published ruling of the Shariah Council.³⁶² Once such matters have been sent to the SAC for ruling by the banks, or as previously stated, by a financial institution to seek advice, the ruling furnished shall be binding.³⁶³ It is important to understand that though financial institutions are at liberty to either seek advice from the SAC, and the advice or ruling is only binding after it is sought and rendered, but this is not the case for courts, which have to perforce send all Shariah matters to the council for opinion and treat it as binding.

There is also an in-house Shariah advisory committee which is constituted under the Islamic Financial Services Act 2013, and the purpose of this body is to tender advice to the banks to bring their functions in line with Islamic law.³⁶⁴ Members of this committee are required to possess the requisite knowledge of Islamic law and necessary expertise,³⁶⁵ and in order to avoid any conflict between these in-house Shariah committees and the National Shariah Councils, there are several restrictions on the appointment of members to these committees, who cannot be at the same time members of both the council and the committee and can also not sit on the committee of more than one Islamic bank.³⁶⁶ In case of any conflict between any ruling of the in-house Shariah Advisory Committee, and the National Shariah Advisory Council, the latter prevails.³⁶⁷

The Second National-level Shariah Advisory Council works on the securities side, as part of the Securities Commission of Malaysia. It is an up-gradation of an Islamic Instrument Study Group (IISG) formed in 1994 by the Securities Commission, which made decisions on issues related to Islamic capital market and was then made a formal body called the Shariah Advisory Council, in 1996. This council ensures that the Islamic capital market complies with the Shariah Principles. Its purpose or jurisdiction includes advising the commission on all matters related to the comprehensive development of the Islamic Capital Market and serving as the first point of reference for all matters related to the Islamic capital market, its functions and operations.³⁶⁸

Apart from this, this SAC also plays a key role in assisting the Securities Commission in regulating the Islamic capital market. It, in effect, provides an informal enforcement mechanism for the quasi-legislative guidelines issued by the Securities Commission under the Capital Market and Services Act, 2007.³⁶⁹ These guidelines are the primary mode of regulation of the Islamic capital market and are issued in consultation with Shariah experts from the council itself. The SAC not only provides advice and opinion for the formation of these guidelines but also, on basis of these guidelines and their

compliance, issues diktats regarding a share being Shariah compliant or not. If compliance is not made with the guidelines, there is a great chance of a share losing its Shariah-compliant status of which a list is issued twice a year by the SAC mentioning the names of securities that are Shariah compliant and vice versa. Investors are advised to dispose of shares that lose Shariah-compliant status, and dividends paid on them are not to be kept by the investors but are to be given in charity. This advice, though not enforceable,³⁷⁰ is authoritative from a religious perspective and thus yields results. In providing this informal and quasi-enforcement mechanism, the SAC is further facilitated by the presence of independent Shariah advisors/in-house committees as approved by the Securities Commission, within issuers of Islamic securities.³⁷¹

Comparable to the provision under the Central Bank of Malaysia Act 2009, which requires courts to refer the matter to the SAC, there is a similar provision in the Capital Markets and Services Act 2007, which requires that where Shariah matters arise before courts or arbitrators, they should be referred to SAC³⁷² and the ruling rendered is to be treated as binding.³⁷³ Thus, Shariah matters related to banking are sent to the Shariah Council of the central bank, and those related to Securities and the Islamic capital market, are sent to the Shariah Council of the Securities Commission. In case of a conflict between the council and any other in-house Shariah advisory body, the ruling given by the council would prevail.³⁷⁴

Jurisprudence on Islamic Finance

Despite the great efforts of the Malaysian government, there still are some uncertainties and discrepancies that arise in the jurisprudential realm. Civil courts in Malaysia have an uneasy relationship with Islamic finance matters.

With the inclusion of clause (1A) in Article 121 of the Federal Constitution vide an amendment in 1988, the jurisdiction of civil courts on matters involving Islamic law was ostensibly taken away and passed on to separately established Shariat courts.³⁷⁵ However, the effect of this amendment especially in relation to Islamic finance matters was diluted by the civil courts, primarily on the basis that Islamic finance matters are commercial matters falling under the Federal list, while Shariah courts can only wield their jurisdiction in relation to matters that fall within the state list. Further, the jurisdiction of the Shariat court was ousted in respect of IFIs on the basis that Shariat courts can only have jurisdiction over persons who profess the Islamic faith. Although this may seem to be a technical anomaly, on basis of this, Shariat courts have been de facto barred from taking cognizance of corporate matters, because they involve companies and not individuals who profess Islam.³⁷⁶ These contentions were crystallized in the case of *Bank Islam Malaysia Berhad (BIMB) v Adnan bin Omar*, where the plaintiff raised a preliminary objection to the jurisdiction of the civil court. The plaintiff argued that since BIMB (plaintiff) was an Islamic bank, the civil court lacked jurisdiction. The objection

was overruled on the basis that the matter fell in the federal list, and list 1 of the Ninth Schedule allowed parliament to enact laws on it whereas Shariat Courts have jurisdiction only in state matters. Secondly, since the bank was a corporate body, it cannot profess Islam, and thus Shariat court lacked jurisdiction.³⁷⁷

The ousting of the Shariat court's jurisdiction in Shariah matters has resulted in anomalous judgments by civil courts that fail to appreciate the essence of Islamic finance. Most of these cases involve either Bay al Inah or Bay Bithaman Ajil (BBA) sales transactions. The former is a transaction comparable to a loan transaction, but in this, to effect this loan, the bank buys an asset from the borrower and makes him a fixed payment which is the loan amount. Then the bank resells the same asset to the borrower, on a deferred payment basis with a profit margin. On the other hand, the latter is directly an asset financing agreement, where the bank buys an asset on behalf of the borrower and sells it to the borrower on a deferred payment basis, again with a profit margin. This way the bank does not give a loan amount, but instead finances the buying of an asset, and is then repaid with a profit margin. In looking at these cases, the civil court's approach toward these cases can be seen in ascending order, beginning from a policy of least intrusion into the essence of Islamic principles, and then moving onto a policy of proactive engagement with these concepts.

In *Bank Islam Malaysia Berhad vs Adnan Bin Omar*, a BBA facility was extended to a customer named Adnan Bin Omar. The bank purchased a property for the customer, and sold it to him, of which the payment was to be made in monthly installments and the payments were secured by way of a charge created on the property. The customer defaulted on the payment of installments, and the bank sought to recover the amount by obtaining a foreclosure proceeding. The customer challenged the bank's right to obtain a foreclosure proceeding based on several claims against the legitimacy of the BBA transaction itself, and its non-compliance with several procedural laws, especially the rules of the High court. This was a typical case, where it was impossible to comply with the laws and procedures that would otherwise apply to similar transactions, and this is what formed the basis of the customer's claim. He argued that the amount of loan that was listed in the contract, was never actually received by him but what he received was in fact a must lesser amount. Secondly, according to the rules, the bank must mention separately the actual amount advanced, and the interest charged on it, but the bank did not do so. The customer highlighted several other similar discrepancies which made the facility illegitimate and thus no claim should arise for the bank under its canopy.

Another very interesting thing about the case was that even after obtaining the foreclosure proceedings, the customer still remained in debt to the bank, which was representative of the crippling weight of the transaction that was supposed to be an alternative to the burdensome interest-based transactions. Despite all of this, the court tried to resolve this dilemma by not delving into

the details of the transaction and ruling in favor of the bank saying that the plaintiff was bound to pay the whole selling price since he was well aware of the terms of the contract.³⁷⁸ The court only applied the classical common law approach of strict application of the terms of the contracts and did not delve into the nitty-gritty of a BBA transaction, which would otherwise have opened up a Pandora's box for the bank. This restraint however was lost as the court's started to engage more deeply with the contours of a BBA transaction, in subsequent cases.³⁷⁹

Two other cases are *Affin Bank Berhad v Zulkifli Abdullah*³⁸⁰ and *Malayan Banking Berhad v Marilyn Ho Siok Lin*.³⁸¹ Both of these cases involved a BBA transaction as well. The court criticizing the previous narrow approach of the courts based on classical common law principles and in neglect of Shariah, held that BBA facility was similar to a conventional loan and the banks could not claim unearned profits for the whole tenure not yet expired, as that would amount to interest calculation in violation of IBA 1983 which forbids everything that is against the injunctions of Shariah. Despite the fact that the court proscribed unearned profits in a BBA facility, it restrained itself from delving into the questions about the legitimacy and legality of a BBA transaction itself.³⁸²

In *Arab Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd & Ors*, the court held that the BBA facility itself was contrary to the provisions of IBA 1983 since it was un-Islamic. This judgment was the beginning of the court's proactive engagement with Islamic financial transactions and practices, and its inquiry into the legitimacy of the transactions. This case also pertained to a BBA facility where the same issue was under consideration. The plaintiffs were asked to pay the whole amount of the selling price in the event of default. The court took up several facets of the BBA transaction, in light of the interpretation provided under several Madahib, and held that it was not a bona fide sales transaction but a financing transaction which was null and void under the provisions of both IBA and BAFIA.³⁸³ This judgment was overturned by the court of appeal which held that a BBA contract was valid, and the court had taken a wrong approach which involved either rewriting the BBA contract to make it more equitable or rejecting its validity as a whole, both of which were against the framework of the law.³⁸⁴

There are several other cases that manifest the inconsistency in court's decisions while grappling with Islamic finance/transactions. In *Dato' Hj. Nik Mahmud bin Daud v BIMB*, the plaintiff made a BBA transaction with a bank whereby he sold a property in cash which was immediately resold to him by the bank on a deferred payment basis. He later claimed that the said transaction was null and void since it was in contravention to Kelantan Malay Reservation Enactment 1930 (KMRE). The KMRE Section 7 (i) strictly prohibits the transfer of ownership of property by a Malay to a non-Malay. Since the bank was not gazetted as a Malay or a native of Kelantan, the plaintiff argued that the transaction was void. Here again, the court had to exercise its discretion, and in that, it looked at the real intention of the parties

and held that the sale and purchase were not actual but was only to facilitate the BBA transaction.³⁸⁵ In resolving this controversy however, the court created another controversy which questioned the legitimacy and essence of the transaction of BBA, which under Islamic law is only legitimate as it is a sale and purchase agreement. By its judgment, the court essentially reduced a BBA transaction and its process to a legal device or stratagem being used to carry out a transaction otherwise not valid under Islamic law.³⁸⁶

In order to solve these discrepancies, a new arrangement was brought in place under the Central Bank of Malaysia Act 2009, which made it mandatory upon courts and arbitrators to refer all matters related to Shariah, to the National SAC, and treat them as bindings the ruling rendered subsequently.³⁸⁷ In result to this arrangement, *Tan Sri Khalid Ibrahim v Bank Islam Malaysia Berhad*, was the first case in the history of the Malaysian courts, where a High Court judge made reference to the SAC for confirmation of the Shariah status of an agreement.³⁸⁸ This new arrangement on the face of it seems to have taken away the court's status as the final arbiter in all cases involving Islamic finance and Shariah but this may not be the case. Despite the fact that courts are now bound to take and abide by the ruling of the Shariah Advisory Council, the ruling of the SAC only pertains to the question of law posed to them and is an ascertainment of the relevant Islamic law to be applied. SAC does not delve into the specific facts of the case, therefore, the discretion to 'apply' the rulings rendered, on the specific facts of the case, is still of the courts³⁸⁹ who use it quite generously, diluting the impact of this arrangement to a great extent.³⁹⁰ However, what this arrangement has done is that the courts ability to question the essence of various types of Islamic transactions, and construe them according to their own common-law understanding, has been done away with to a great extent.

The vision of the Malaysian government was not just to have Islamic banking but an entire architecture for Islamic finance. This resulted in continuous and comprehensive institutional support to all sectors of Islamic finance, allowing the industry to flourish. On the legislative side, the IBA 1983 allowed for the establishment of Islamic banks. Following this enactment, the BIMB was established as the first Islamic bank and was allowed a grace period of 10 years, in which the Malaysian government observed the viability of Islamic banking. The bank achieved tremendous growth, and consequently, the SPTF and later SPI scheme widened the ambit to allow conventional banks to enter the arena as well. The conventional banks were first allowed to operate Islamic banking windows and later fully fledged subsidiaries. This allowed for astronomical growth in Islamic banking institutions, as existing institutions ventured into the Islamic banking market. Discrepancies that could hamper the level playing field were eradicated through amendments, orders, and guidelines. The banking industry was complemented, in terms of the flow of finance and management of liquidity by the creation of the Islamic capital market, which allowed for a variety of financial instruments to develop that provide for effective management of liquidity for IFIs. Apart

from the legislative and policy measures, capacity-building also remained the focus of the Malaysian government and it carried out training programs to harness the potential of the IF industry. To ensure that the basic anchors of Shariah are preserved and protected, SAC was established at the National level to cater to both the banking and the securities industry, in collaboration with the key regulators. The regulators, including the Central Bank of Malaysia and Securities Commission, had a key role to play in the development of the industry through their keen oversight and the master plans that they introduced for the industries, i.e., the FSMPs of 2001–2010 and 2011–2020 for the banking sector, and the Capital Market Masterplan for the securities sector. Although the jurisprudential terrain of Malaysia represents some disconnects in the court's understanding of Islamic financial instruments, which has resulted in controversial verdicts, however, the Malaysian government has considerably resolved the conundrum by making it mandatory for courts to seek and follow the advice of the SAC in all Shariah matters.

Conclusion

No financial center became an IFC only due to favorable circumstances, though it could be counted as one reason. The correlation that exists, and that we see flowing throughout this chapter, reflects the interplay between the extraneous factors and the response they garnered from within. Take the great depression as a point, and one sees how the US responded to it in a manner that defined its financial trajectory for the next several decades, filled with strict regulations followed by de-regulation and vice versa. The UK took major falls, but its economy being strong enough to withstand the ripples, turned out more stable and the steps it took were more in sync with how its economy evolved gradually. Singapore was affected greatly by the 2008 crisis, and its economy was pushed into recession, while also getting mired into several financial scandals such as Temasek Investments scandal. Its response was not to launch an abrupt offensive but to allow new forces to enter the economy and revive it. The engagement with the Islamic finance industry post-2008 crisis lays testament to this. Hong Kong's financial journey was populated by the Stock Market Crash of 1973, followed by the 1987 crash and the 2008 crisis which affected Hong Kong greatly, but after every such crisis, Hong Kong was prepared to overhaul and re-stimulate its economy with steps that catered to changed economic realities. Japan reflects the same theme in its overall journey. Despite this receptiveness to changing hints from global financial forces, these jurisdictions except for the UK could not do much to accommodate Islamic finance. This can be attributed to the peculiarity and specificities that the Islamic financial paradigm brings with it, and this specificity demands a parallel setup that these jurisdictions either are not willing or capable to provide. What this parallel setup could look like becomes clear from the example of Malaysia and Dubai, and the efforts that they undertook to accommodate Islamic finance. Change in legislation,

supplemented with the provision of required structures, further coupled with the setting up of separate supervisory bodies are the very basic elements that float from the steps taken by these jurisdictions. Without these, the introduction of Islamic finance would either remain too minimal or get mixed up with conventional finance leading to institutional entanglements which would be hard to unknot.

Notes

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14. Lord Justice Bingham, 'Inquiry into the Supervision of The Bank of Credit and Commerce International' (Return to an address of the Honorable House of Commons, 22 October 1992) [Chapter 2](#), Clause 2.22.
15. Richard Dale, 'Reflections on the BCCI Affair: A United Kingdom Perspective' (1992) 26 International Lawyer 949, 951.
16. Richard Dale, 'Reflections on the BCCI Affair: A United Kingdom Perspective' (1992) 26 International Lawyer 949, 954.
17. Richard Dale, 'Reflections on the BCCI Affair: A United Kingdom Perspective' (1992) 26 International Lawyer 949, 953.
18. Abbreviations: The Barings (Inquiry Report), BB & Co: Baring Brother & Co Ltd., BAM: Barings Assets Management Limited, BSL: Barings Securities Ltd., BFS: Barings Futures Singapore Plc Ltd., BIB: Barings Investment Bank.

19. 'Report of The Board of Banking Supervision Inquiry into the Circumstances of the Collapse of Barings' (Return to an order of the Honorable House of Commons, UK government, 1995), para 1.18.
20. 'Report of The Board of Banking Supervision Inquiry into the Circumstances of the Collapse of Barings' (Return to an order of the Honorable House of Commons, UK government, 1995), para 1.22.
21. 'Report of The Board of Banking Supervision Inquiry into the Circumstances of the Collapse of Barings' (Return to an order of the Honorable House of Commons, UK government, 1995), para 1.25.
22. 'Report of The Board of Banking Supervision Inquiry into the Circumstances of the Collapse of Barings' (Return to an order of the Honorable House of Commons, UK government, 1995), para 1.26.
23. 'Report of The Board of Banking Supervision Inquiry into the Circumstances of the Collapse of Barings' (Return to an order of the Honorable House of Commons, UK government, 1995), para 1.33.
24. 'Report of The Board of Banking Supervision Inquiry into the Circumstances of the Collapse of Barings' (Return to an order of the Honorable House of Commons, UK government, 1995), para 1.41.
25. 'Report of The Board of Banking Supervision Inquiry into the Circumstances of the Collapse of Barings' (Return to an order of the Honorable House of Commons, UK government, 1995), para 1.6.
26. 'Report of The Board of Banking Supervision Inquiry into the Circumstances of the Collapse of Barings' (Return to an order of the Honorable House of Commons, UK government, 1995), para 1.51 and 1.55.
27. 'Report of The Board of Banking Supervision Inquiry into the Circumstances of the Collapse of Barings' (Return to an order of the Honorable House of Commons, UK government, 1995), para 1.66.
28. 'Report of The Board of Banking Supervision Inquiry into the Circumstances of the Collapse of Barings' (Return to an order of the Honorable House of Commons, UK government, 1995) 257–263.
29. Michael Taylor, 'Financial Services and Markets Act 2000 – I' (2000) 30 *Amicus Curiae* 3.
30. Financial Services and Markets Act 2000, s 2, 3, 4, 5, 6.
31. Rosa M. Lastra, Northern Rock and Banking Law Reforms in the UK, *The Failure of Northern Rock: A Multi-dimensional Case-study*, 135.
32. David T. Llewellyn, 'The failure of Northern Rock: A multi-dimensional case-study' (SUERF – The European Money and Finance Forum, Vienna, 2009) 14.
33. Treasury Committee, *The run on the Rock* Fifth Report (HC 2007–08, 56–I) 14.
34. Treasury Committee, *The run on the Rock* Fifth Report (HC 2007–08, 56–I) 14.
35. As per FSA, Liquidity risk is defined as 'the risk that a firm, although balance-sheet solvent, cannot maintain or generate sufficient cash resources to meet its payment obligations in full as they fall due or can only do so at materially disadvantageous terms'.
36. Treasury Committee, *The run on the Rock* Fifth Report (HC 2007–08, 56–I) 26.
37. Treasury Committee, *The run on the Rock* Fifth Report (HC 2007–08, 56–I) 35.
38. Treasury Committee, *The run on the Rock* Fifth Report (HC 2007–08, 56–I) 36.
39. Treasury Committee, *The run on the Rock* Fifth Report (HC 2007–08, 56–I) 5.
40. David T. Llewellyn, 'The failure of Northern Rock: A multi-dimensional case-study' (SUERF – The European Money and Finance Forum, Vienna, 2009) 28.
41. Financial Times, 'The Financial Conduct Authority: What It Does and Who Is Charge', (Telegraph UK) <<https://www.telegraph.co.uk/finance/newsbysector/banksandfinance/8874588/The-Financial-Conduct-Authority-what-it-does-and-who-is-charge.html>> accessed 19 February 2022.

42. Heidi Mandanis Schooner and Michael Taylor, 'Convergence and Competition: The Case of Bank Regulation in Britain and the United States' (1999) 20 *Michigan Journal of International Law* 595, 651.
43. Heidi Mandanis Schooner and Michael Taylor, *Convergence and Competition: The Case of Bank Regulation in Britain and the US* (1999) 20 *Michigan Journal of International Law* 595, 649.
44. Investment banking very simply is an activity where an investment banker buys the stocks of a company after evaluation of its creditworthiness and in speculation of its growth by taking into account various factors. This process is called 'Underwriting' and investment bankers charge a particular fee on such investments. Thus, they act as brokers on behalf of investors. Investment bankers are approached only by investors who have a good command over market practices and thus can make a good decision and are not prone to manipulation.

On the other hand, the customers of commercial banks are usually novices in terms of investment in securities. Thus, if commercial banks also perform investment banking activities, and carry out underwriting, they automatically have a conflict of interest as they are very likely to advise their customers (who lack knowledge of the market) to invest in companies to get their commissions, even if the companies are not sound and do not promise growth and good yield. This is a phenomenon that has occurred quite a lot where commercial banks urged their clients to invest in companies of their affiliates or others that gave them the highest commission, and the customers were made to suffer losses.

This is the conflict of interest that was eliminated by the separation of commercial and investment banking.

45. Howard H. Preston, 'The Banking Act of 1933' (1933) 23 *The American Economic Review* 585.
46. For instance, in 2003 and 2004, Lehman Brothers acquired, including BNC Mortgage and Aurora Loan Services, five mortgage lenders that specialized in Alt-A loans where loans are extended without full documentation.
47. John Kwaku Mensah Mawutor, 'The Failure of Lehman Brothers: Causes, Preventive Measures and Recommendations' (2014) 5(4) *Research Journal of Finance and Accounting*.
48. Franklin Allen and Elena Carletti, 'An overview of the crisis: Causes, Consequences, and Solutions' (2010) 10(1) *International Review of Finance* 1.
49. Franklin Allen and Elena Carletti, 'An overview of the crisis: Causes, Consequences, and Solutions' (2010) 10(1) *International Review of Finance* 1, 2.
50. Michael Lim Mah-Hui, 'Old Wine in New Bottles: Subprime Mortgage Crisis-Causes and Consequences' (2008) 3 *Journal of Applied Research in Accounting and Finance* 3.
51. Franklin Allen and Elena Carletti, 'An overview of the crisis: Causes, Consequences, and Solutions' (2010) 10(1) *International Review of Finance* 1, 2.
52. Franklin Allen and Elena Carletti, 'An overview of the crisis: Causes, Consequences, and Solutions' (2010) 10(1) *International Review of Finance* 1, 2.
53. It is a type of insurance that covers the eventuality of debtors defaulting on their loans. However, in the 2008 crisis, insurance companies had issued these instruments without having enough money to back them up which added fuel to fire.
54. Michael Lim Mah-Hui, 'Old Wine in New Bottles: Subprime Mortgage Crisis-Causes and Consequences' (2008) 3 *Journal of Applied Research in Accounting and Finance* 3, 4.
55. Franklin Allen and Elena Carletti, 'An overview of the crisis: Causes, Consequences, and Solutions' (2010) 10(1) *International Review of Finance* 1, 2.
56. Henrik Dossdall and Byron Z. Rom-Jensen, 'Letting Lehman Go: Critique, Social Change, and the Demise of Lehman Brothers' (2017) 42(3) *Leibniz Institute for the Social Sciences* <<https://www.jstor.org/stable/44425368>> accessed 26 April 2021.

57. Repo 105 is an accounting loophole that allows for repurchase transactions whereby a company may classify a short-term loan as a sale and subsequently, use the proceeds from the sale to reduce its liabilities. In the case of Lehman Brothers, Repo 105 transactions recognized the transactions as sales instead it was borrowings, and this allowed it to keep the said borrowings off the balance sheet.
58. John Kwaku Mensah Mawutor, 'The Failure of Lehman Brothers: Causes, Preventive Measures and Recommendations' (2014) 5(4) *Research Journal of Finance and Accounting*.
59. John Kwaku Mensah Mawutor, 'The Failure of Lehman Brothers: Causes, Preventive Measures and Recommendations' (2014) 5(4) *Research Journal of Finance and Accounting*.
60. Katalina Bianca, 'A Retrospective of the Troubled Asset Relief Program' (2011) *Wolters Kluwer Law & Business*.
61. Emergency Economic Stabilization Act 2008, s 101.
62. Emergency Economic Stabilization Act 2008, s 3(9).
63. Emergency Economic Stabilization Act 2008, s 101(c).
64. Emergency Economic Stabilization Act 2008, s 103.
65. Emergency Economic Stabilization Act 2008, s 106.
66. Antonio M. DiNizo Jr, 'The Martin Act: A Tool for Counteracting Financial Deregulation' (2018) 23 *Stanford Journal of Law, Business & Finance* 214.
67. Thomas W. Joo, 'Lehman 10 Years Later: The Dodd-Frank Rollback' (2019) 50 *Loyola University Chicago Law Journal* 565.
68. Thomas W. Joo, 'Lehman 10 Years Later: The Dodd-Frank Rollback' (2019) 50 *Loyola University Chicago Law Journal* 568.
69. Antonio M. DiNizo Jr, 'The Martin Act: A Tool for Counteracting Financial Deregulation' (2018) 23 *Stanford Journal of Law, Business & Finance* 210, 214.
70. Dodd-Frank Wall Street Reform and Consumer Protection Act, s 953(b).
71. Celia R. Taylor, 'The Dodd-Frank Death Knell' (2018) 49 *Loyola University Chicago Law Journal* 661.
72. Celia R. Taylor, 'The Dodd-Frank Death Knell' (2018) 49 *Loyola University Chicago Law Journal* 660.
73. Dodd-Frank Wall Street Reform and Consumer Protection Act, title 10.
74. Celia R. Taylor, 'The Dodd-Frank Death Knell' (2018) 49 *Loyola University Chicago Law Journal* 666.
75. Federal Reserve Act, s 13(3).
76. Martin Neil Baily and others, 'The Impact of the Dodd-Frank Act on Financial Stability and Economic Growth' (2017) 3(1) *The Russell Sage Foundation Journal of the Social Sciences* <<https://www.jstor.org/stable/10.7758/rsf.2017.3.1.02>> accessed 26 April 2021.
77. This is the threshold for 'assets worth'. It means that a company owning assets that are valued above \$50 billion, would face stringent and extraordinary regulatory supervision, and have to fulfill extra regulatory requirements.
78. Martin Neil Baily and others, 'The Impact of the Dodd-Frank Act on Financial Stability and Economic Growth' (2017) 3(1) *The Russell Sage Foundation Journal of the Social Sciences* <<https://www.jstor.org/stable/10.7758/rsf.2017.3.1.02>> accessed 26 April 2021.
79. The Dodd-Frank Act created, through Title 10, Consumer Financial Protection Bureau (CFPB) to consolidate the federal oversight of financial products to a single entity. On the other hand, it absolved the Office of Thrift Supervision (OTS) which was responsible to monitor financial institutions engaged in risky practices.
80. For example, section 1473(f)(2) requires CFPB and other agencies to 'jointly, by rule, establish minimum requirements to be applied by a State in the registration of appraisal management companies'.

See also: By way of this section of the Dodd-Frank Act, the Financial Institutions Reform, Recovery and Enforcement Act of 199 was amended by adding a new section at the end of it which reads as follows:

‘The Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration Board, the Federal Housing Finance Agency, and the Bureau of Consumer Financial Protection shall jointly, by rule, establish minimum requirements to be applied by a State in the registration of appraisal management companies. Such requirements shall include a requirement that such companies— (1) register with and be subject to supervision by a State appraiser certifying and licensing agency in each State in which such company operates; (2) verify that only licensed or certified appraisers are used for federally related transactions; (3) require that appraisals coordinated by an appraisal management company comply with the Uniform Standards of Professional Appraisal Practice; and (4) require that appraisals are conducted independently and free from inappropriate influence and coercion according to the appraisal independence standards established under section 129E of the Truth in Lending Act’.

81. Martin Neil Baily and others, ‘The Impact of the Dodd-Frank Act on Financial Stability and Economic Growth’ (2017) 3(1) The Russell Sage Foundation Journal of the Social Sciences <<https://www.jstor.org/stable/10.7758/rsf.2017.3.1.02>> accessed 26 April 2021.
82. John Plender and Avinash Persaud, ‘The day Dr Evil wounded a financial giant’ *Financial Times* (22 August 2006) <<https://www.ft.com/content/144f84ca-31fd-11db-ab06-0000779e2340#axzz2iZcapFyO>> accessed 16 January 2022.
83. Kelechi Okorafor, ‘Principles-based or Rules-based system? A Case for Reform of the Regulatory Approach to Corporate Governance in the Nigerian Banking Sector’ (L.L.M. thesis, University of Manitoba 2009) Ch 4, 10–11.
84. The Sarbanes-Oxley Act, through various of its sections, including Section 3, 108, 208, 302, 303 and several others made it mandatory upon the Securities and Exchange commission to promulgate rules and regulations in order to implement the reforms, procedures and controls proposed in the act within a stipulated time period.
85. Report of the HPEC on making Mumbai an International Financial Center, ‘Case Studies: London, New York, Singapore, Dubai’ (2007) Ch 3, 36 and 42 <<https://dea.gov.in/sites/default/files/chapter03.pdf>> accessed 17 January 2022.
86. *People v. Federated Radio Corporation* (1926) 244 New York 33, 38–39.
The powers granted to New York State Attorney General are expansive in nature, and the Martin Act, concomitantly, does not recognize the defence of lack of intent for a conviction.
Sections 352, 353 and 358 of the act read collectively empower the attorney general to carry out investigations, take any action as deemed fit and bring criminal charged against any person who may be involved in securities fraud, and these sections do not place a condition for intent being there to constitute fraud, thus making it a strict liability offense.
87. *People vs Barysh* (1978) 408 New York Supplement.2d 190.
See also: *People vs Barysh* (1978) 408 New York Supplement2d 190, 192.
88. Heidi Mandanis Schooner and Michael Taylor, ‘Convergence and Competition: The Case of Bank Regulation in Britain and the United States’ (1999) 20 Michigan Journal of International Law 595, 651.
89. Alejandro Portes, ‘A Tale of Three Cities: The Rise of Dubai, Singapore, and Miami Compared’ (2020) 28(3) Spanish Sociological Review 9.
90. Alejandro Portes, ‘A Tale of Three Cities: The Rise of Dubai, Singapore, and Miami Compared’ (2020) 28(3) Spanish Sociological Review 9.

91. J.J. Woo, *Singapore as an International Financial Centre: History, Policy and Politics* (Palgrave Macmillan Studies in Banking and Financial Institutions 2016) 28.
92. J.J. Woo, *Singapore as an International Financial Centre: History, Policy and Politics* (Palgrave Macmillan Studies in Banking and Financial Institutions 2016).
93. J.J. Woo, *Singapore as an International Financial Centre: History, Policy and Politics* (Palgrave Macmillan Studies in Banking and Financial Institutions 2016) 28.
'It reduced the corporate tax from 40% to 10% and furthermore, for banks operating Asian Currency Units, they abolished the 20% minimum reserve requirement'.
94. J.J. Woo, *Singapore as an International Financial Centre: History, Policy and Politics* (Palgrave Macmillan Studies in Banking and Financial Institutions 2016).
95. J.J. Woo, *Singapore as an International Financial Centre: History, Policy and Politics* (Palgrave Macmillan Studies in Banking and Financial Institutions 2016), 58.
96. Report of the HPEC on making Mumbai an International Financial Center, 'Case Studies: London, New York, Singapore, Dubai' (2007) <<https://dea.gov.in/sites/default/files/chapter03.pdf>> accessed 17 January 2022.
97. These three categories of licenses issued to banks, namely full banks, restricted banks, and offshore banks, are granted under section 4 of the Banking Act.
98. Edith E. M. Johnson, 'Hong Kong and Singapore: The Future of Asian Financial Centers' (1985) 9 *Fletcher Forum* 353.
99. Edith E. M. Johnson, 'Hong Kong and Singapore: The Future of Asian Financial Centers' (1985) 9 *Fletcher Forum* 353.
100. Edith E. M. Johnson, 'Hong Kong and Singapore: The Future of Asian Financial Centers' (1985) 9 *Fletcher Forum* 353.
101. Ravi Chandran, 'Banking Law Reforms in Singapore' (2000) 28 *International Business Law* 31.
102. Ravi Chandran, 'Banking Law Reforms in Singapore' (2000) 28 *International Business Law* 31.
103. Ravi Chandran, 'Banking Law Reforms in Singapore' (2000) 28 *International Business Law* 31.
104. Ravi Chandran, 'Banking Law Reforms in Singapore' (2000) 28 *International Business Law* 31.
105. Ravi Chandran, 'Banking Law Reforms in Singapore' (2000) 28 *International Business Law* 31.
106. Ravi Chandran, 'Banking Law Reforms in Singapore' (2000) 28 *International Business Law* 31.
107. J.J. Woo, *Singapore as an International Financial Centre: History, Policy and Politics* (Palgrave Macmillan Studies in Banking and Financial Institutions 2016).
108. Securities and Future Act 2006, s 232(1)(5).
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110. J.J. Woo, *Singapore as an International Financial Centre: History, Policy and Politics* (Palgrave Macmillan Studies in Banking and Financial Institutions 2016).
111. J.J. Woo, *Singapore as an International Financial Centre: History, Policy and Politics* (Palgrave Macmillan Studies in Banking and Financial Institutions 2016).
112. Rule 14 of Order 10 allows the High Court of Singapore to transfer the matter to SICC, on its own motion, if it considers that the matter involves international and commercial issues, and it does not require any prerogative orders to be made.
113. The Constitution of Republic of Singapore, 1965, art. 95.
114. Legal Profession Act, s 36P.
115. Supreme Court Judicature Act, s 18M; Legal Profession Act, s 36P.
116. For detailed updated list of foreign registered lawyers with the SICC, please visit the following link: <<https://www.sicc.gov.sg/registration-of-foreign-lawyers/foreign-lawyers>> accessed 17 January 2022.
117. Reciprocal Enforcement of Commonwealth Judgements Act; Reciprocal Enforcement of Foreign Judgement Act; Choice of Court Agreement Act.

118. To look for the published copies of the decisions of SICC, please visit the following website: <<https://www.sicc.gov.sg/hearings-judgments/judgments>> accessed 17 January 2022.
119. As already stated, the President of Singapore, under Article 95 of the Constitution, is vested with the authority to make appointment of the international judges.
120. Supreme Court Judicature Act, s 18K; Rules of Court, rule 23.
121. *BCBC Singapore Pte Ltd v PT Bayan Resources TBK* (2016) Singapore International Commercial Court 1.
122. *BCBC Singapore Pte Ltd v PT Bayan Resources TBK* (2016) Singapore International Commercial Court 1 [14].
123. Rules of the Court, rule 14 and 15, Order 110.
124. *BCBC Singapore Pte Ltd v PT Bayan Resources TBK* (2016) Singapore International Commercial Court 1 [48].
125. Tharman Shanmugaratnam, 'Budget Speech 2009 – Keeping Jobs, Building for the Future' (Singapore Parliament, Singapore, 22 January 2009) <https://www.mof.gov.sg/docs/default-source/default-document-library/singapore-budget/budget-archives/2009/fy2009_budget_statement.pdf?sfvrsn=d3c6b949_2> accessed 15 January 2022.
126. Tharman Shanmugaratnam, 'Budget Speech 2009 – Keeping Jobs, Building for the Future' (Singapore Parliament, Singapore, 22 January 2009) <https://www.mof.gov.sg/docs/default-source/default-document-library/singapore-budget/budget-archives/2009/fy2009_budget_statement.pdf?sfvrsn=d3c6b949_2> accessed 15 January 2022.
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128. Rolf Jordan, 'Singapore in Its Worst Recession for Years: The Effects of the Current Economic Crisis on the City-State's Economy' (2009) 28(4) *Journal of Current Southeast Asian Affairs* <<https://journals.sagepub.com/doi/pdf/10.1177/186810340902800405>> accessed 11 July 2021.
129. The holding's portfolio included companies namely Singapore Airlines, Neptune Orient Lines, and Chartered Semiconductor Manufacturing.
130. Rolf Jordan, 'Singapore in Its Worst Recession for Years: The Effects of the Current Economic Crisis on the City-State's Economy' (2009) 28(4) *Journal of Current Southeast Asian Affairs* <<https://journals.sagepub.com/doi/pdf/10.1177/186810340902800405>> accessed 11 July 2021.
131. Rolf Jordan, 'Singapore in Its Worst Recession for Years: The Effects of the Current Economic Crisis on the City-State's Economy' (2009) 28(4) *Journal of Current Southeast Asian Affairs* <<https://journals.sagepub.com/doi/pdf/10.1177/186810340902800405>> accessed 11 July 2021.
132. Rolf Jordan, 'Singapore in Its Worst Recession for Years: The Effects of the Current Economic Crisis on the City-State's Economy' (2009) 28(4) *Journal of Current Southeast Asian Affairs* <<https://journals.sagepub.com/doi/pdf/10.1177/186810340902800405>> accessed 11 July 2021.
133. Rolf Jordan, 'Singapore in Its Worst Recession for Years: The Effects of the Current Economic Crisis on the City-State's Economy' (2009) 28(4) *Journal of Current Southeast Asian Affairs* <<https://journals.sagepub.com/doi/pdf/10.1177/186810340902800405>> accessed 11 July 2021.
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135. Rolf Jordan, 'Singapore in Its Worst Recession for Years: The Effects of the Current Economic Crisis on the City-State's Economy' (2009) 28(4) *Journal of Current Southeast Asian Affairs* <<https://journals.sagepub.com/doi/pdf/10.1177/186810340902800405>> accessed 11 July 2021.
136. Rolf Jordan, 'Singapore in Its Worst Recession for Years: The Effects of the Current Economic Crisis on the City-State's Economy' (2009) 28(4) *Journal of Current Southeast Asian Affairs* <<https://journals.sagepub.com/doi/pdf/10.1177/186810340902800405>> accessed 11 July 2021.
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148. Mohd Yazid Bin Zul Kepli, 'Islamic Finance in Singapore: Legal and Regulatory Challenges' (2013) 31 *Singapore Law Review* 279, 291.
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151. Mohd Yazid Bin Zul Kepli, 'Islamic Finance in Singapore: Legal and Regulatory Challenges' (2013) 31 *Singapore Law Review* 279, 292.
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154. Mohd Yazid Bin Zul Kepli, 'Islamic Finance in Singapore: Legal and Regulatory Challenges' (2013) 31 *Singapore Law Review* 279, 298.

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159. Raj Joshua Thomas, 'Islamic Banking and Finance – Regulatory Regimes in Malaysia and Singapore' (2011) 29 *Singapore Law Review* 165, 175.
160. Administration of Muslim Law Act, Act No. 27 1966.
161. Muhammad Haniff Hassan and Sharifah Thuraiya Su'ad Ahmad Alhabshi, 'The Training, Appointment, and Supervision of Islamic Judges in Singapore' (2012) 21 *Pacific Rim Law & Policy Journal* 189, 190.
162. Administration of Muslim Law Act 1966, s 35 (2), s 52 (1), s 115.
163. Administration of Muslim Law Act 1966, s 34 (1).
164. Muhammad Haniff Hassan and Sharifah Thuraiya Su'ad Ahmad Alhabshi, 'The Training, Appointment, and Supervision of Islamic Judges in Singapore' (2012) 21 *Pacific Rim Law & Policy Journal* 189, 194.
165. The fees charged by banks for borrowing above a set amount of money or credit facility allowed by the bank.
166. Catherine Schenk, 'Regulatory Reform in an Emerging Stock Market: the case of Hong Kong, 1945–86' (2004) 11 *Financial History Review* 139, 145.
167. Issue of shares to existing shareholders in a prorate manner to not dilute the existing shareholdings.
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'Right issue is when shares are offered at a special price by a company to its existing shareholders, in the ratio of the shares they hold so as not to cause an imbalance in the control and ownership of the company'.
169. One important exchange that opened up in this period was the Far East Exchange (FEE), which opened up because of HKSE not agreeing to entertain new entrants into the market by increasing its seats. Opening up of FEE was followed by other exchanges including the Kam Ngan Stock Exchange (KNE) and the Kowloon Stock Exchange (KSE).
Catherine Schenk, 'Regulatory Reform in an Emerging Stock Market: the case of Hong Kong, 1945–86' (2004) 11 *Financial History Review* 139, 147–149.
170. Catherine Schenk, 'Regulatory Reform in an Emerging Stock Market: the case of Hong Kong, 1945–86' (2004) 11 *Financial History Review* 139, 149.
171. Catherine Schenk, 'Regulatory Reform in an Emerging Stock Market: the case of Hong Kong, 1945–86' (2004) 11 *Financial History Review* 139, 152.
172. The Bretton Woods system was a monetary order that established rules of commercial and financial relations among the US, Canada, Western European Countries, Australia and Japan in a way that promoted international stability and prevented competitive devaluation of currency among other things had collapsed, after Nixon introduced drastic measures one of which was to disallow the conversion of dollar to gold. These measures which also included wage and price freezes, surcharge on imports in order to counter inflations were referred to as the 'Nixon Shock', and there was subsequent devaluation of dollar under the Smithsonian Agreement which came into place in 1971, whereby a new dollar standard as compared to the previous gold standard was created and the currencies of a number of industrialized countries were pegged to dollar instead of Gold.
173. 'The impact of financial crises on International Migration' (2010) 37 *International Organization for Migration*, 8.

174. Catherine Schenk, 'Regulatory Reform in an Emerging Stock Market: the case of Hong Kong, 1945–86' (2004) 11 *Financial History Review* 139, 153.
175. Protection of Investors Ordinance, s 3 and 8.
176. Protection of Investors Ordinance, s 7.
177. Barry Alexander K. Rider, 'The Regulation of Insider Trading in Hong Kong' (1975) 17 *Malaya L Rev* 310, 341.
178. Securities Ordinance, s 25.
179. 'The Regulation of Insider Trading in Hong Kong' (1975) 310, 341.
180. Securities Ordinance, s 26.
181. Securities Ordinance, s 30.
182. Alan Au, 'Regulating Securities Fraud and Market Manipulation in Hong Kong: Part XII of the Securities Ordinance' (1988) 18 *Hong Kong Law Journal* 25.
See also: s 135 and 136, Securities Ordinance.
183. Securities Ordinance, s 136.
184. Securities Ordinance, s 139 and 141.
185. David C. Donald and Paul W. H. Cheuk, 'Hong Kong's Public Enforcement Model of Investor Protection' (2017) 4 *Asian Journal of Law and Society* 349, 363.
186. Stock Exchange of Hong Kong.
187. *Attorney General v. Li Fook Shiu, Ronald* (1990) 1 *Hong Kong Cases* 1.
188. Corporate Finance Institute, 'What caused the Black Monday Crash?' <www.corporatefinanceinstitute.com> accessed 17 January 2022.
189. Douglas W. Arner and Antonio M. Da Roza, 'Financial Regulation in Hong Kong: Time for a Change' (2010) 5 *Asian Journal of Comparative Law* 1, 4.
190. Douglas W. Arner and Antonio M. Da Roza, 'Financial Regulation in Hong Kong: Time for a Change' (2010) 5 *Asian Journal of Comparative Law* 1, 4.
See also: Horace W.H. Yeung and Flora Huang, 'Law and Finance: What Matters: Hong Kong as a Test Case' (2012) 15 *Asian Journal of Law and Economics* 1.
'This culminated into a paradigm shift which was so radical, that Jackson and Roe (2009) alleged that Hong Kong has one of the most intense securities regulators in the world. The securities and futures commission continued to expand its scope to the extent that by 2009/2010 it had increased its budget to a whopping HKD 730 million'. An important indicator of this intense public enforcement is the direct staff per million of population ratio, for which the figure in Hong Kong is 58.47, a more than double of the figure in US, which has a ratio of 24.29 despite it being a place where enforcement intensity is very high. This means that for every 1 million of the population in the country, the number of staff employed in public enforcement departments was 24.29 in US, while it was 58.47 in Hong Kong which is considerably higher.
191. David C. Donald and Paul W.H. Cheuk, 'Hong Kong's Public Enforcement Model of Investor Protection' (2017) 01 *The Chinese University of Hong Kong Faculty of Law Research Paper* 349, 372.
In Hong Kong, all actions against companies for market misconduct have been commenced by a public body. SFC added another new aspect to these cases when it started filing cases to disqualify the directors of corporate bodies for breach of fiduciary duties or for involvement in dubious activities.
192. *Securities and Futures Commission v. Tiger Asia Management LLC* (2011) *Hong Kong Exchanges and Clearing* 824.
193. *Securities and Futures Commission v. Tiger Asia Management LLC* (2012) 2 *Hong Kong Law Reports and Digest* 281.
194. *Securities and Futures Commission v. Tiger Asia Management LLC* (2013) *Hong Kong Exchanges and Clearing* 703.
195. *Re PCCW Ltd* (2009) *Hong Kong Exchanges and Clearing* 738 (CA).
196. Horace W.H. Yeung and Flora Huang, 'Law and Finance: What Matters: Hong Kong as a Test Case' (2012) 15 *Asian Journal of Law and Economics* 1, 16.
While the UK and US have had more than 500 and 100 enforcement cases respectively, Hong Kong also maintains an average of 100 enforcement cases, which is

- considerably high considering the narrower scope of SFC, and the size of the market. SFC does not hesitate to initiate criminal proceedings against abusers and take them to courts. The first criminal conviction took place in 2008 for insider trading after it had been criminalized in 2003, under the Securities and Futures Ordinance.
197. Douglas W. Arner and Antonio M. Da Roza, 'Financial Regulation in Hong Kong: Time for a Change' (2010) 5 *Asian Journal of Comparative Law* 1, 14–15.
 198. Douglas W. Arner and Antonio M. Da Roza, 'Financial Regulation in Hong Kong: Time for a Change' (2010) 5 *Asian Journal of Comparative Law* 1, 17.
 199. Douglas W. Arner and Antonio M. Da Roza, 'Financial Regulation in Hong Kong: Time for a Change' (2010) 5 *Asian Journal of Comparative Law* 1, 14.
 200. Douglas W. Arner and Antonio M. Da Roza, 'Financial Regulation in Hong Kong: Time for a Change' (2010) 5 *Asian Journal of Comparative Law* 1, 25.
 201. Douglas W. Arner and Antonio M. Da Roza, 'Financial Regulation in Hong Kong: Time for a Change' (2010) 5 *Asian Journal of Comparative Law* 1, 20.
 202. Masahiro Takada, 'Japan's Economic Miracle: Underlying Factors and Strategies for Growth' (1999) IR 163, 14.
 203. Konosuke Odaka, 'The Evolution of Social Policy in Japan' (2002) World Bank Institute Working paper 33053, 3 <<https://documents1.worldbank.org/curated/en/580821468042904090/pdf/330530JP0Social0policy01PUBLIC1.pdf>> accessed 17 January 2022.
 204. A consumer economy is one which has a high consumer spending as a ratio of its GDP which leads to growth. How crucial this was for Japan's economy, would become visible further on, when Japan had to cover the deficit in consumer spending from its trade surplus, which became an area of concern for the government. However, in this period, since there were efforts to boost both domestic spending and international trade, it had not become an issue.
 205. Berkley Roundtable on the International Economy Politics and Productivity: Developmental Strategy and Production Innovation in Japan (BRIE Working Paper #30, 1987), 10–14.
 206. Marius B. Jansen and Fred G. Notehelfer 'Japan, the late 20th and early 21st centuries/ Economic Change' (Britannica) <<https://www.britannica.com/place/Japan/International-relations#ref23220>> accessed 14 July 2021.
 207. Fukuo Kawata, 'Preserving Japan's balance of payment position in an open economy' (1965) 3 *The Developing Economies* 107, 111 <https://www.ide.go.jp/library/English/Publish/Periodicals/De/pdf/65_01_07.pdf> accessed 25 July 2021.
 208. Michael M. Hutchison, Takatoshi Ito and Frank Westermann, 'The Great Japanese Stagnation: Lessons for Industrial Countries' (2005) EPRU Working Paper Series, No. 2005–13, 4 <<https://www.econstor.eu/bitstream/10419/82046/1/wp-05-13.pdf>> accessed 17 January 2022.
'Although Japan took steps to revive its economy, and reduced its dependence on oil, which was shown in the lesser impact on its economy of a subsequent increase in oil prices in the 1979'.
 209. Masahiro Takada, 'Japan's Economic Miracle: Underlying Factors and Strategies for Growth' (1999) IR 163, 16.
 210. Berkley Roundtable on the International Economy Politics and Productivity: Developmental Strategy and Production Innovation in Japan (BRIE Working Paper #30, 1987), 14–17.
 211. Charles Yuji Horioka, 'The Causes of Japan's Lost Decade: The role of household consumption' (2006) ISER Working Paper 12142 <https://www.nber.org/system/files/working_papers/w12142/w12142.pdf> accessed 17 January 2022.
'This meant that there was stagnation in spending on basic things, such as clothing, footwear, transport, education and food, and non-alcoholic beverages, which dramatically effected the ratio of household consumption collectively'.
 212. Masahiro Takada, 'Japan's Economic Miracle: Underlying Factors and Strategies for Growth' (1999) IR 163, 16.

This was because the industrial production was no longer impacted by the Oil crisis, because Japan shifted towards nuclear energy as an alternative to Oil.

213. Frank Langdon, 'Japan–United States Trade Friction: The Reciprocity Issue' (1983) 23 *Asian Survey* 653.
214. Masahiro Takada, 'Japan's Economic Miracle: Underlying Factors and Strategies for Growth' (1999) IR 163, 16.
215. In the early 1970s Japan had the world's second highest tariffs on manufactured goods, but under this pressure, and under its commitment to the GATT and IMF, it started to take steps to remove trade barriers.
216. Naoi Megumi and Okazaki Tetsuji, 'Political Economy of Trade Liberalization: The case of post-war Japan (RIETI Discussion Paper 13–E-090, 2013) 5.
217. Yujiro Hayami and Yoshihisa Good, 'Economics and Politics of rice policy in Japan: A perspective of Uruguay Round' (1997) 6 *National Bureau of Economic Research* 371.
218. Marius B. Jansen and Fred G. Notehelfer 'Japan, the late 20th and early 21st centuries/ Economic Change' (Britannica.com) <<https://www.britannica.com/place/Japan/International-relations#ref23220>> accessed 14 July 2021.
219. Mitsuo Matsushita, 'The Structural Impediments Initiative: An Example of Bilateral Trade Negotiation' (1991) 12 *Michigan Journal of International Law* 436.
220. This initiative had a very big impact on Japan's liberalization decision and its pace. This came about as a series of negotiations which took place between Japan and USA, which criticized Japan's closed economy for the trade imbalance, where oligopolistic large industries linked together by stock-holding and inter-locking directorates, exclude outside parties from participating in the domestic economy.
221. Mitsuo Matsushita, 'The Structural Impediments Initiative: An Example of Bilateral Trade Negotiation' (1991) 12 *Michigan Journal of International Law* 436.
222. James Chen, 'What is Gen-Saki' (*Investopedia.com*, 25 December 2020) <<https://www.investopedia.com/terms/g/gen-saki.asp>> accessed 14 July 2021.
223. Impact Loans, as the name suggests, are those loans that are doled out to those investors whose anticipated investments are deemed by the banks to be sustainable and who fulfill the bank's set criteria for such loans. These are usually given at lower interest rates. In Japan, the foreign currency loans were hence referred to as 'impact loans'.
224. Masahiko Takeda and Philip Turner, 'The Liberalisation of Japan's Financial Market: Some Major Themes' (1992) 34 *Bank for International Settlements Economic Paper* 1, 102.
225. Ministry of Finance, Japan 'The background and basic principles pertaining to a fundamental review of the foreign exchange control system' (*mof.go.jp*) <https://www.mof.go.jp/english/about_mof/councils/customs_foreign_exchange/e1a702f2.htm> accessed 14 July 2021.
226. Masahiko Takeda and Philip Turner, 'The Liberalisation of Japan's Financial Market: Some Major Themes' (1992) 34 *Bank for International Settlements Economic Paper* 1, 102.
 'A major leap came in 1980 with the amendment of Foreign Exchange and Trade Control Act of 1949 which made several concessions towards liberalization. There was further liberalization of impact loans, and non-residents were allowed to have bank accounts. With this, the Japanese citizens were allowed to hold interest bearing foreign currency accounts with Japanese banks. There was also the easing of the designated-company restriction, which created a bar on foreign ownership of a company's assets was removed from several companies, and only 11 companies remained within the ambit of this restriction'.
227. United States Government Accountability Office, 'Bank Regulatory Structure: Japan' (GAO Chapter Report, GAO/GGD-97-5, 1996).

228. Hideki Kanda, 'Developments in Japanese Securities Regulation: An Overview' (1995) 29 *International Lawyer*. 599, 603.
229. Hideki Kanda, 'Developments in Japanese Securities Regulation: An Overview' (1995) 29 *International Lawyer*. 599, 604.
 'First, a 5 percent rule was introduced, whereby anyone who acquired more than 5% shares in a public limited company had to make certain disclosures. Second the rule on stock tender offers were liberalized. Further amendments came in following the scandals in the industry whereby mainly, all brokerage firms were prohibited from giving any sort of compensation to their clients'.
230. Masahiko Takeda and Philip Turner, 'The Liberalisation of Japan's Financial Market: Some Major Themes' (1992) 34 *Bank for International Settlement Economic Paper* 1, 113.
231. Berkley Roundtable on the International Economy Politics and Productivity: Developmental Strategy and Production Innovation in Japan (BRIE Working Paper #30, 1987), 64.
 Although areas such as construction bidding were still closed, and many cultural barriers remained.
232. Dario F Robertson, 'Japanese Offshore Banking: Toward a World Financial Center in Tokyo' (1984) 8 *Fletcher Forum* 63, 65.
 'It allows them to open accounts with authorized banks in the unit, in designated currencies, which are usually free from withholding taxes, interest rates ceilings and foreign exchange control'.
233. Dario F Robertson, 'Japanese Offshore Banking: Toward a World Financial Center in Tokyo' (1984) 8 *Fletcher Forum* 63, 69–70.
 'First, this facility allowed Japan to have a degree of control over the increasing internationalization of Yen. Most of Japanese exports use yen as the medium of exchange, whilst for imports, dollar is used, which reduces access to yen funds and creates an imbalance. This facility allowed the disbalance to be countered'.
 'Second, it provided Japanese banks with a stable source of dollars to finance mounting energy and raw material imports. Japan faced a lot of problem when dollars were in short supply even in the US owing to its monetary policy or because of periodic lack of liquidity'.
 'Third, Japan faced an invisible deficit which had to be balanced out by way of merchandise exports. The OBU provided Japan with funds to balance out its invisible deficit'.
 'Fourth, the OBU provided Japanese investors a diversified market to manage their assets in order to mitigate the risk'.
234. Dario F Robertson, 'Japanese Offshore Banking: Toward a World Financial Center in Tokyo' (1984) 8 *Fletcher Forum* 63, 72–74.
 'These included loss of revenue due to tax exemptions, leakages from the Tokyo OBU hampering domestic monetary policy effectiveness, curtailment to some extent of the government's power to influence exchange rates by controlling capital outflows and inflows, and trade frictions resulting from loss of business to other offshore banking units of other IFCs'.
235. Andrew M. Pardieck, 'The formation and transformation of securities law in Japan: From the bubble to the Big Bang' (2001) 19 *Pacific Basin Law Journal* 9.
236. 'Japanese Big Bang' (*fsa.go.jp*, January 2000) <https://www.fsa.go.jp/p_mof/english/big-bang/ebb37.htm> accessed 14 July 2021.
237. Brian Arthur Pomper 'The Japanese Financial Reform of 1993: Will reform spark innovation', (1995) 28 *Cornell International Law Journal* 525, 526 <<http://scholarship.law.cornell.edu/cilj/vol28/iss2/9>> accessed 14 July 2021.
238. Brian Arthur Pomper 'The Japanese Financial Reform of 1993: Will reform spark innovation', (1995) 28 *Cornell International Law Journal* 525, 527 <<http://scholarship.law.cornell.edu/cilj/vol28/iss2/9>> accessed 14 July 2021.

239. Brian Arthur Pomper ‘The Japanese Financial Reform of 1993: Will reform spark innovation’, (1995) 28 *Cornell International Law Journal* 525, 528 <<http://scholarship.law.cornell.edu/cilj/vol28/iss2/9>> accessed 14 July 2021.
- This was because Article 65 of the Japanese Securities and Exchange Law imposed a strict separation between banking and securities activities, because of which banks were losing out on a very lucrative industry and was subsequently losing depositors eyeing larger profits and moving to the securities industry. These reforms allowed banks to also operate in the securities industry by way of their subsidiaries, in which they had more than 50% ownership. Hence this reform abolished the wall that had prevented banks from dealing in the capital market for 40 years.
240. United States Government Accountability Office, ‘Bank Regulatory Structure: Japan’ (GAO Chapter Report, GAO/GGD-97-5, 1996).
- ‘Such as a high number of non-performing loans piling up mainly because of bank’s lending to the real-estate sector which had collapsed, deposit insurance was depleting, and new scandals came to fore’.
241. Brian Arthur Pomper ‘The Japanese Financial Reform of 1993: Will reform spark innovation’, (1995) 28 *Cornell International Law Journal* 525, 527 <<http://scholarship.law.cornell.edu/cilj/vol28/iss2/9>> accessed 14 July 2021.
242. It came to fore that several of the largest and most important securities companies in Japan had been providing improper compensation to their best corporate clients by reimbursing them for losses incurred on the Tokyo stock exchange.
243. Brian Arthur Pomper ‘The Japanese Financial Reform of 1993: Will reform spark innovation’, (1995) 28 *Cornell International Law Journal* 525, 526 <<http://scholarship.law.cornell.edu/cilj/vol28/iss2/9>> accessed 14 July 2021.
- ‘Although granting of the compensation was not illegal, but guaranteeing the same was illegal, since it removed corporations’ incentive to invest wisely in worthwhile stocks, since they no longer have to worry about losing money. This practice wasted useful capital on speculative, unproductive stock, and prevented capital from being invested to support worthwhile ventures’.
244. United States Government Accountability Office, *Bank Regulatory Structure: Japan* (GAO Chapter Report, GAO/GGD-97-5, 1996).
- ‘A securities trader in its New York office had initiated improper trades over an 11-year period that had gone undetected. Reported losses totaled more than 1 billion dollars. Banking regulators in the US issued cease and desist orders against Daiwa requiring a virtual cessation of trading activities in the United States’.
245. Bank for International Settlements: Monetary and Economic Department, ‘The financial crisis in Japan during the 1990s: how the Bank of Japan responded and the lessons learnt’ (BIS Paper no. 6, 2001) 4–5.
- ‘They were both ill-managed institutions and this was the first case of failure of urban deposit taking institutions’.
246. Bank for International Settlements: Monetary and Economic Department, ‘The financial crisis in Japan during the 1990s: how the Bank of Japan responded and the lessons learnt’ (BIS Paper no. 6, 2001) 6.
247. Bank for International Settlements: Monetary and Economic Department, ‘The financial crisis in Japan during the 1990s: how the Bank of Japan responded and the lessons learnt’ (BIS Paper no. 6, 2001) 7–8.
248. Bank for International Settlements: Monetary and Economic Department, ‘The financial crisis in Japan during the 1990s: how the Bank of Japan responded and the lessons learnt’ (BIS Paper no. 6, 2001) 8–11.
- ‘Another crisis and series of failures started in October 1997, when the authorities stepped in to take action against troubled banks in the Kansai area (Western Japan). This was followed by successive failures in November of Sanyo Securities, Hokkaido Takushoku Bank, Yamaichi Securities and Tokuyo City Bank. Major financial institutions collapsed almost on a weekly basis in the month of November 1997’.

249. Bank for International Settlements: Monetary and Economic Department, 'The financial crisis in Japan during the 1990s: how the Bank of Japan responded and the lessons learnt' (BIS Paper no 6, 2001) 12–13.
- Initially it was bought by another institution formed by Ripple Wood, a US investment fund. In the interim period, LTCB continued its business. The necessary liquidity was provided by the Deposit Insurance Corporation, financed in turn by the Bank of Japan.
250. Masahiko Takeda and Philip Turner, 'The Liberalisation of Japan's Financial Market: Some Major Themes' (1992) 34 Bank for International Settlement Economic Paper 1, 59.
251. Masahiko Takeda and Philip Turner, 'The Liberalisation of Japan's Financial Market: Some Major Themes' (1992) 34 Bank for International Settlement Economic Paper 1, 59–61.
252. Masahiko Takeda and Philip Turner, 'The Liberalisation of Japan's Financial Market: Some Major Themes' (1992) 34 Bank for International Settlement Economic Paper 1, 61–62.
253. Michael M. Hutchison, Takatoshi Ito and Frank Westermann, 'The Great Japanese Stagnation: Lessons for Industrial Countries' (2005) EPRU Working Paper Series, No. 2005–13, 2 <<https://www.econstor.eu/bitstream/10419/82046/1/wp-05-13.pdf>> accessed 17 January 2022.
254. Constitutional Amendment No. 1 of 2003, 10 January 2004.
255. Federal Law No. 8 of 2004, art 3.
256. Dubai Law No. 9 of 2004.
257. 'DIFC-LCIA Arbitration Centre' (Web Page, 2018) <[Http://Www.Difclcia.Org/Overview.aspx](http://www.difclcia.org/Overview.aspx)>, Archived At <[Https://Perma.Cc/R654-S5ut](https://perma.cc/R654-S5ut)> (Overview) accessed 17 January 2022.
258. DIFC Authority, 'DIFC Authority Annual Review 2015' (Report, 2015) 49 <[Https://Www.Difc.Ae/Files/6014/6641/8043/Difcauthorityannualreview_2015.Pdf](https://www.difc.ae/files/6014/6641/8043/Difcauthorityannualreview_2015.pdf)> accessed 17 January 2022.
259. Alejandro Carballo, 'Law of the Dubai International Financial Centre: Common Law Oasis or Mirage within the UAE?' (2007) 21 Arab Law Quarterly 91.
260. 'It is referring to the DIFC financial services and market regulators which is the Dubai Financial Services Authority. The DIFC Financial Advisory Council is created to provide advice on IF, develop IF industry in DIFC'.
261. According To the Jurisdiction Clauses Available On The Official Website of DIFC Courts, 'the DIFC Courts Deal With Any Civil or Commercial Claims or Actions Where The Parties Agree In Writing To File Such Claim or Action With It Whether Before or After The Dispute Arises, Provided That Such Agreement Is Made Pursuant To Specific, Clear And Express Provisions'. <[https://Www.Difccourts.Ae/Application/Files/1515/9774/9107/Difc-Courts-Opt-In-Clause.Pdf](https://www.difccourts.ae/application/files/1515/9774/9107/Difc-Courts-Opt-In-Clause.Pdf)> accessed 17 January 2022.
262. The Dubai Law No. 12 of 2004, art 6.
- The DIFC courts apply any law chosen by the parties in the agreement. The language of Article 6 enunciates this point also. Article 6 states, 'The Courts shall apply the Centre's Laws and Regulations, except where parties to the dispute have explicitly agreed that another law shall govern such dispute, provided that such law does not conflict with the public policy and public morals'.
263. The Dubai Law No. 12 of 2004, art 3.
264. Alain Farhad and Matei Purice, 'An Introduction to the Dubai International Financial Centre – A Jurisdiction within a Jurisdiction' (2013) 7 Romanian Arbitration Journal 1, 72.
265. 'When the DIFC courts were started, there was a condition that either you are directly related to DIFC through office, assets in DIFC to utilize the arbitration forum of DIFC, but through the amendment an opt-in option is provided to the

- parties where an option was provided to everyone, does not matter if they have any relation to DIFC or not, to have their matters arbitrated in DIFC’.
266. Law No. 16 of 2011 Amending Certain Provisions of Law No. 12 of 2004 Concerning Dubai International Financial Centre Courts (Dubai), art 5(A)(1)(B).
267. Law No. 16 of 2021, art 5(A)(1)(B).
268. The Islamic Finance Rules, art 1.1.1.
269. DIFC Law No. 13 of 2004, art. 9.
270. DIFC Law No. 13 of 2004, art 10.
271. Andrew Henderson, ‘Limiting the Regulation of Islamic Finance: Lessons From Dubai’ (2007) 1 *Law and Financial Markets Review* 213.
272. DIFC Law No. 13 of 2004, art. 13.
273. Paul Lee, ‘The Regulation of Securities and Islamic Finance in Dubai: Implications for Models of Shari’ah Compliance’ (2016) 15 *University of California, Los Angeles Journal of Islamic and Near Eastern Law* 1.
274. Islamic Finance Rules, rule 6.1.5.
275. Islamic Finance Rules, s 3.4.1.
276. Islamic Finance Rules, s 3.4.1(F).
277. Islamic Finance Rules, s 3.7.
278. Islamic Finance Rules, s 3.5.1.
279. Islamic Finance Rules, s 3.5.2.
280. Islamic Finance Rules, s 3.5.3.
281. Islamic Finance Rules, s 6.3 and 6.4.
282. Islamic Finance Rules, sec 3.8.1 and 3.8.2.
283. DIFC Law No. 1 of 2004, art 41(1) and 42(3).
284. DIFC Law No. 1 of 2004, art 78(1) And 80.
285. DIFC Law No. 1 of 2004, art 90.
286. Paul Lee, ‘The Regulation of Securities and Islamic Finance in Dubai: Implications for Models of Shari’ah Compliance’ (2016) 15 *University of California, Los Angeles Journal of Islamic and Near Eastern Law* 1.
287. Andrew Henderson, ‘Limiting The Regulation of Islamic Finance: Lessons From Dubai’ (2007) 1 *Law and Financial Markets Review* 213.
288. Law No. 12 of 2004, art 7(2), 7(3).
 ‘Once A Decision Is Ratified International Enforcement Is Ensured through Numerous International Treaties As Outlined in the DIFC Enforcement Guidelines: DIFC Courts, Enforcement Guide 2018’.
289. *Daman Real Capital Partners Co LLC V Oger Dubai LLC* (Judicial Tribunal for Dubai Courts and DIFC Courts, Cassation No 1/2016, 19 December 2016).
290. The Dubai-DIFC Judicial Committee Is Also Known As the ‘Judicial Tribunal’ or ‘Joint Judicial Committee’.
 The Committee determines issues of jurisdiction between the Emirati and DIFC Courts and was established by decree no 19 of 2016 (Dubai), art 1.
291. *Dubai Water Front LLC V Chenshan Liu* (Judicial Tribunal For Dubai Courts And DIFC Courts, Cassation No 2/2016, 19 December 2016) 6.
292. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958.
293. ‘Under the New York Convention, only those countries can take advantage of the convention who are signatory to it. UAE is signatory to the convention, but DIFC is not, since it is not a state. So, the awards announced by DIFC have to be ratified by Dubai Courts for their enforcement, since Dubai courts are an organ of the UAE state, which is a contracting party to the convention’.
294. *Macsteel International LLC V Airmech Dubai LLC* (2011) Unreported, Dubai Court of First Instance, Case No 268/2010, 12 January 2011.

295. *Macsteel International LLC V Airmech Dubai LLC* (2011) Unreported, Dubai Court of First Instance, Case No 268/2010, 12 January 2011.
296. Islamic Finance Update, 'The Dana Gas Case: Sanctity of English Contract Upheld, Notwithstanding Claims of Shariah Non-compliance' (*Covington*, 2017) <<https://www.cov.com/en/news-and-insights/insights/2017/12/islamic-finance-update-the-dana-gas-case>> accessed 7 September 2021.
297. *Dana Gas Pjsc V Dana Gas Sukuk Ltd & Ors* (2017) England and Wales High Court 2928.
298. *Dana Gas Pjsc V Dana Gas Sukuk Ltd & Ors* (2017) England and Wales High Court 2928.
299. 'Dana Gas Repayment Leaves Sukuk legal Precedents Still Lacking' (*Fitch Wire*, 2020) <<https://www.fitchratings.com/research/islamic-finance/dana-gas-repayment-leaves-sukuk-legal-precedents-still-lacking-15-10-2020#:~:text=Dana%20Gas%20Repayment%20Leaves%20Sukuk%20Legal%20Precedents%20Still%20Lacking,-Thu%2015%20Oct&text=Fitch%20Ratings%2DLondon%2FDubai%2D,another%20restructuring%2C%20Fitch%20Ratings%20says>> accessed 17 January 2022.
300. 'Dana Gas Repayment Leaves Sukuk legal Precedents Still Lacking' (*Fitch Wire*, 2020) <<https://www.fitchratings.com/research/islamic-finance/dana-gas-repayment-leaves-sukuk-legal-precedents-still-lacking-15-10-2020#:~:text=Dana%20Gas%20Repayment%20Leaves%20Sukuk%20Legal%20Precedents%20Still%20Lacking,-Thu%2015%20Oct&text=Fitch%20Ratings%2DLondon%2FDubai%2D,another%20restructuring%2C%20Fitch%20Ratings%20says>> accessed 17 January 2022.
301. Islamic Finance Update, 'The Dana Gas Case: Sanctity of English Contract Upheld, Notwithstanding Claims of Shariah Non-compliance' (*Covington*, 2017) <<https://www.cov.com/en/news-and-insights/insights/2017/12/islamic-finance-update-the-dana-gas-case>> accessed 7th September 2021.
302. *Meydan Group LLC v. Banyan Tree Corporate Pte Ltd* (ARB 003/2013 and CA 005/2014) <<https://www.tamimi.com/law-update-articles/the-decree-19-judicial-tribunal-and-its-consequences-redefining-the-scope-of-the-difc-courts-jurisdi/>> accessed 17 January 2022.
303. Law No. 12 of 2004, art 7(2)-(3).
Enforcement is confined to physical jurisdiction. The jurisdiction of the DIFC courts to accept a case is different from their jurisdiction to enforce their judgment. The relation between physical/geographical jurisdiction and enforcement powers is something which is a general concept of law. For the DIFC, since it is an independent separate jurisdiction separate to the UAE legal jurisdiction, so any enforcement outside DIFC is happening in the jurisdiction of UAE. Here the point is that DIFC judgments have to be enforced outside DIFC, but the outside mechanism for enforcement of these judgments in Dubai (which is outside DIFC but within UAE) is different from the mechanism for enforcement of DIFC judgments in let's suppose Sharjah (which is outside DIFC and outside Dubai but is within UAE).
304. Law No. 12 of 2004, art 7(2)(b) and 42(2).
305. DIFC Law No. 13 of 2004, art. 13.
306. Paul Lee, 'The Regulation of Securities and Islamic Finance in Dubai: Implications for Models of Shari'ah Compliance' (2016) 15 *University of California, Los Angeles Journal of Islamic and Near Eastern Law* 1.
307. Islamic Finance Rules, s 6.3 and 6.4.
308. Law No. 12 of 2004.
309. DIFC Law No. 10 of 2004.
310. DIFC Law No. 3 of 2004, art 8.
311. Alejandro Carballo, 'Law of the Dubai International Financial Centre: Common Law Oasis or Mirage within the UAE?' (2007) 21 *Arab Law Quarterly* 91.

312. Mohamad Akram Laldin, 'Islamic Financial System: the Malaysian Experience and the Way Forward' (2008) *Department of Fiqh and Usul, International Islamic University Malaysia*, 223.
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2 English Commercial Courts and Islamic Finance Disputes

English Commercial Courts (ECCs) are famous for providing effective resolution to international commercial disputes. The ECCs have an international reputation to resolve disputes according to the commercial needs of the transaction. The courts have significantly contributed to the promotion of international financial services in London. Owing to the credibility of the ECCs, Beximco Pharmaceuticals, a leading pharmaceutical company in Bangladesh, and Shamil Bank of Bahrain, a prominent bank in Bahrain, chose the English court as a court of jurisdiction for the Murabaha agreement reached between the two organizations. Hence in the backdrop of this case, this chapter will examine the resolution of Islamic finance (IF) disputes in the ECC.

In order to understand the ECC's approach toward Islamic Finance (IF) disputes, this chapter has first included a historical analysis of the evolution of ECC in the UK. The historical perspective defines the underlying principles leading to the current precedents on IF disputes in the ECC. The precedents align with the general approach of ECC, which is premised upon an appreciation of the market needs of commercial transactions. However, this tendency of the ECC toward IF disputes give rise to legal uncertainty in global IF industry making ECCs an unfavorable choice of jurisdiction. Brexit has added a further layer of uncertainty for operation of Islamic financial institutions IFIs in the UK.

English Courts on the Commercial Law

History of English Commercial Courts

Prior to the 16th century, justice was administered in courts of law in England. Judges used to apply laws based on literal interpretation. Principles of law included stare decisis whereby a prior decision has binding authority for the later disputes. The court of law used to be bound by previous decisions, which ensured certainty but strict adherence to precedent, was also a

cause of developing unjust and ambiguous principles. Sometimes literal application of the law is used to lead to ambiguous outcomes such as¹

[A] statute provides that any person wearing orange Doc Marten boots is entitled to receive a sum of money if they present themselves at the Town Hall on a particular date. Bertha has a splendid pair of orange Doc Marten boots that she wears to stride towards the Town Hall at the appointed time to receive her reward. Unfortunately, she is forced to walk through a muddy puddle in the car park which briefly obscures the orange color of her boots in a dirty brown film of mud. A literal application of the statute would mean that Bertha would not be entitled to receive the reward because her boots were not orange at the time specified by the legal rule. Clearly, we would think such an application of that rule to be unfair because her boots were really orange and their color only temporarily obscured by the mud. In such situations, there is a need for judges to be able to reach a just conclusion, even if that is not the conclusion suggested by the literal application of the law.²

This limitation of law led to a need for flexibility in the literal interpretation of law.³ Parties aggrieved by ineffectiveness or non-availability of remedies began writing petitions for equitable justice to the King. Lord Chancellor who was the head of the secretarial department of state used to hear the petitions against courts of law.⁴ Thus, principles of equity began to develop, and the court of Chancery came into existence to administer principles of equity to resolve disputes.⁵

The objective of the law was the provision of justice by strict application of legal principles to resolve disputes. An example of principles of common law is damages for breach of contract. The objective of equity was to ensure the just resolution of the dispute as per the discretion of judges. Equity is all about correcting the injustices and conscience of individuals regardless of legal principles.⁶ Example of equitable principle is specific performance.⁷

The court of law and court of chancery used to operate separately. Both, the common law justice system and the equity-based system, used to run on distinct principles of fairness in separate courts. This separation of law from equity caused two major problems. First, since the court of law did not implement equitable principles and the court of equity did not recognize legal principles, often plaintiffs found themselves filing a suit in inappropriate jurisdictions. This essentially meant that defendants would raise the equitable defense in a court of law, which would end up restraining the action/the final judgment and force the plaintiff to bring a separate action in a court of Chancery.⁸ As a result, the plaintiff had to bring an action in proper jurisdiction; otherwise, the defendant could restrain the action, which used to cause delay for both parties.⁹

The Judicature Act 1873 merged the court of law with the court of equity. The merger of both the courts into one judicial system resolved the issues of delay. Consequently, there came about a single court with various divisions to administer justice according to legal as well as equitable principles. The Act 1873 introduced a procedural fusion of law and equity and over time substantial fusion developed through precedents.¹⁰

Interestingly, equitable principles had accommodated commercial needs quite readily.¹¹ Merchants preferred equity courts for speedy trials as well as acceptance of mercantile customs.¹²

The court of Chancery, which dealt with commercial matters, offered an exemption from the delays of due process as presented in the forms of action and jury system. It can be observed in *Carrier's case*, which was heard in the Star chamber in 1473 (15th century).¹³ There was an alleged felony by a foreign merchant, and felony was a matter for the court of law. However, the Chancellor refused to refer the case to the court of law so that a foreign merchant did not have to deal with delays routinely caused by the court of common law.¹⁴ Court of equity such as Star chambers was indifferent regarding the procedure and could bypass due process for the sake of commercial needs.¹⁵

Getting recognition for commercial needs in common law was a very lengthy task that took years of struggle to come into the shape that it is today. Previously, merchant disputes were dealt with under the principle of equity, which did not follow the doctrine of *Stare decisis*, making the outcome of every dispute different, which took away the certainty that commercial entities yearn for. There started the struggle to get commercial needs recognized and incorporated in the body of law which was initially done through adopting mercantile customs into the national legal system. Commercial needs were initially facilitated under the mercantile law, and this still had to face a lot of resistance and rebuke from stakeholders of common law. However, despite this resistance, the pressing needs of the merchants eventually lead to a time when a compromise was reached between lawyers and merchants, and commercial law started to develop as a separate field of law. These efforts started to materialize only in the 18th century when Lord Mansfield adopted mercantile customs into his judgment.¹⁶

Court of Common Law and Commercial Law

Merchants used to resolve their disputes among themselves until the 16th century. The beginning of the 17th century saw the engagement of common law courts to resolve merchant disputes. By the 18th century, political will escalated the development of mercantile law within the national legal system of England. The end of the 18th century saw the ECCs emerging as the most suitable venue to resolve merchant disputes in England. This development led to the promotion of commercial courts in London to the extent that today the ECCs are a choice of jurisdiction for the international business

community. The major reason for ECCs popularity is the accommodation of the commercial needs of the business community. In the preceding part of this section, the incorporation of mercantile customs into the common law court has been explored.

In 16th century Europe, there was a culture of trading in fairs and ports. These fairs and ports were strategically located on the trading routes like the French fair in the county of Champagne and were particularly important in the development of international commercial customs. In England fair used to run under the King who used to hold the court in the fairs too. Fair courts, also known as pie powder, were held by merchants who used to apply merchant customs to resolve disputes.¹⁷ Court of Staple was no different than fair courts except the staple courts existed at ports to collect customs duties and control trades.¹⁸

This historical setting helped the promotion of commercial customs into the trade. For instance, it was a mercantile custom to use reputation as a tool to prevent unjust practices among merchants. In the system of fairs and trade, there was a regulated entry to fair and it was significantly easy to freely disseminate the flow of information regarding the reputation of merchants.¹⁹ This served as a deterrent for professional merchants who could face isolation, bans and bad reputation by word of mouth if they tried to break commitments.²⁰

Over time, the trade-in between England grew and expanded outside Europe. The merchants started trading finished goods, which paved way for industrialization in England. System of fair courts and staple courts no longer remained a feasible option to resolve merchant disputes.²¹ Additionally, the gradual end of the system of fairs and the emergence of widespread trade in different centers made it difficult to freely disseminate information.²² Therefore, merchants' reputation could no longer act as a barricade against dishonesty, all the more because the local merchants were dealing with mostly foreign merchants.²³

The Admiralty courts and Star chamber started to deal with merchant disputes and completely replaced the fair and staple courts.²⁴ Private tribunals also surfaced to handle commercial disputes during those times. Common law court too became accommodating of mercantile needs to compete with Admiralty courts, Star chamber and private tribunals.²⁵

From the 16th to 17th centuries, few merchant disputes were brought before a court of law,²⁶ most merchant disputes were resolved in the Admiralty court and the Star chamber.²⁷ Star chamber and Admiralty court were rivals to the court of common law.²⁸ Merchants used to prefer the Star chamber or Admiralty court over common law courts such as the courts at Westminster.²⁹

Although mercantile law was primarily administered through fair court, pie powder, staple court, admiralty courts, the Star chambers, commissioner of assurances, merchant juries and private tribunals but the development of international trade in England empowered merchants to promote

international commercial arbitration as well.³⁰ In all these venues, merchants were either involved in dispute resolution as judges or mercantile law was enforced to resolve disputes.³¹ At one point, merchants also put great efforts to setup special merchant courts. These efforts though did not materialize but created awareness among the legal fraternity about merchants' distrust over courts of common law.³²

The introduction of *assumpsit* was aimed to overcome the distrust among merchants by the common law courts.³³ *Assumpsit* refers to the common law action to recover damages for breach of a contract. It originated in the 14th century, as a remedy whereby merchants could seek recovery or damages for any negligent act, improper handling or failure to fulfill a promise by a defendant. It allowed a recourse to merchants under common law to seek recovery for such acts or obligations of others that failed to fulfill the responsibility entrusted to them. *Assumpsit* actions allowed the Common law courts to facilitate merchant disputes as an appropriate alternative to the notion of specialized merchants' courts.³⁴ It ensured the calls for the creation of special merchant courts due to the inability of common law to accommodate merchant customs die down. In this way, the merchant cases also came under the scrutiny of common law.³⁵

Assumpsit action was an attempt to address two major issues, which prevented merchants from approaching common law. The first issue was to overcome procedural delays, which was a problematic feature of common law for merchants.³⁶ Second, *assumpsit* actions included equitable remedies, which were often based on mercantile customs to resolve merchant disputes. Under the action of *assumpsit* even if the evidence was not up to the standard, a cause of action could still arise without any express reference to the law merchant.³⁷ *Assumpsit* actions also allowed decisions to be taken on an ad-hoc basis to facilitate merchants.³⁸

Lawyers realized that the archaic values of the legal system were changing rapidly under the *assumpsit* actions. Despite, it was essential to discourage the establishment of a special merchant court, which would have challenged the institutional norms of the English legal system.³⁹ Moreover, the studies by Jerry Mashaw and Philip Hamburger represented that a system of courts (such as the suggestion of merchant courts) unreviewable by common law courts would have been alien to the Anglo-American legal traditions.⁴⁰ An illustration of this attitude could be observed when Blackstone called these courts in commentaries as a 'petty tyranny'.⁴¹ Hence, opposition to specialized merchant courts led to the introduction of *assumpsit* actions, which resulted in recognition of commercial realities by common law in two phases.

- First, mercantile customs were recognized and implemented in common law courts.
- Second, commercial law developed as a distinct body of law based on precedents.

First Phase: Recognition of Commercial Needs

In this regard, the most important was time bargains which were speculative transactions that involved trading in stocks through speculation on market movements. Investors used to make money on price fluctuations in stock markets. The time between sale and purchase of stock must exceed three days to benefit from market movements. The Number and III Practice of Brokers and Stock Jobbers (the Broker's Act 1696) Act 1696 was the first attempt to prevent speculative activities in London Stock Exchange. The Broker's Act 1696 banned time bargain by way of restricting time between buying and selling to three days, and in the 18th century, a restriction against time bargain was enacted in the Barnard's Act 1735.⁴² This Act came into contestation in the case of *Wells v. Porter*, wherein a broker Wells sued his client Porter for non-payment of work done on the client's behalf to buy and sell time bargains on Spanish and Portuguese public stocks.⁴³ Porter argued that the contract between him and Wells should be considered void under the terms of the Barnard's Act 1735, which banned time bargains.

The court disagreed and decided in favor of Wells. The court held that the statute did not apply to foreign stocks.⁴⁴ In *Wells v Porter*, the court supported speculative contracts on foreign stocks under the freedom of contract. Mercantile practice was promoted over legislative requirements.⁴⁵

An important political development that complemented this legal environment that was accommodating of commercial needs was the rise of Whigs in the British political spectrum.⁴⁶ They were firm believers of the common law but also wanted to reduce social disorder.⁴⁷ One of the chief adherents of this movement was Lord Chief Justice Mansfield who provided a space within common law for mercantile customs.⁴⁸ Mansfield's reforms incorporated special jurors and other merchant advisers into common law litigation.⁴⁹ He sought to provide litigants with certainty by incorporating mercantile customs into his judgments to establish them as binding rules.⁵⁰ Thus, the initial penetration of mercantile law in central common law court through the actions of *assumpsit* reached its zenith in the time of Lord Mansfield who incorporated commercial usages into English legal system.⁵¹

Second Phase: Incorporation of Commercial Law into National Legal System

As stated previously, there were rising demands from the merchant community for the establishment of separate merchant courts to resolve merchant disputes. Private settlement of merchant disputes was also becoming more prevalent by the 17th century.⁵² This proposal to establish merchant court included the appointment of merchant judges, a faster, simpler procedure than ordinary courts, low fees, decisions based on mercantile customs and state authorization that would enable some type of compulsory processes.⁵³ In response to these demands, and to assuage the concerns of the merchant

community, Mansfield instead of establishing separate courts, incorporated mercantile customs into law and adopted effective procedures such as calling merchants as advisors and expert witnesses in merchant disputes.⁵⁴

Lord Mansfield used foreign examples, quoted works of juris consults, portions of the Civil Law, and stressed, if necessary, equity rather than precedent to develop commercial law.⁵⁵ By his efforts, mercantile law had developed into commercial law in the 18th century. Mansfield was also appointed as Chief Justice in 1756, after 30 years of law practice. His desire was indeed to reduce litigation (accommodate the commercial needs) but also to preserve judicial economy.⁵⁶ He allowed commercial needs to be accommodated within the traditions of common law.⁵⁷ Mansfield's attitude toward commercial law was reflective of the courts' growing tendency toward adapting themselves to the pressures of mercantile need.⁵⁸ The development of mercantile law into a distinct field of law was thus largely an outcome of judicial decisions.⁵⁹

Find out milestone cases decided by Mansfield that led to the incorporation of commercial customs into the common law.

- 1 In the case of *Pillans v. Van Mierop*, Justice Mansfield declared that the law of merchants and the law of land is the same. In this case, Lord Mansfield ignored the doctrine of *assumpsit* and the doctrine of consideration, in favor of fair dealing and consent in the Law of Merchant.
- 2 Another important case decided by Mansfield was *Jones v. Randall*. In England, the enforceability of contracts relied upon the doctrine of *assumpsit*, and Lord Mansfield trying to free the commercial law from pre-commercial forms of laws and actions noted that it would be strange if we go back to the time of Richard to see what a case and find the law, even after there has been such a great increase in arts and commerce, and the circumstances that define commercial realities. This judgment was very important as it tried to cut the development of law away from pre-commercial precedents, which were a great barrier to the development of commercial law.
- 3 In *Miller v. Race*. In this case, a thief had stolen a banknote from the mail and gave it to the plaintiff who accepted it as part of regular trade and sought to use it which was contested by the defendant on the basis that because the plaintiff got the banknote from a thief who himself did not have a legal right, such right can also not be passed on to the plaintiff. The question that arose here was whether someone who does not have a legal right in a bank note can pass it on to someone else. Had it been a horse, the plaintiff would have to relinquish it in favor of the defendant and then seek recovery from the thief. However here, Lord Mansfield decided in favor of the plaintiff saying that bank notes were essentially used as money and cash in the ordinary transactions of business, and since it is currency, so like money it cannot be traced and cannot be recovered after it has passed on as currency. In giving this judgment, Lord Mansfield upheld a

centuries-old practice of merchants, where instruments having the force of currency was used and passed on and the more readily and frequently, they were passed on and endorsed, the more their value as currency was established and this allowed for facilitation of trade. For this system to work, such instruments had to pass on from hand to hand without the need for a careful inquiry, as not required for cash, hence making a person liable to return a bank note would have curtailed this practice and Mansfield judgment was very prescient in this regard.

English judges' contribution toward commercial law is evident and far-reaching, for instance, in the derivatives industry, it was Woolf JJ who first laid out a definition for swaps in *Hazell v Hammersmith and Fulham LBC*.⁶⁰ This definition of the swap has been since then well recognized among derivative industry participants.⁶¹ London's current status as an international financial center is largely an outcome of economic benefits the City's financial position generates, which is not possible without supportive legal infrastructure.⁶² Therefore, the economic needs of commercial transactions have always been accommodated in the ECCs and above explain its culmination into the present form over a long period.⁶³

Current Status of English Commercial Court

This section explores features of ECCs, which make it the first choice of jurisdiction among prominent organizations in general and international commercial organizations in particular.

ECCs operate as part of the High court.⁶⁴ The statistics indicate that 75% of the court's business is generated from international cases. It means that the parties incorporate in their contract English Law, as the governing law, and English courts, as the forum of choice, because they deem ECC the most suitable forum for dispute resolution. ECCs decide the international disputes pertaining to the following subject matters; contractual disputes, fraud, finance/regulatory, technology and engineering, intellectual property and insurance,⁶⁵ import and export of goods, carriage of goods by sea, land and air, banking and financial services, insurance and reinsurance, markets and exchanges, commodities, oil, gas and natural resources, the construction of ships, agency, arbitration and competition matters.⁶⁶

International cases are brought before ECC under the choice of jurisdiction clause inserted in contracts between international business organizations.⁶⁷ Judgments pronounced by ECC regarding a dispute of international nature are also effective innumerable jurisdiction. For instance, the Brussels I Regulation and European Enforcement Order enforce the judgments passed by English courts within European Union.⁶⁸ Furthermore, by virtue of several reciprocal arrangements between the UK and other countries, the judgments pronounced by ECC have extra-territorial enforcement and recognition. The New Zealand's Reciprocal Enforcement of Judgments Act 1934 is one example. The ECC's judgments are enforceable in New Zealand

under the Reciprocal Enforcement of Judgments Act 1934 once the judgment is registered in New Zealand High Court.⁶⁹ Unless the registration is set aside, the foreign judgment shall have the same force and effect as it is pronounced by a national court of New Zealand.⁷⁰

ECCs evolved as a result of commercial law developed through centuries, speedy trials, impartial judges, expert judges, efficient case management and disclosure and transparency.⁷¹ All these factors are further discussed separately in the succeeding part of this section.

A Well-Developed Body of Commercial Law

Merchants used to have their disputes resolved before the fair courts or courts of staple.⁷² The reason for that was, they wanted speedy justice over lengthy common law court proceedings for the resolution of mercantile disputes.⁷³ These cases were dealt with by the courts at the fair or the courts located in the seaport towns, there is no record of them present in the law reports of that time.⁷⁴

In the 17th century, during the period of Lord Coke, there are few reported mercantile cases.⁷⁵ This is because the cases were not decided based on the law of England but based on the customs of the merchant.⁷⁶ The party appearing before the court had to prove that he was a merchant, i.e., essentially a question of fact, for the court to decide the dispute.⁷⁷

Mercantile law was introduced in the courts of law in the 18th century during the period of Lord Mansfield.⁷⁸ In his principal work, he developed principles of commercial law based on the customs of merchants.⁷⁹ In this regard, Mansfield LJ referred to every civilized system of law, including Scotland, Rome and the old laws of the sea.⁸⁰ Thus, the mercantile law started to be administered by the judges of the King's Bench. Keeping in mind that the judges found it difficult to understand disputed commercial transactions presented before them, Lord Russell of Killowen and Mr. Justice Mathew setup an elaborate system of rules for the Commercial Courts in 1894.⁸¹ They aimed to provide cheap and speedy trial while maintaining the principles of fairness.

Speedy Trials

Statistics indicate the average length of the trial for the ECC to be nine (9) days.⁸² The provided number of days, although has comparatively increased from the average length of the trial in 2017–18 of seven (7) days, reflects adjudication of commercial matters in the UK as speedy and efficient.⁸³

Furthermore, the Commercial Court Guide Notes, under section F. 3, provides that on the application of either party, the courts may expedite the hearing of the dispute, noting that there exists sufficient urgency and importance. The application must be made to the Commercial Court Office with notice to all the other parties.⁸⁴

Impartial Judges

The concept of judicial independence is well-entrenched in UK's constitution. Judges decide the dispute relying on established precedents and render their judgments free of any influence or governmental control. This is manifested in the process of judicial appointment. It is the responsibility of the Judicial Appointment Commission ('JAC'), an independent non-public departmental body, to appoint judges and maintain judicial independence.⁸⁵ The JAC is chaired by a layperson and is mandated to recommend and select candidates based on merit and in the process thereof, encourage diversity among the existing pool of candidates.⁸⁶

Expert Judges

In terms of the appointment of judges, the English legal system does not recognize career judiciary. The English judges, however, are appointed among the senior legal practitioners having years of experience at the highest level of practice.⁸⁷ Having said that, English courts also contain the features of specialist judges, for dealing with disputes of international dimension or where there are laws from multiple jurisdictions applicable, or there are multiple parties involved. For instance, disputes pertaining to engineering and building construction are instituted before Technology and Construction Court (TCC). Mr. Justice Jackson and Mr. Justice Ramsey headed this specialist court. They both were previously world-class advocates, accumulated with a wealth of experience and knowledge in the field.⁸⁸

Efficient Case Management

The English courts seek to achieve efficiency in the progress of cases by actively managing and monitoring the cases. The case management includes identifying disputed issues at an early stage; fixing timetables; dealing with as many aspects of the case as possible on the same occasion; controlling costs; disposing of cases summarily where they disclose no case or defense; dealing with the case without the parties having to attend court, and giving directions to ensure that the trial of a case proceeds quickly and efficiently.⁸⁹ In addition, the ECCs provide varied speedy injunctions, including asset-freezing injunction, search and seizure orders, mandatory or prohibitory injunctions.⁹⁰ Lastly, English Courts deter fictitious claims by imposing costs of litigation on the losing party.⁹¹ This practice discourages malicious claims.

Disclosure and Transparency

English procedure rules follow the 'cards on the table approach', that requires the parties to disclose and provide access to their adversary to all the relevant and non-privileged information.⁹² This approach provides parties the

opportunity to evaluate the strengths and weaknesses of their dispute before proceeding to the trial. Furthermore, the court, under certain circumstances during the trial, can also direct the non-parties to the suit to disclose the relevant documents.⁹³ The standard requirement of disclosure in English Court can be prescribed to three categories⁹⁴:

- 1 It will include a proportionate search of the party's own documents, on which it is relying on;
- 2 The search of adverse documents, which adversely affect either his own or the other party's case;
- 3 The search of required documents that are required to be disclosed by the directions of practice.⁹⁵

The parties and their legal representatives are strictly required by law to comply with the requirements of disclosure, and in violation thereof, the court may also subject them to sanctions, that include adverse costs, or adjournment of hearing orders.⁹⁶

Islamic Finance Developments in the UK

Oil wealth generated liquidity in the early 1970s in Arab countries. Arab countries avoided using conventional banks for a long time. 'Many had previously solved the problem by not using a bank: if you are poor and have little cash there is no need for banks. By the middle of the last decade, however, businessmen and other citizens found that they could not store all their cash under the bed'.⁹⁷ Therefore, Islamic Development Bank marked the beginning of IF in the world in 1975.⁹⁸ Within five years, Islamic financing began through the use of the Murabaha agreement on the London Metal Exchange (LME) in 1980. This was the beginning of a wholesale IF market in the UK to facilitate liquidity to the Middle Eastern institutions.⁹⁹ Since then the LME has become a prominent stakeholder supporting the Sharia Compliant funds in the City.¹⁰⁰ Wholesale banks funded trade leasing and project financing through Islamic Investment in the 1980s.¹⁰¹ A relatively simple structure of products in the wholesale market kept the market 'outside the scope of the regulators'.¹⁰²

The retail market began operation in the 1990s when a few Middle East and South East Asian banks started offering Islamic home financing plans in the country. The growth of the retail market was slow on account of uncompetitive pricing and the absence of regulatory protection for consumers.¹⁰³ Currently, five full fledge Islamic banks and 20 conventional banks are offering Islamic financing services in the UK.¹⁰⁴ Details of all the five Islamic banks are given below.¹⁰⁵

- 1 Qatari owned Al-Rayan Bank – a retail bank¹⁰⁶
- 2 The Bank of London and the Middle East (BLME) – a wholesale bank. BLME opened in 2007, was funded by Kuwait's royal family Al-Sabah, Boubyan Bank Kuwait and other institutional investors.¹⁰⁷

- 3 Qatar Islamic Bank (UK) – an investment bank
- 4 Gatehouse bank – wholesale investment bank and
- 5 Abu Dhabi Islamic Bank (UK) – a retail bank.¹⁰⁸

In 2003, HSBC became the first conventional bank to offer house financing based on Islamic principles, ‘using a Shariah Compliant model in which the bank took the property title and leased it back to the customer over 25 years who then paid rent plus payments towards the purchase price’.¹⁰⁹

Citi, Deutsche and HSBC are some of the international institutions that are operating Islamic windows in the City to develop this niche of finance.¹¹⁰ London has witnessed an interbank transaction between conventional and Islamic banks. This has boosted capital market operations in the City.¹¹¹

Islamic Capital Market

The UK is contributing to the growth of the Islamic Capital market through the Royal Mint. Director Chris Howard said, ‘The growth in Islamic Investment globally and the clarification of how gold and silver can be included within it, could drive upwards of \$20bn of investment in gold ... bullion products’.¹¹²

Since 2017, Royal Mint has been offering Shariah-compliant investment in bullion products. Amanie Advisors on behalf of Royal Mint worked with AAOIFI and World Gold Council to ensure investment into bullion products offered by Royal Mint complied with AAOIFI Shariah Standards on Gold.¹¹³

Opening Royal Mint for Islamic investors had made it possible for the Mint to tap demand for investment in gold, which has been estimated to be around £4 billion by the World Gold Council. Investment in bullion products will help resolve liquidity issues facing Islamic banks in the absence of a robust capital market.¹¹⁴ Islamic fund managers can also diversify their portfolio through investment in bullion products.¹¹⁵

Shariah-Compliant Funds

Management of Shariah-compliant funds has been made available to Middle Eastern clients since 1986. The first Halal mutual fund was launched in 1997.¹¹⁶ Since then, numerous Shariah-Compliant funds have been listed on LSE. In 2009, Moody rated the Shariah fund issued by BLME as ‘A’. This was the only Shariah fund ever rated as ‘A’ by an international rating agency.¹¹⁷

The UK offers sophisticated investment opportunities in the infrastructure sector for Islamic investors.¹¹⁸ Development projects such as the Shard, Battersea Power Station regeneration, London Gateway, the Olympic Village and redevelopment of Chelsea Barracks owed their funding to Islamic finance.¹¹⁹

Sukuk

LSE has listed 65 sukuk worth \$48 billion altogether.¹²⁰ In 2007, sukuk for the UAE-based National Central Cooling Company (Tabreed) was listed on

LSE. The \$200 million worth of sukuk was the first sukuk listed on LSE.¹²¹ The British government issued the first sovereign sukuk in 2014. Over £2 billion sovereign sukuk was the first sovereign sukuk issued by a non-Islamic jurisdiction. HSBC, Barwa Bank of Qatar, CIMB Malaysia, National Bank of Abu Dhabi and Standard Chartered structured the deal.¹²² British government sold £200 billion sukuk to institutional investors.¹²³ Assessment on the issuance of the second sukuk is ongoing in consultation with all the UK Islamic Banks (UKIBs).¹²⁴

Islamic Finance Education

Numerous UK universities are offering postgraduate degrees in IF, 69 courses were offered during 2016.¹²⁵ Prominent educational institutions offering courses on Islamic finance are

- 1 Institute for securities and investments in association with L'Ecole Supérieure des Affaires (L'ESA), Islamic finance qualification (IFQ)
- 2 Institute of Banking and Insurance
- 3 Educational institutions offering education in IF industry (CISI)
- 4 Chartered Institute of Management Accountants (CIMA)
- 5 Association of International Accountants (AIA)
- 6 Institute of Banking and Insurance (IIBI)¹²⁶

Promotion of Islamic Finance Domestically and Internationally

UK's first Islamic finance task force was setup to raise inward investment and contribute to the economic benefits.¹²⁷ The task force was entrusted with the objective of promoting the UK IF industry in the domestic as well as global markets.¹²⁸ The task force organized the World Islamic Economic Forum 2013 in London. It was a great achievement on the credit of the Islamic finance task force in terms of promoting London as a Western hub of Islamic finance.¹²⁹

All-Party Parliamentary Group, chaired by Naz Shah MP and co-chaired by Lord Sheikh, confirms Parliament's support for IF in the UK.¹³⁰ Owing to the All-Party Parliamentary Group, the IF industry is well represented in Parliament to address issues obstructing its smooth operation.¹³¹

Islamic Finance Advisory Group (IFAG) was formed in 2000. The group comprised Andrew Buxton, former Chairman of Barclays Bank, Eddie George of the Bank of England, representatives from the Treasury, FSA, the Council of Mortgage Lenders financial institutions and the Muslim community.¹³² IFAG published a report called 'Global Trends in Islamic finance and the UK market'. This report gives the most recent and comprehensive insight into the growth of the IF industry in national and international markets.¹³³

Islamic Insurance Association of London (IAL) 'ensure that the insurance industry plays a full role in the development of the Islamic Finance industry and its future regulation'.¹³⁴ IAL is a private body aiming to promote

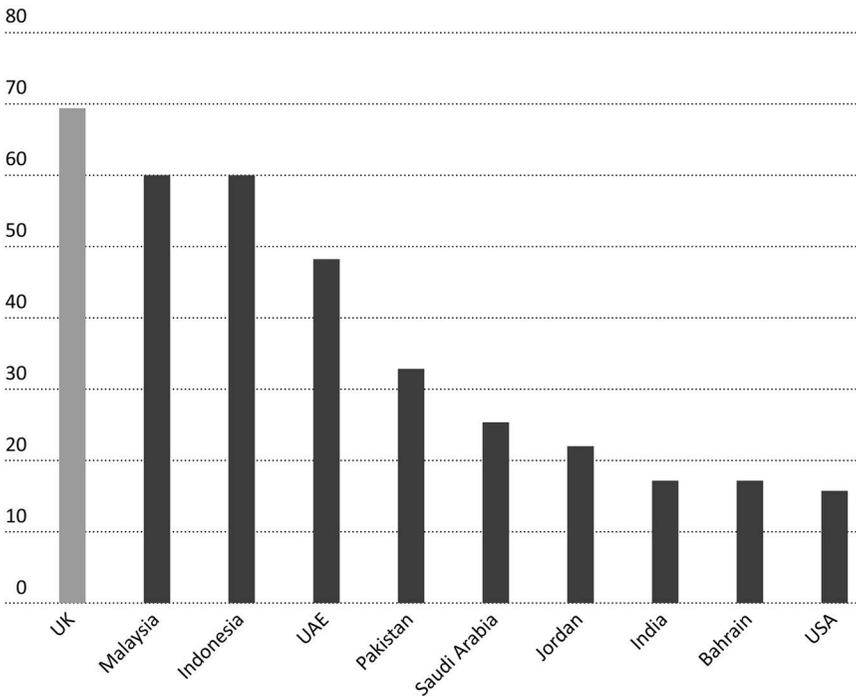


Figure 2.1 Number of Islamic Finance Courses by Country

Source: TheCityUK, 'Global Trends in Islamic Finance and the UK Market' (TheCityUK, 2017) 21 <<https://www.thecityuk.com/research/global-trends-in-islamic-finance-and-the-uk-market-2019/>> accessed 5 July 2022.

Shariah-compliant insurance, it was launched in 2015.¹³⁵ Its objective is to connect Shariah-compliant insurance in London to prominent centers of Islamic finance in the globe (Figures 2.1–2.3).¹³⁶

'Regulatory Development of IF in the UK'.¹³⁷

Legal and Regulatory Support

UK government has actively promoted the industry through tax relief and reforms over issues of debt.¹³⁸ Multiple Stamp Duty Land Tax (SDLT) was waived in the Finance Act 2003. Amendments were introduced to place IF products on the same footing as conventional products through the Finance Acts 2005, 2006 and 2007.¹³⁹

The most important legislative development in 2003 was to remove multiple charges of SDLT on mortgages (Shariah Compliant). It was a result of a recommendation made by a working group led by Lord George, the Governor of the Bank of England.¹⁴⁰

The FSA had identified three major concerns regarding the authorization of Islamic banks in the country. These include the definition of deposit, the

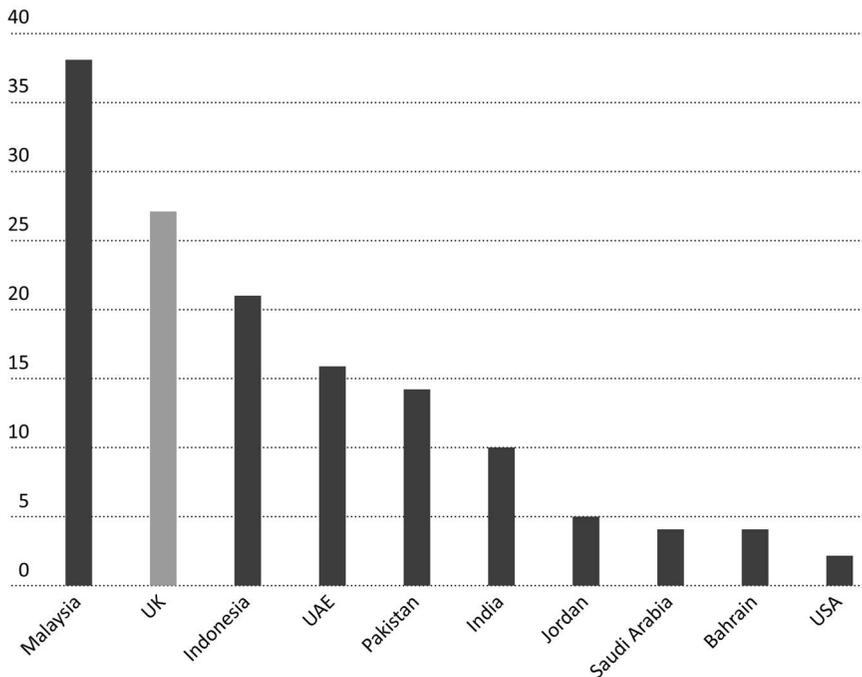


Figure 2.2 Number of Islamic Finance Degree Courses by Country

Source: TheCityUK, 'Global Trends in Islamic Finance and the UK Market' (TheCityUK, 2017) 22 <<https://www.thecityuk.com/research/global-trends-in-islamic-finance-and-the-uk-market-2019/>> accessed 5 July 2022.

role of SSBs and transparency in a financial promotion.¹⁴¹ The FSA has been collaborating with Islamic banks in addressing all three concerns.

While processing the authorization of the Islamic Bank of Britain, the stakeholders come across the differences in the definition of 'deposit' under (IBB) UK law and the Shariah law.¹⁴² In the UK, 'deposit is defined as a "sum of money paid on terms under which it will be repaid either on-demand or in circumstances agreed by parties"'.¹⁴³ The repayment of the deposit is guaranteed subject to the solvency of the bank.¹⁴⁴ In Islamic banks, repayment of the deposit is not guaranteed. IBB and FSA came up with an arrangement under which the 100% return of deposit is guaranteed for regulatory purposes. Customers are later given the option to waive their guarantee in compliance with Shariah.¹⁴⁵

At the moment Shariah scholars sitting on the SSBs have advisory role. Islamic finance products are approved under the advice of the SSBs. The advisory role of Shariah scholars does not require compliance with regulatory requirements. There is a debate in the literature over more authority should be granted to SSBs. English courts also referred to SSBs' role to overcome the Shariah arbitrage. In the future, if Shariah scholars assume authority exceeding advisory roles such as the position of director, FCA's 'Fit and Proper

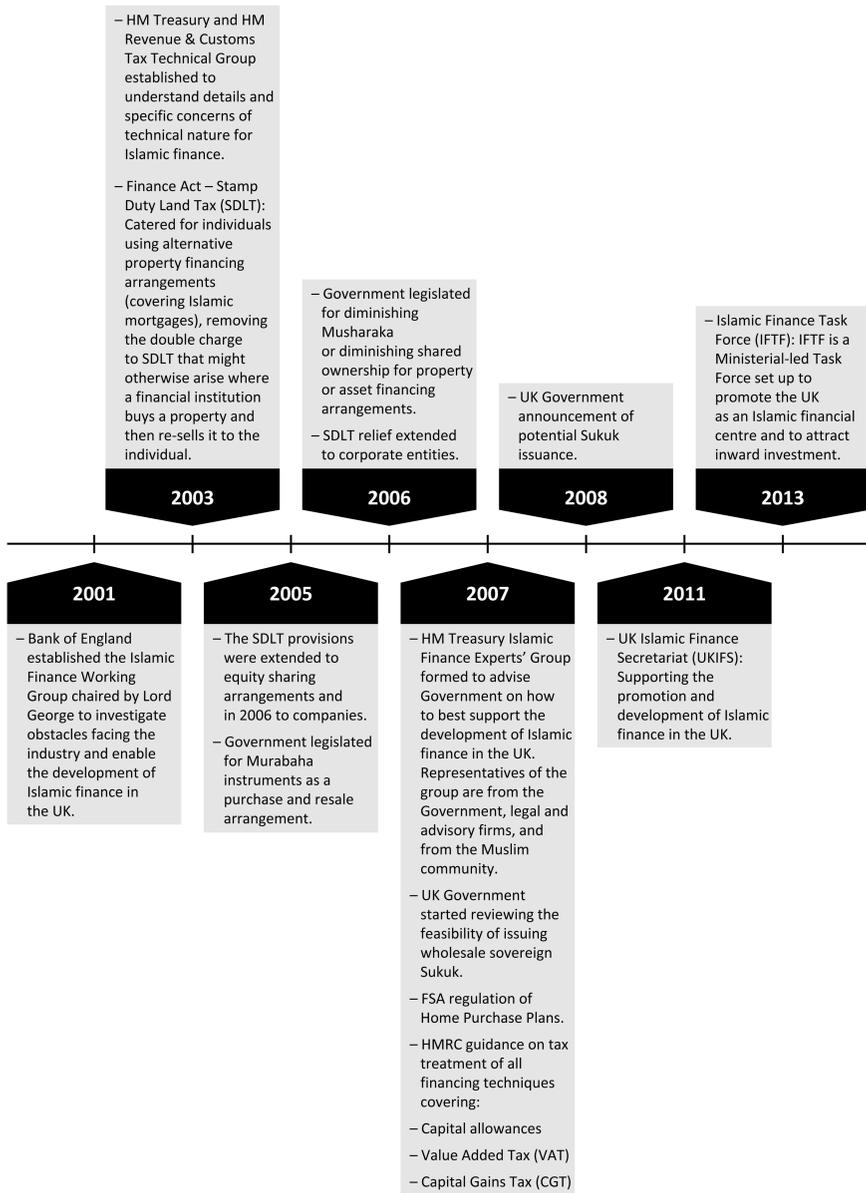


Figure 2.3 Regulatory Development of Islamic Finance in the UK

criteria' will become applicable to the Shariah scholars. Regulatory restrictions regarding sitting on multiple boards will be triggered as well. This potential future role will require FCA to bring the SSBs under its supervisory mechanism.¹⁴⁶ The financial regulator does not plan to regulate the role of SSBs in IFIs.

Financial promotion of products should be made with complete disclosure of risks and benefits. FSA worked out strategies to ensure financial products marketed to customers include complete information relevant to customers regarding the risk profile of the products.¹⁴⁷

BASEL III Compliance with Islamic Banking

Basel III emphasizes the assessment of liquidity management of the banks.¹⁴⁸ Basel III introduces measures to avoid the impacts of the financial crisis on the banking industry by introducing liquidity requirements.¹⁴⁹

Liquidity refers to a financial institution's strength to 'maintain the balance between financial inflows and outflows over time'.¹⁵⁰ Conventional banks can avail of debt from the market or sell their debts to maintain the required level of liquidity. Liquidity risk arises when a financial institution anticipates a failure to maintain the balance of outgoing and incoming cash. The risk is caused by 'market disruption or by credit downgrades'. Liquidity risk if materialized can prevent the bank from 'meet[ing] obligations to repay depositors and financing parties and fulfill financing commitment' result in a bank run.¹⁵¹ The bank fails to make payments to depositors, and customers' confidence shook, which can send interrupt to the entire financial system.

Basel III introduces a Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR) to regulate Liquidity Risk. LCR regulates short-term liquidity risk, i.e., for 30 days. 'The liquidity coverage ratio (LCR) will require banks to have sufficient high-quality liquid assets to withstand a 30-day stressed funding scenario that is specified by supervisors'.¹⁵² NSFR is intended to regulate long-term liquidity risk, i.e., during a year. 'The Net Stable Funding Ratio (NSFR) is a longer-term structural ratio designed to address liquidity mismatches. It covers the entire balance sheet and provides incentives for banks to use stable sources of funding'.¹⁵³

LCR and NSFR will aggravate the potential liquidity issues facing the IF industry. These liquidity ratio requirements will affect the competitiveness of Islamic banks through an increase in cost. NSFR requirements have a more severe impact because this ratio requires banks to reduce reliance on short-term liquidity instruments. 'Islamic banks are largely deposit funded (over 50% in general) with main maturities less than one year'.¹⁵⁴

Islamic banks encounter difficulty maintaining liquidity and controlling liquidity risk. The reasons why IF encounters liquidity issues include access to limited sources of finance and limited methods to diversify the portfolio. Restrictions on borrowing from financial markets, selling debt and the underdeveloped nature of the Islamic money market limit the sources of

funding for Islamic banks. Moreover, excessive ‘liquidity of Islamic banks cannot be transferred to conventional non-Shariah banks’ and a lack of innovation results in ‘lack of liquid Islamic investment tools with short term maturities’.¹⁵⁵

Liquidity risk measures introduced in the third framework have a significant impact on Islamic banking.¹⁵⁶ Basel III requirements are too stringent to allow Islamic banks to operate profitably owing to liquidity risk in the market. There is a need for the Islamic banking industry to develop liquidity management tools for the growth and stability of this new system. Liquidity management is possible through a vibrant secondary capital market.

To overcome the liquidity issues relevant to Basel III requirements, the Bank of England has started ‘Shariah Compliant Central Bank liquidity facilities’ in 2017.¹⁵⁷ Bank of England has incorporated the Bank of England Alternative Liquidity Facility, as its subsidiary in 2018. This subsidiary ‘will be used to segregate the Shariah-Compliant Facility (SCF) from the Bank’s other interest-based activity’ for Islamic banks to overcome the liquidity issues in compliance with Basel III.¹⁵⁸

The Bank of England allowed access to its deposit facility without interest. The purpose was to accommodate ‘greatest demand, given that a more limited range of liquid market instruments is available to Islamic banks compared with other banks’.¹⁵⁹

Islamic Finance Disputes in English Courts

Islamic Finance Principles as the Choice of Law in the UK

Freedom to contract is a fundamental principle underlying the Contract Act 1990. Private individuals are free to bind each other legally into contractual arrangements. Parties are free to choose the law which will apply to the contractual arrangements among them. This choice of law is governed by the Rome Convention in the UK. Rome Convention provides rules to regulate the freedom to contract.¹⁶⁰ These rules include:

- 1 Parties should choose the law applicable to their contractual arrangements.
- 2 Either through terms of contracts or later under circumstances of the case.
- 3 Parties have the freedom to choose multiple laws applicable to various parts of a contract.¹⁶¹

In the English courts, the question of choice of law in contractual arrangements activates the application of the Rome Convention. Under section 2.1 of the Contracts (Applicable Law) Act 1990, the Convention applies to the entire contract law regime in the UK.¹⁶²

The application of the Rome Convention to the IF disputes was first discussed at length in *Shamil Bank v Beximco Pharmaceuticals*. Defendants raised

the defense of the non-Shariah compliant nature of the murabahah agreement.¹⁶³ This argument required the court to consider the interpretation of Shariah laws under the Rome Convention.¹⁶⁴

The brief facts of the case are that Shamil bank from Bahrain and Beximco Pharmaceuticals from Bangladesh entered into a murabahah financing agreement in 1995.¹⁶⁵ Beximco Pharmaceuticals could not make payments under the Murabaha agreement and, consequently, the parties restructured the payments which were further amended in 2001 and 2002.¹⁶⁶ Beximco Pharmaceuticals again defaulted on the payments as scheduled under the restructured agreement.¹⁶⁷ Shamil bank filed suit against Beximco Pharmaceuticals for repayment of the debt along with compensation in the English High court (Queen's Bench Division, Commercial Court) in 2003.¹⁶⁸

Governing law clause of the Murabahah agreement stated that '[s]ubject to the principles of the Glorious Shari'a [Islamic laws], this agreement shall be governed by and construed in accordance with the laws of England'.¹⁶⁹ Beximco Pharmaceuticals attempted to defend its defaults in payment by challenging the validity of the murabaha agreement under Shariah law. Defendants argued the murabaha agreement signed between the parties was *void ab initio* under Shariah law; therefore the agreements could not be enforced under English law as well.¹⁷⁰

The legal issue court identified was if Shariah law was applicable under the Rome Convention. Morison J said, 'The first question is whether the words "subject to the principles of Glorious Shari'a" mean that in order to be enforceable, the agreements must both be valid under English law and Shari'a law, as the English court may find it to be'.¹⁷¹

Since the agreement between Shamil bank and Beximco Pharmaceuticals was signed in 1995, the Rome Convention became applicable to the dispute for the question of choice of law. The governing law clause was interpreted against Rome Convention art 3 which provides for the choice of foreign law.¹⁷² Hence, the English court considered the interpretation of Shariah law as applicable to the murabaha agreement.

It turned out that the choice of law clause is applicable to the law of a country under the Rome Convention. Shariah laws did not constitute a valid choice of law as per Rome Convention. In other words, parties did not refer to a national legal system of a country where Shariah law was implemented. Since Shariah law did not form part of a national legal system, therefore, it was not possible for the court to apply English law to interpret principles of Shariah that do not have a backing of a national legal system. Thus, Morison J distinguished between the application of laws of a country and application of non-national laws by saying.

This court is well used to disputes about foreign law and, if necessary, it will determine what a judge in a foreign court would decide had he received submission about Islamic law. That is not the same exercise as determining what, as a matter of English law or applying English law principles, the principles of religious-based law are.¹⁷³

Porter LJ affirmed the High court's decision under the Rome Convention. Later, this developed into a legal principle in *Halpern v Halpern* when the court of appeal agreed with Potter LJ.¹⁷⁴ Lord Justice Waller stated that '... the starting point for the Rome Convention was a point accepted by all countries party to that Convention, that laws could not exist in a vacuum; by "laws" were meant laws enforceable in the courts of countries whether parties to the Convention or other states'.¹⁷⁵

In *Halpern v Halpern*, the question of governing law of the agreement led the High court to discuss the application of the Rome Convention.¹⁷⁶ The appellant attempted to draw a contrast between the instant case and *Shamil bank v Beximco Pharmaceuticals* suggesting that the Jewish law (Halakha) is a well-recognized body of law which should be applied under the Rome Convention.¹⁷⁷ Waller LJ rejected the argument and upheld principle developed in *Shamil Bank v Beximco Pharmaceuticals*. Application of the Rome Convention rendered the application of Jewish law to be inapplicable as Halakha was not a national law of a country.¹⁷⁸

In the light of the precedent developed in *Shamil Bank v Beximco Pharmaceuticals* and through *Halpern v Halpern*, the High court in *the Investment Dar Company KSCC v Blom Developments Bank Sal (TID v Blom)* identified the need to interpret Shariah law.¹⁷⁹ Judge Purle QC precluded this need owing to the parties' recognition of English Law as the governing body saying that,¹⁸⁰ 'this contract, governed, as I say, by English law, precluded purportedly the wakeel, TID, from taking any point on non-compliance with the Sharia'.¹⁸¹

The brief facts of the case were that Blom Developments Bank (Blom), a Lebanese company, was the claimant in this case and the Investment Dar Company (TID) was the defendant.¹⁸² The dispute arose out of a *wakala* (agency) contract. According to the agency contract, Blom was the depositor which employed TID as an agent.¹⁸³ As per the agency agreement, Blom deposited around \$ 1million to TID.¹⁸⁴ TID was a fund manager, and it invested funds into the Treasury Pool which the parties had categorically agreed to avoid as a venue for investment.

TID made default in the payments which were due under its contractual liability. The default was an outcome of its unsuccessful investment strategy.¹⁸⁵

Moreover, TID invested Blom's deposit into the treasury pool in violation of the agreement between TID and Blom. TID defended its decision to invest the Blom's deposit '... in good faith in its treasury pool upon the assumption, it was free to do so...'.¹⁸⁶ Master Bragge passed a summary judgment in favor of Blom, whereby TID was required to pay over \$1 million to Blom.¹⁸⁷ Deciding the case under English law, Purle J QC upheld the ruling and ordered a provisional payment of the principal amount by TID.¹⁸⁸

In *Dubai Islamic Bank (DIB) v PSI Energy Holding Company*, the dispute arose out of the agency (*wakala*) agreement between DIB and PSI.¹⁸⁹ The agency agreement was signed to finance short-term receivables, whereby DIB advanced the funds to defendants, but the funds were used to finance

projects other than those agreed upon.¹⁹⁰ This case was also decided under English law.¹⁹¹

Flaux J disregarded the application of the Islamic laws referring to the principles established in *Shamil Bank v Beximco Pharmaceuticals* and further clarified in *Halpern v Halpern*.¹⁹² Hence, from all these cases, it is an established precept that English courts do not entertain Shariah law as a governing law under the Rome Convention, primarily because it is a non-national body of law, and thus in all such cases, the courts decided the disputes on basis of English contract law.

Doctrine of Incorporation

The doctrine of freedom to contract holds great sanctity not only under any particular jurisdiction but also under contract law applied transnationally. Courts are very reluctant to curb such freedom because of the sanctimonious value attached with this. This doctrine essentially dictates that parties are free to enter into a contract and have the complete autonomy to decide whether and with whom the contract should be entered into, and what terms should form the contract of the agreement. Since these terms represent the wishes of the parties, the courts generally do not interfere in this, except in cases where there is a violation of the governing laws, or the terms are very unfair toward either party or to the contract. Following this doctrine, under English contract law also, parties can incorporate provisions of foreign laws into a contract, the act of incorporation is called the doctrine of incorporation. In *Islamic Investment Bank v Symphony Gems*, the court sought expert's opinions regarding the explanation of *Murabaha* and *wakala* agreements to consider the application of Shariah law under the doctrine of incorporation.

The brief facts of the case were that the Islamic Investment Company of the Gulf (Bahamas) Ltd (claimant) was seeking to obtain summary judgment against Symphony Gems Nevada (the defendants) for breach of a *Murabaha* agreement.¹⁹³ Symphony Gems NV approached the Islamic Investment Company of the Gulf (Bahamas) Ltd for the financing of certain specified diamonds using *Murabaha* agreement.¹⁹⁴ Symphony Gems specified the diamonds which it requested to be bought from Precious (HK) Ltd.¹⁹⁵ Islamic Investment Company purchased rough diamonds from Precious (HK) Ltd and sold them to Symphony Gems on installment payments.¹⁹⁶ The payment schedule, along with the payment dates and amount, was mentioned in the *Murabaha* agreement.¹⁹⁷

Islamic Investment Company paid the \$15 million to Precious (Hong Kong) Ltd to purchase the specified diamonds.¹⁹⁸ Islamic Investment Company did not receive any installment from Symphony Gems, which were due under the *Murabaha* agreement. Symphony Gems refused to make payments and defended the default in payments on the ground of non-delivery of the supplies, i.e., the delivery of diamonds was not made to Symphony Gems by Precious (HK) Ltd as agreed and therefore no obligation for payments of price

arose.¹⁹⁹ Islamic Investment Company claimed that under Shariah laws, payment is not subject to delivery in a sale agreement like Murabaha. Symphony Gems by Precious (HK) Ltd challenged the validity of the Murabaha agreement under Shariah law. Defendant alleged that the Murabaha agreement signed between the parties was not a Shariah-compliant arrangement.²⁰⁰

Having received experts' opinions on the question of the validity of the *Murabahah* agreement, Tomlinson J was convinced that the *Murabaha* agreement was not compliant with the principles of Shariah. Despite this, Tomlinson J held that the agreement would be governed by English law.²⁰¹ This is further clarified in *Shamil Bank v Beximco Pharmaceuticals* when Potter LJ identified the problems with the interpretation of Islamic laws and emphasized the need for reference to specific rules of Shariah law to activate the doctrine of incorporation.²⁰² Potter LJ said,

The general reference to principles of Sharia, in this case, affords no reference to, or identification of, those aspects of Sharia law which are intended to be incorporated into the contract, let alone the terms in which they are framed. It is insufficient for the defendants to contend that the basic rules of the Sharia applicable *in this case* are not controversial. Such 'basic rules' are neither referred to nor identified. Thus, the reference to the 'principles of ... Sharia' stands unqualified as a reference to the body of Sharia law generally.²⁰³

An attempt to interpret Shariah law under the doctrine of incorporation led English judges to believe that Shariah is a complicated body of law, capable of multiple interpretations. It is impossible for secular judges to appropriately interpret Shariah laws on account of multiple interpretations of Islamic laws.²⁰⁴ It has been frequently emphasized that specific provisions of Shariah law should be inserted in a contract to avail benefits of doctrine of incorporation. Thus, the absence of specific provisions of Shariah laws (which provisions do not exist) along with the difficulty to choose an opinion from among the four schools of thoughts were the reasons that further prevented the court in the *Shamil bank v Beximco Pharmaceuticals* from an interpretation of Shariah law.²⁰⁵

Role of Shariah Supervisory Boards (SSBs)

Morison J was satisfied with the approval, which was issued by Shamil bank's SSB regarding the validity of the Murabaha agreement in question.²⁰⁶ In *TID v Blom*, the court mentioned that approval of TID's SSB was sufficient to establish the validity of Murabaha agreement.²⁰⁷ Potter LJ emphasized that the interpretation of Shariah law should be the responsibility of SSBs in Islamic banks.

To discourage Shariah arbitrage, it is important to increase SSBs' authority and responsibility regarding the product development process. Instead of an

advisory role, if Shariah scholars participate in managerial positions such as the board of directors, Shariah arbitrage can be considerably discouraged. As members of the board of directors, scholars will have to comply with the 'Fit and Proper Test' criteria applicable to members of the board of directors. These requirements have been examined in detail in [Chapter 6](#).

Impact of the English Court's Approach toward Islamic Finance Disputes

Commercial Purposes

Charles Proctor suggests that the courts were being protective of Islamic banking practices in the UK by not interpreting Islamic finance-related agreements. This approach aims to protect the IF industry from a precedent which can obstruct innovation in the future.²⁰⁸ According to Proctor, '... the English decisions to enforce agreements which may have been doubtful in terms of their shariah-compliance are, in fact, a positive for the development of the Islamic financial markets in the United Kingdom'.²⁰⁹ In other words, the court of appeal's decision to avoid interpretation of Shariah law, in *Shamil bank v Beximco Pharmaceuticals* will protect the IF industry in the UK. The court in *Halpern v Halpern* clarified that the court in *Shamil bank v Beximco Pharmaceuticals* refrained from the interpretation of Shariah to protect the UK IF industry.²¹⁰

The underlying reason English courts have refused to interpret Islamic laws is to protect the IF industry by not defining the current market practices such as the definition of Murabaha and the wakala agreement. The ECC tended to accommodate the commercial needs of the market ever since its inception as described in the earlier part of this chapter in which this author has explored the historical development of ECC.

Shariah Arbitrage

There is a clear absence of mandatory standards applicable to Islamic banking practices. AAOIFI has setup Shariah standards for IFIs, which are adopted by IFIs on a voluntary basis. These standards do not have binding status. On one hand, the non-binding nature of Shariah standards encourages innovative banking products and transactions. In the absence of mandatory standards, IFIs structure diverse transactions to accommodate clients' needs. SSBs are set up to obtain professional advice and approval on the Shariah-compliant nature of agreements. The agreements are concluded after a thorough examination by scholars, financiers and lawyers employed by both parties.

On the other hand, in case of disputes, the defaulting party challenges the Shariah-compliant nature of the very agreements, which were initially approved by their own SSBs. The absence of mandatory standards and regulations makes it difficult to ascertain Shariah's complaint nature of disputed

agreements in a court of law. This creates a gap which is called Shariah arbitration. This Shariah arbitration was further promoted when English courts refrained from the interpretation of Shariah law in the name of protection to industry.

The court avoids the interpretation of agreements prevalent among the Islamic banks to avoid defining the standard Islamic banking practices through judicial decisions. The definition of *the Murabaha* agreement by the courts in the UK, for instance, will become legally binding over the court as well as industry participants in the country. The legal definition of Islamic banking products will restrict the innovations in the IF market. This approach although reflects the historical practice of ECC is causing legal uncertainty among Islamic banks around the globe.²¹¹

On one hand, freedom to the contract being an underlying principle of English Contract law facilitates the implementation of Shariah law in a conventional contract.²¹² On the other hand, the English courts' approach toward the interpretation of Shariah is obstructive of the development of the global IF industry. This approach 'can be more significant barriers in practice ... and can lead to a greater lack of uniformity across jurisdiction ...'.²¹³ The courts' reluctance to interpret Shariah has caused a great deal of uncertainty among IF industry participants in the globe which is further aggravated by Brexit.

Brexit and Islamic Finance in the UK

After World War II, France, Germany, Luxembourg, Belgium and the Netherlands established the European Economic Community (EEC) by signing the Treaty of Rome in 1954. Treaty of Rome was signed to promote economic cooperation among European nations to ensure future conflict among the European nation will be 'not only unthinkable but materially impossible'.²¹⁴ The Treaty of Rome later became an integral part of European Union (EU) law and is currently known as the Treaty on the Functioning of the EU.

The ECC emerged into the EU under the Maastricht Treaty in 1992. Unlike EEC, the EU expanded the cooperation from economic development, to political, judicial, security and defense matters. Currently, 28 European states have become part of the EU which promotes the single market to ensure free movement of people, goods, services and capital. Three leading institutions are running the EU:

- 1 The European Parliament
- 2 The European Council
- 3 The European Commission

Establishment of the EU along with a focus to create a single market and break barriers resulted in enormous prosperity in Europe. This is in addition to the fact that European nations became more focused to contribute toward

the EU and receive the benefits of being a part of the EU. EU saved the world from witnessing European nations engaging in bloody conflicts after World War II. Nonetheless, the Brits decided to exit the EU in the 2016 referendum for three major reasons related to economy, sovereignty and politics.

The Brits understood that the EU had failed in addressing the unemployment in southern Europe which reached over 20%. Staying in the EU with such a high unemployment rate was considered detrimental to Britain's economy. Particularly, London is an international center of financial activities that brings financial benefits that no other EU member state is capable to contribute. According to proponents of Brexit, staying in the EU did not resolve the economic challenges the UK encountered, instead London had to contribute to overcoming the unemployment in southern Europe.²¹⁵

There was growing unrest among the British over immigrants arriving in Europe. Some EU member states believed accommodating the immigrants is a moral obligation, whereas others considered dealing with immigrants is a national matter which should not involve the EU. Brits considered the EU had taken away its sovereign authority for lawmaking over certain issues, particularly laws concerning immigrants.²¹⁶

The question of leaving or remaining in the EU had caused a split among two major political parties in the country. Members of Labour as well as Conservative parties have voted in favor of and against Brexit. The situation at the time of the Brexit referendum in 2016 was such that Labour and Conservative parties were against Brexit but there was a third group comprising members of both parties voting to exit the EU. Promoters of Brexit upheld the national interest of the UK over the collective interest of Europe.²¹⁷ Referendum 2016 resulted in favor of Brexit with a close ratio of 52:48.

Following the Brexit referendum, British Prime Minister Teresa May triggered the art 50 Treaty on European Union. Art 50 lays procedures for member states to exit the EU. UK and EU reached a withdrawal agreement to make the British exit effective. May failed to convince the British Parliament to accept the deal concluded between the UK government and EU leaders, thus May resigned in 2019. This ensued a constitutional crisis over the decision to exit the EU with or without a deal.²¹⁸ Boris Johnson won the election in 2019 and the British mandated Johnson to lead them into an exit from the EU. Johnson successfully obtained a deal from the EU which was acceptable to the British Parliament and currently transition period is going on.

Completion of the transitional period is indicating that the financial services industry has witnessed a decline in its activities.²¹⁹ The UK financial regulators are very well aware of the outflow of foreign investments as a result of Brexit.²²⁰ Certainly, Dublin makes the most appropriate choice for the financial industry participants to ensure presence in Europe.²²¹

John Foster considers the UK IF the market will remain sustainable with Brexit because '... UK would attract more foreign investment being outside the EU...'.²²² Michael Randall suggests the provision of IF services can be an

alternate source to raise foreign direct investment in the UK post-Brexit. IF services can then be offered to EU-27 to ensure eurozone access for Islamic investors.²²³ Dr. Morrison has extensively examined the impact of Brexit on IF in the UK. His analysis presents IF as a source to strengthen UK financial sector post-Brexit.

Nonetheless, Morrison also recognizes the potential impact of economic slowdown on the performance of Islamic banks.²²⁴ Similarly, the analysts in London are insisting the policymakers ensure the legal and regulatory framework for the UK IF industry remains favorable for Islamic investors.²²⁵ Such as reissuance of the Islamic bond was not a part of the initial issuance in 2014. Given the impact of Brexit on foreign investment, the British policymakers issued the second sovereign Islamic bond in 2019.²²⁶

Conclusion

In this chapter, we first looked at the history of the incorporation of mercantile law into the common law over time, and how it came to be commercial law. It has been explored that the ECCs have become the choice of jurisdiction for foreign parties, who choose English law as their choice of law because of the favorable and accommodating treatment that commercial interests receive in English courts.

Moving on we looked specifically at how the English courts have catered to disputes about Islamic finance. In this regard, we look at case law and identify rules and established precepts that have been distilled from the court's jurisprudence in these cases. The first main principle that emerges is that English courts are wary of allowing for the application of Shariah law in interpreting contracts, under the Rome convention, on the premise that Rome convention only caters to a national body of law whereas Shariah is not applicable fully in any country so as to have the status of a national body of law, thus cannot be applied.

The second rule that emerges is that even under the doctrine of incorporation, the courts are reluctant to interpret Islamic finance contracts on basis of Shariah law, because of a lack of coherent Shariah rules and standards and differing interpretations resulting from Shariah not being a unified body of law. The courts have thus shied away from engaging or resolving this conundrum and engaging with the orthodox debate over religious principles. The general presumption arising from this approach is that the English courts are trying to protect the growth potential of the IF industry, by making sure that no precedent is established that may stifle the diversification of the industry. However, contrary to this, it is seen that the court's reluctance to engage fully with IF disputes has resulted in uncertainty that has given rise to Shariah arbitrage.

Moreover, we have examined Brexit, which has raised concerns for the Islamic finance industry and has discussed its ramification for Britain also in respect of the insecurity of commercial interests in the backdrop of Brexit. As

an alternative, Ireland is now becoming a destination of choice for these commercial interests since Ireland has the most feasible landscape to offer to these interests. Thus Dublin makes an appropriate alternate for IFIs which are operating in London for the reasons which are extensively explored in [Chapter 3](#).

Notes

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11. Alastair Hudson, *Understanding Equity & Trusts* (Ch The Principles of Equity, Routledge, 2016) 10.
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17. William C. Jones, 'An Inquiry into the History of the Adjudication of Mercantile Disputes in Great Britain and the United States' (1958) 25 *University of Chicago Law Review* 445, 447–448.
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20. Paul R. Milgrom, Douglass C. North and Barry R. Weingast, 'The Role of Institutions in the Revival of Trade: The Law Merchant, Private Judges, and the Champagne Fairs' (1990) 2 *Economics and Politics* 1, 19 and 20.

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'The Chancery and Star chambers were run under the equitable principles'.
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 - 1 'Pie powder – Followed the principles of law merchant. Were setup by merchants themselves to deal with crimes in the markets and trading fairs, which included disputes between merchants, thefts and acts of violence. Disputes here were decided summarily and on the spot. Pie Powder court are said to have existed from the 11th century and century. However, by the 17th century, they had started losing their appeal and were finally abolished with the court act 1971.
 - 2 Court of staple – Established through Ordinance of the staple which established staple ports, and also created staple court to hear disputes regarding them. These courts also decided commercial disputes separately from common law, on basis of merchant law. These courts faded out around the 16th century.
 - 3 Star chambers – Late 15th century to mid-17th century – Purpose was to supplement the activities of common law and equity courts and were created to ensure fair enforcement of laws against socially and politically powerful people whom the ordinary courts would be hesitant to convict.
 - 4 Court of admiralty – Came into existence around 1360s. These courts dealt with issues relating to maritime contract, injuries and offenses and had jurisdiction over waters. They further dealt with mercantile and shipping cases. First there were three separate admiralty courts and were later merged into one high court of admiralty. This Remained in existence till 1875 and were later merged into normal courts.

- 5 Commissioner of assurances.
 - 6 Merchant juries – These were impaneled by the motion of the Court of King’s bench in 1645, to decide commercial disputes. But its use remained without a proper system. In 1730, a statute provided for the use of such juries at the expense of the requesting party, but these did not materialize as envisaged and faded by time.
 - 7 Private tribunals – Did not have a definite form of force of law, were private arrangements by merchants’.
31. William C. Jones, ‘An Inquiry into the History of the Adjudication of Mercantile Disputes in Great Britain and the United States’ (1958) 25 *University of Chicago Law Review* 445, 446.
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 34. J.H. Baker, ‘The Law Merchant and the Common Law Before 1700’ (1979) 38 *Cambridge Law Journal* 295, 308.
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 39. Christian R. Burset, ‘Merchant Courts, Arbitration, and the Politics of Commercial Litigation in the Eighteenth-Century British Empire’ (2016) 34 *Law and History Review* 615, 644–646.
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 41. Christian R. Burset, ‘Merchant Courts, Arbitration, and the Politics of Commercial Litigation in the Eighteenth-Century British Empire’ (2016) 34 *Law and History Review* 615, 638.
 42. Jackson Tait, ‘Speculation and the English Common Law Courts, 1697–1845’ (2018) 10 *Libertarian Papers* 1, 7. ‘Time bargains were credit transactions whereby an investor contracted to buy or sell shares at a future date and price. A length of time longer than three days was necessary to make the contract financially viable by giving enough time for the market to fall or rise. It was not necessary to own the actual shares to engage in a sell transaction. This was the speculative trading practice that came under the most criticism, and it was associated with reckless gambling’.
 43. *Wells v. Porter* (1836) 2 Bing. (N.C.) 722, 132 *England Law Report* 278.
 44. Jackson Tait, ‘Speculation and the English Common Law Courts, 1697–1845’ (2018) 10 *Libertarian Papers* 1, 13.
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 46. Christian R. Burset, ‘Merchant Courts, Arbitration, and the Politics of Commercial Litigation in the Eighteenth-Century British Empire’ (2016) 34 *Law and History Review* 615, 635.

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48. Christian R. Burset, 'Merchant Courts, Arbitration, and the Politics of Commercial Litigation in the Eighteenth-Century British Empire' (2016) 34 *Law and History Review* 615, 636.
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50. J.H. Baker, 'The Law Merchant and the Common Law Before 1700' (1979) 38 *Cambridge Law Journal* 295, 297.
51. Christian R. Burset, 'Merchant Courts, Arbitration, and the Politics of Commercial Litigation in the Eighteenth-Century British Empire' (2016) 34 *Law and History Review* 615, 637.
52. J.H. Baker, 'The Law Merchant and the Common Law Before 1700' (1979) 38 *Cambridge Law Journal* 295, 459.
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58. William C. Jones, 'An Inquiry into the History of the Adjudication of Mercantile Disputes in Great Britain and the United States' (1958) 25 *University of Chicago Law Review* 445, 446.

The statement of Justice Scrutton summarizes the whole development of merchant needs in English Commercial Law. 'Since the time of Lord Mansfield other judges have carried on the work that he began and as the result of their labors the English Law is now provided with a fairly complete code of mercantile rules and is consequently inclined to disregard the practice of other countries'.

59. George Williams Keeton, *English Law: The Judicial Contribution* (W J Holman Limited Dawlish, 1974) 174.

According to George W Keeton:

'It [was] one of the major achievements of the Common Law judges that this great body of law [mercantile law] became part of the law of England, not by the enactment of a commercial code as was often the case abroad, but by judicial decision. It was only when this had occurred that, in the nineteenth century, important parts of it [mercantile law] were codified in statutes such as the Bill of Exchange Act and the Partnership Act. Long before that date, mercantile customs had been made applicable to all transactions irrespective of the status of those who entered into them'.

60. *Hazell v. Hammersmith and Fulham LBC* (1990) 2 QB 697, 739–740.
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81. T. E. Scrutton, 'The Work of the Commercial Courts' (1921) 1(1) *Cambridge Law Journal* 6, 7. 'This was not a proper system but particular provisions that were added to the existing rules and order, in order to further regulate commercial dispute resolution. These provisions were referred to as the 'Notice as to commercial causes'. It contained 12 main provisions, such as disputes to be taken directly to commercial judges charged with commercial business, allowing judge the discretion to make orders as he thinks fit for speedy determination of cases etc'.
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'These rules on the proper law are designed to respect and support the exceptions of the contracting parties, in accordance with the primary objective of contract law; to promote certainty, predictability, commercial convenience and uniformity of results, regardless of forum; and thus, to facilitate the conduct and promote the growth of international trade and commerce'.

161. Convention on the Law Applicable to Contractual Obligations (signed on 19 June 1980] 80/934/EEC <<https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=celex%3A41980A0934>> accessed 23 October 2021.

‘A contract shall be governed by the law chosen by the parties. The choice must be express or demonstrated with reasonable certainty by the terms of the contract or the circumstances of the case. By their choice, the parties can select the law applicable to the whole or a part only of the contract’.

162. Contracts (Applicable Law) Act, 1990, sec 2(1).
 ‘The Rome Convention applies to contracts made on or after 1st April 1991’.
163. *Shamil Bank of Bahrain v. Beximco Pharmaceuticals Limited and Others* (2003) England and Wales High Court 2118 (Comm) [15].
164. *Shamil Bank of Bahrain v. Beximco Pharmaceuticals Limited and Others* (2003) England and Wales High Court 2118 (Comm) [40].
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171. *Shamil Bank of Bahrain v. Beximco Pharmaceuticals Limited and Others* (2003) England and Wales High Court 2118 (Comm) [19].
172. Rome Convention art 3.1 states:

‘A contract shall be governed by the law chosen by the parties. The choice must be expressed or demonstrated with reasonable certainty by the terms of the contract or the circumstances of the case. By their choice the parties can select the law applicable to the whole or a part only of the contract’.

See also Mario Giuliano and Paul Lagarde, ‘Report on the Convention of the Law Applicable to Contractual Obligations’ (1980) 282 Official Journal of the European Communities, 1–50.

173. *Shamil Bank of Bahrain v. Beximco Pharmaceuticals Limited and Others* (2003) England and Wales High Court 2118 (Comm) [37].
174. *Halpern v. Halpern* (2007) England and Wales Court of Appeal (Civil Division) 291 [32].
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179. *The Investment Dar Company KSCC v Blom Developments Bank Sal* (2009) England and Wales High Court 3545 (Ch), 2009 WL 5386898 [3].
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 ‘... that the reason for TID’s non-payment is that its investment activities have not been as successful as hoped and anticipated and that it has encountered serious cash flow problems. It seems to follow from this that ... TID is not holding sums now on trust which equate to the amount originally deposited’.
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189. *Dubai Islamic Bank PJSC v. PSI Energy Holding Co & Ors* (2013) England and Wales High Court 3186 (Comm) [3].
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191. *Dubai Islamic Bank PJSC v PSI Energy Holding Company (a Bahraini Corporation) & Ors* (2013) England and Wales High Court 3186 (Comm) [11].
 According to Justice Flaux, ‘[a]greement was governed by and construed following English law “save in so far as inconsistent with the principles of Sharia law”. As a matter of English law, that proviso is of no effect, as a religious law can never apply as the applicable law so that in construing the RSA, Sharia law is irrelevant’.
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193. *Islamic Investment Company of the Gulf (Bahamas) Ltd v. Symphony Gems NV and Others* (2002) WL 346969 (QBD (Comm Ct)), 1.
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 ‘Subject only to an argument which Mr. Joseph, who has appeared for all three defendants, has put forward relating to the alleged incapacity of the claimant company to enter into this agreement in the light of its Memorandum and Articles of Association, it seems to me that it is not of any relevance to the issues which I have to decide what are the essential features of a Murabaha contract. The fact is that, as Dr Samaan [an expert in Islamic laws] states and as I have no reason to think is in any way inaccurate, this contract does not have the essential characteristics of a Murabaha contract. Furthermore, it is a contract governed by English law. I must simply construe it according to its terms as an English law contract’.
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See also: *The Investment Dar Company KSCC v Blom Developments Bank Sal* (2009) England and Wales High Court 3545 (Ch), 2009 WL 5386898 [17].
Purle J referred to the complicated nature of the *Shariah* law stating ‘... I do not think it appropriate for me to go through the expert evidence in detail because I am satisfied that I cannot resolve which expert is correct on this application’.
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‘Whilst in one sense this court will answer any question posed of it, however difficult, it is improbable, in the extreme, that the parties were truly asking this court to get into matters of Islamic religion and orthodoxy. This is especially so when the bank has its religious board to monitor the compliance of the bank with the board’s perception of Islamic principles of law in an international banking context’.
207. *The Investment Dar Company KSCC v Blom Developments Bank Sal* (2009) England and Wales High Court 3545 (Ch), 2009 WL 5386898 [17].
Purle J referred to the fact that the *Shariah* non-compliance argument was ‘... a lawyer’s construct ... especially as the *Shariah* committee approved of this transaction’.
208. Charles Proctor, *The Law and Practice of International Banking* (Oxford University Press, 2010) 793.
See also (2007) England and Wales Court of Appeal (Civil Division) 291 [33].
209. Charles Proctor, *The Law and Practice of International Banking* (Oxford University Press, 2010) 793.
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‘*Shamil* was a case in which ..., the court was striving to find the true intention of the parties, and what it was not prepared to accept was a construction of a clause “subject to the principles of the glorious Shari’a, this agreement shall be governed by and construed in accordance with the laws of England” in a way which by introducing some selected terms from *Sharia* law would or might defeat the commercial purposes of the contract’.
211. Abdul Karim Aldohni, ‘The Challenge of Islamic Banking Disputes in the English Courts: The applied law’ (2009) 24 *Butterworths Journal of International Banking and Financial Law* 350, 355.
212. Nicholas H.D. Foster, ‘Islamic Finance Law as an Emergent Legal System’ (2007) 21 (2) *Arab Law Quarterly* 170, 173.
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www.independent.co.uk/voices/brexit-eu-referendum-why-did-people-vote-leave-immigration-nhs-a7104071.html> accessed 12 January 2022.

‘This would seem to support the popular theory that this was essentially a giant protest vote against the political class by people who feel economically “left behind” in modern Britain’.

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3 Islamic Finance Developments in the Republic of Ireland

Ireland presents itself as a gateway for Islamic finance (IF) to enter the Euro region.¹ The country has set certain objectives to achieve through Islamic finance, as specified by the Department of Finance.² These objectives include attracting investment from Middle Eastern countries; the provision of ethical investment opportunities to Irish investors; and facilitating the Muslim population of Ireland to invest in trading ventures according to their religious beliefs.³ According to International Financial Services Centre (IFS) Strategy 2020, 'Islamic Finance will continue to feature in the sectoral and regional strategies outlined in IFS 2020'.⁴

The Finance Act 2010

The core objective of the Irish government is to attract foreign investment by presenting the Republic as a gateway to the eurozone. In this context, the Finance Act 2010 marks the first step toward accommodating Islamic finance within the Irish financial system.⁵ This legislation introduces the concept of 'Specified Financial Transaction'⁶ into the regulatory framework, including 'Credit Transactions' affecting murabaha and diminishing musharakah; 'Deposit Transactions' affecting mudaraba and wakala; and 'Investments transactions' affecting sukuk.⁷ Following the example of legislation in the UK, the Irish government has allowed equal tax treatment for some of the Islamic finance products through the Finance Act 2010.⁸

Prior to analyzing this legislation, it is essential to understand some of the distinct features of IF which need to be accommodated in a secular country like Ireland. Shariah (Islamic law) is based on the Holy Quran which supports trade and commerce.⁹ 'The basic idea is that dealings between people should be just and equitable'.¹⁰ Social justice, therefore, underlies the principles of Islamic finance.¹¹ Islamic finance is regulated by Islamic laws. The Islamic laws are deduced from the Holy Quran and Sunnah (derived from the Prophet Mohammed's (Peace be upon him) life). These principles include prohibitions on interest,¹² prohibition on speculative activities/gharar and the prohibition on investments in pork, pornography, alcohol and gambling (i.e., investments in unethical businesses)¹³; products have to be based on

identifiable/tangible assets¹⁴ and the establishment of a Shariah supervisory board (SSB) within the particular financial institution is essential.¹⁵

An Islamic financial system operating within a conventional financial setup encounters two issues: first, under Islamic laws, money is a means and not an end in itself.¹⁶ Money, therefore, should not be used to produce money, and therefore interest is prohibited.¹⁷ Alternatively, profit and loss sharing is encouraged in Islamic finance.¹⁸ Consequently, financial transactions are strongly based on the sharing of risk and reward between the provider of funds (the investor) and the user of funds (the entrepreneur). In addition, the credit itself is not the starting point of any transaction, but productivity is. Credit worthiness, however, plays an important role in the funding decision process and collateral and other risk mitigants are widely accepted.¹⁹

Nonetheless, the absence of interest raises concerns relating to interest deductions to which investors are entitled in conventional finance, but which are not available where Islamic finance products operate within a conventional financial setup.²⁰

For example, interest payments are generally tax-deductible; however, if payments are structured under Islamic financing techniques as profit-participating payments or payments related to dealings in assets, then these will not necessarily be tax-deductible.²¹

Similarly, in cases of financial institutions paying interest to their customers, they can deduct these interest payments from their gross income before calculating taxes. Islamic financial institutions, on account of the absence of interest, cannot avail of this deduction, which results in increased cost.²²

Secondly, in the absence of interest-based financing, which constitutes the very foundation of the conventional financial system, Islamic finance relies on contractual obligations, which give rise to profit and loss sharing transactions,²³ with the essential presence of a tangible asset underlying the product.²⁴ The presence of a tangible asset underlying an Islamic finance product greatly reduces the risk of complex 'financial engineering', which was a major cause of the global financial crisis in 2008.²⁵ However, it makes Islamic finance an asset-backed/based financing system, which sharply contrasts with conventional finance in substance, thus requiring distinct legal arrangements.²⁶

Islamic Finance Products

'In the desire to provide sustainable and justified distribution of wealth and income, Islamic finance has attempted to find alternatives to the conventional form of financing'.²⁷ In this connection, generally known Islamic financial instruments include murabaha, mudaraba, musharakah, ijara, takaful and sukuk. Musharakah, mudarabah and murabahah have been explored in detail in the preceding section. Following is an explanation of ijara, diminishing musharakah, takaful and sukuk.

Under an ijara (similar to a lease)²⁸ transaction, an asset is identified by the customer (a customer can be an individual or a financial entity) and is purchased

by a financial institution and is leased to the customer. The customer can have possession of the asset but ownership remains with the financial institution. The customer makes rental payments to the financial institution.²⁹

Diminishing musharakah is different from ijara in that the installment payments include cost plus profit instead of cost plus rent. Furthermore, with every installment the customer's share in the asset increases and the profit ratio decreases.³⁰ 'The asset is generally rented to the customer for an amount equal to the economic return on investment and which is equivalent to the interest payable in a conventional transaction'.³¹

Companies raise capital and investments through sukuk. sukuk can be defined as 'certificates' whereby the issuer is usually a Special Purpose Vehicle (SPV) issuing the Sukuk. The SPV then invests the proceeds from the issuance of the Sukuk into some Shariah-compliant transaction or product. Sukuk holders usually hold an undivided share in the underlying asset (which can be a transaction or product). sukuk holders and the SPV then share the return on the investment in the underlying asset.³² The return on sukuk is called the 'investment return' in the Finance Act 2010, and this return is considered as the equivalent to interest.³³ Underlying these certificates are products which are Shariah-compliant and approved by the SSB of the issuing authority.³⁴

Takaful means 'mutual agreement'. Takaful can be defined as Islamic insurance. The underlying principle of takaful rests on 'mutuality'.³⁵ Under a takaful arrangement, the policyholder makes a contribution which is a 'gift or donation' to a mutual fund organized by a takaful provider. The fund is used to meet the 'claims and operating costs and the surplus is then distributed among the policyholders on the maturity of the policy'.³⁶

The takaful industry has developed various models to invest in the takaful fund to make a profit. The two most commonly used models are the 'Wakala or full-scale agency model' and the 'mudaraba model'.³⁷ In the agency model, the takaful service provider acts as an agent for the policyholders' mutual funds and charges an 'agency fee'.³⁸ The mudaraba model enables the takaful providers to invest the mutual fund into another Shariah-compliant product or transaction. The takaful provider 'receives a share of the income generated by investing the pooled funds'.³⁹

Islamic Finance Products Addressed in the Finance Act 2010

After a careful study of Islamic finance products, the Department of Finance introduced legislation to facilitate equal tax treatment for those Islamic finance products, which yield similar returns 'in substance as comparable conventional products'.⁴⁰ The Finance Act 2010 amended the Taxes Consolidation Act 1997 in this regard.⁴¹ The purpose of the 'equal tax treatment' provisions is to prevent specific Islamic finance products from having an 'anomalous tax result' that would hugely affect their competitiveness in the current regulatory system.⁴²

In the case of Shariah-compliant transactions and structures within the funds, leasing and insurance industries, generally the Irish tax treatment is the same as that applying to conventional transactions.⁴³ Currently, the Islamic finance products that can get equal tax treatment in Ireland include:

- 1 Credit transactions covering murabaha and diminishing musharakah
- 2 Deposit transactions like mudaraba and Wakala
- 3 Investment transactions such as sukuk⁴⁴

Islamic finance products, on account of their structure, used to attract multiple Stamp Duty Land Tax (SDLT) in the UK.⁴⁵ For instance, in the case of sukuk, initially when an SPV purchased the asset from the originator, it had to incur SDLT. When the SPV transferred the asset back to the originator at the end of the transaction, again SDLT was paid. Additionally, since sukuk holders hold a share in the underlying asset, the return on their investment can also become liable to stamp duty.⁴⁶

The Finance Act 2010 provides an exemption from stamp duty on the return to s.⁴⁷ Essentially, ‘where the [Finance Act 2010] applies, the return (or profit) on any product defined as a “specified financial transaction” is treated as interest for all the purposes of the Taxes Acts.’⁴⁸

Nevertheless, the Finance Act 2010 does not provide stamp duty exemptions to any of the credit transactions (murabaha and diminishing musharakah) arising under specified financial transactions.⁴⁹ In other words, the Finance Act 2010 fully resolves the tax complications regarding the absence of interest by treating the return/profit on the transaction or products as a payment of interest,⁵⁰ yet the stamp duty issue remains to be addressed.

Double Taxation Agreements

Moving closer to the goal of embracing Islamic finance within the country’s financial system, Ireland has concluded double taxation agreements with Saudi Arabia,⁵¹ Bahrain,⁵² Kuwait⁵³ and the United Arab Emirates (UAE).⁵⁴ Double taxation agreements ensure that the ‘income and capital gains’ generated in the contracting states are prevented from being double-taxed, thus ensuring fair treatment for tax purposes. On the one hand, these agreements prevent tax evasion, and, on the other hand, they protect the income from being double-taxed.⁵⁵ In fact, these agreements are an effective source of developing trade and cooperation among the participating states. The Irish government’s success in concluding these arrangements with well-targeted oil-producing countries is clearly an encouraging strategy.

Irish Stock Exchange

Moreover, in 2005, the Irish Stock Exchange listed its first sukuk transaction, thus opening Irish financial markets to Shariah-compliant products. The first

Irish Islamic finance program (the Oasis Certificate Programme) was listed by Citibank in 2007. Currently, a number of Islamic funds are registered with the Irish Stock Exchange supervised by the Central Bank of Ireland.⁵⁶ The Finance Act 2012 further facilitates Islamic finance products⁵⁷ by widening the definition of ‘finance company’ and amending the conditions of transactions.⁵⁸

Islamic Banking in Ireland

Islamic banking comprises more than 80% of the overall IF industry. In Ireland, in order to facilitate Islamic banking, third bank branch opening is made possible through an amendment to the Central Bank Act 1971, section 73. The Central Bank Act 1971 is amended—(a) in section 7—

- (i) in subsection (1) by inserting ‘or authorization under section 9A’ after ‘license’, and
 - (ii) in subsection (6) (b) by inserting ‘or authorization under section 9A’ after ‘license’, and
- (b) by inserting the following sections after section 9:
Authorization of third-country branches.
9A—(1) In this section and sections 9B and 9C—
‘branch’ means a branch of a relevant credit institution;
‘EEA Agreement’ has the same meaning as it has in the European Communities (Amendment) Act 1993;
‘EEA state’ means—
- (a) a member state of the European Communities, or
 - (b) a state (other than a member state of the European Communities) that is a contracting party to the EEA Agreement;

‘relevant credit institution’ means a credit institution whose head office is located in a state or territory other than an EEA state and which holds an authorization to carry on banking business in that state or territory from the authority that exercises in that state or territory function corresponding to those of the Bank under this Part (‘relevant third country authority’).⁵⁹

Prior to the amendment of section 73, it was not possible for a non-European Economic Area country to open a bank branch in the republic.

Absence of Dispute Resolution Mechanism in the Irish Jurisdiction

There is an absence of provision for dispute resolution mechanisms for potential IF disputes arising in the country in the above-mentioned legislation.⁶⁰ This creates legal uncertainty over the treatment of IF disputes in Ireland. The legal uncertainty is further aggravated by Article 44 of the Constitution of Ireland, *Bunreacht na hEireann*, which makes religious

interpretation by Irish courts open to constitutional challenge.⁶¹ This argument is further developed in [Chapter 3](#), ‘Islamic Finance Disputes in the English Courts’,.

In commercial law, Irish courts follow English precedents as persuasive authority in the absence of binding authority in the Irish constitution, legislation and case law. Nonetheless, examination of religious laws by Irish judges may violate the purpose of Article 44 of the constitution of Ireland.⁶² In other words, even if English courts recognize the need to interpret Shariah laws in the future, the Irish courts will have to deal with constitutional question raised by Article 44.⁶³

A constitutional barrier in Ireland for IF–Article 44 provides protection to religious practices in the country.⁶⁴ This protection is available that to all religions in the country without any discrimination.⁶⁵ Article 44 Constitution of Ireland provides for protection to religious freedom.

Article 44

The State acknowledges that the homage of public worship is due to Almighty God. It shall hold His Name in reverence, and shall respect and honor religion.

- 1 Freedom of conscience and the free profession and practice of religion are, subject to public order and morality, guaranteed to every citizen.
- 2 The State guarantees not to endow any religion.
- 3 The State shall not impose any disabilities or make any discrimination on the ground of religious profession, belief or status.
- 4 Legislation providing State aid for schools shall not discriminate between schools under the management of different religious denominations, nor be such as to affect prejudicially the right of any child to attend a school receiving public money without attending religious instruction at that school.
- 5 Every religious denomination shall have the right to manage its own affairs, own, acquire and administer property, movable and immovable, and maintain institutions for religious or charitable purposes.
- 6 The property of any religious denomination or any educational institution shall not be diverted save for necessary works of public utility and on payment of compensation.

Article 44.1 provides for protection to religious activities and 44.2 subjects this protection to various limitations. These limitations include public order, morality and non-discrimination on religious grounds. Edana Richardson, in her thesis, seeks to explore whether accommodation of IF by the Irish legislature violates the religious protection provided by 44.1, i.e., if the IF disputes are discussed and decided in Irish courts by Irish judges, that will

be an interference with the religion of Islam. In that case, the amendment in Finance Act 2010 will be considered a violation of Article 44.1.⁶⁶

Richardson also explores even though the legislation to accommodate IF is not unconstitutional under Article 44.1, then, whether it was mandatory for Ireland to introduce the legislation. In that case, the legislation violates the limits Article 44.2 imposes on religious freedom to ensure discrimination on religious grounds is prevented.⁶⁷ It is essential to examine if the IF disputes in Irish courts activate the constitutional question under Article 44. *McGrath and O'Ruairc v Trustees of Maynooth College* [1979] ILRM 166 (*McGrath v Maynooth College*) is a key dispute in this regard.⁶⁸

O'Higgins CJ discussed the type of religious discrimination claimed in *McGrath v Maynooth College* by the plaintiff. He said that '... the question remains whether what has been done amounts to discrimination on the grounds of religious status. Discrimination in this respect connotes something which is unjust and unfair'.⁶⁹ Moreover, Henchy J confirmed that positive religious discrimination by the state is justified under Article 44. According to Henchy J:

The constitutional provision invoked here must be construed in terms of its purpose. In proscribing disabilities and discriminations at the hands of the State on the ground of religious profession, belief or status, the primary aim of the constitutional guarantee is to give vitality, independence and freedom to religion. To construe the provision literally, without due regard to its underlying objective, would lead to a sapping and debilitation of the freedom and independence given by the Constitution to the doctrinal and organizational requirements and prescriptions which are inherent in all organized religions. Far from eschewing the internal disabilities and discrimination which flow from the tenets of a particular religion, the State must on occasion recognize and buttress them. For such disabilities and discriminations do not derive from the State; it cannot be said that it is the State that imposed or made them; they are part of the texture and essence of the particular religion; so the State, in order to comply with the spirit and purpose inherent in this constitutional guarantee, may justifiably lend its weight to what may be thought to be disabilities and discriminations deriving from within a particular religion.⁷⁰

The 'positive discrimination' as indicated in *Quinn's Supermarket v Attorney General* confirms that the IF disputes will be discussed and resolved by Irish judges.⁷¹ This is further confirmed by Hamilton CJ in *Re Article 26 and the Employment Equality Bill 1996*.⁷² The assumption that '[t]he possibility of the Irish courts acting in the same manner as the English courts and pronouncing on what conforms to Sharia law and what does not is unconstitutional'⁷³ is not based on the current precedent on the application of the Article 44.

Choice of Law in Irish Courts

In *John Francis Kutchera v Buckingham International Holdings Ltd* (*Kutchera case*) Walsh J precisely described the procedure Irish court followed while dealing with conflict of law rules.⁷⁴

- 1 Matters relating to a corporation's constitution will be resolved by applying the laws of the jurisdiction where the company is registered.⁷⁵
- 2 Application of foreign law by Irish court would depend on 'expert evidence' to be proved by the party requiring application of the foreign law.⁷⁶
- 3 In case of 'conflicting evidence' the Irish court will decide 'between the conflicting expert testimonies'.⁷⁷
- 4 In case of 'insufficient evidence' the Irish laws will be applicable.⁷⁸

The rules described by Walsh J were applicable in old cases that were decided in between 1925 and 1933⁷⁹ prior to the Rome Convention. However, after the Rome Conventions it has to be explored to what extent these rules are compatible with the Rome Convention. Ireland signed the Rome Convention (Convention on the Law Applicable to Contractual Obligations) in 1980 and ratified the Convention in 1991.⁸⁰ The Rome Convention, as applicable in the European Union, had a great influence on the traditional Irish approach to the choice of law issues.⁸¹ According to Irish Law Reform Commission:

Its objective is to establish the uniform choice of law rules with respect to a contract for all member states of the Community The scope of the Rome Convention is determined by Articles 1 and 2. It applies to contractual obligations in any situation involving a choice between the laws of different countries and regardless of whether the country whose law is ultimately applied is an EC member state.⁸²

On a question of choice of law in contracts Irish courts first establish 'proper law' applicable to the contract in dispute.⁸³ The 'proper law' is preferably the expressly agreed law by the parties in the contract. In the absence of such expressly specified law, Irish courts '... might infer from the conduct of the parties that a certain law had been selected as the applicable law. In the alternative, the proper law would be that with which the contract had the closest and most real connection, in the view of the court'.⁸⁴

Moreover O'Flaherty J in *Simon Fraser and Another v Denis Buckle and Others* (*Simon Fraser v Denis*) considered '[t]he essential validity of a contract is generally determined by the proper law of the contract'.⁸⁵ According to O'Flaherty J, it is also essential '... to determine whether the contract is valid or invalid according to the foreign law'.⁸⁶ Public policy is the second crucial factor in the application of parties' choice of law in a contract.⁸⁷ However, a clear

explanation exists of ‘proper law’, ‘public policy’ and ‘validity of contract according to the foreign law’, there is no case where Irish court had applied, or even considered, the application of foreign law.

In the absence of binding precedent in Ireland regarding IF disputes in particular and choice of law disputes in general, it is appropriate to investigate the status of foreign decisions in the legal system of Ireland. Raymond Byrne and J Paul McCutcheon states in ‘The Irish Legal system’,

However, the decisions of ... foreign courts are of persuasive authority and so may be followed at the option of the court. The decisions of foreign courts are regularly cited in and adopted by Irish courts, especially where there is an absence of relevant Irish authority.⁸⁸

Additionally, ‘English decisions are the most commonly cited’ foreign decisions in an Irish court. There are two reasons for this frequent citation of English cases in Irish case law. First, similarities between the two systems on account of the Irish legal system originate from the English system and second, ‘the traditional links between the two systems’.⁸⁹ Therefore, in current commercial law practices in Ireland, it is evident that English decisions will most likely be considered by Irish courts.⁹⁰

Hence, foreign decisions constitute ‘persuasive authority’ for Irish courts. As such, English courts’ decisions are not binding on Irish courts, but they have ‘persuasive authority’ over issues which lack Irish authority.⁹¹ Therefore, this chapter now examines the problems discussed in the above analysis of the IF case law evolving in English courts, which holds strong persuasive authority in the Irish legal system.

Brexit and IF in Ireland

Undoubtedly, Brexit has caused a decline in financial markets in the UK. Businesses and firms are moving to Dublin, Luxemburg and Frankfurt. Particularly, Dublin has seen a significant surge in the number of financial institutions moving from London.⁹² The Republic of Ireland is the only English-speaking nation and common law jurisdiction in Europe. This is why it has already begun attracting business from London.⁹³ Additionally, the pass porting and freedom of service that Dublin offers have the potential to attract international investors from the UK.⁹⁴ Thus, the impacts of Brexit in terms of the financial services industry have proved to be quite favorable for IFSC, Dublin.⁹⁵

Similarly, in terms of Islamic finance, the analysts in London are making sure the legal and regulatory framework of the UK keeps facilitating IF investors.⁹⁶ Despite this, Islamic investors look at Dublin to reach the euro-zone. For Islamic investors, the Republic of Ireland has become the center of attention in the Euro region.⁹⁷ Thus, Brexit indicates that the time is right for the Emerald Island to establish a Euro region IF center.

Islamic Finance Precedent Developing in the US Courts

From the Irish perspective, there is merit in following the US courts' approach toward the resolution of the Islamic finance (IF) disputes. The US courts' approach toward IF dispute is liberal and accommodating.⁹⁸ This approach is favorable to settle the IF industry in a secular state and contrasts with the approach the English courts took regarding the interpretation of Islamic laws under the doctrine of incorporation.⁹⁹ Particularly, the US decisions have been getting strong persuasive authority among Irish courts recently.¹⁰⁰

... [Irish courts] find more appropriate guidance in the decisions of courts in other countries based on a similar constitutional framework than in what at times, appears to be an uncritical adherence to English precedent, which itself, appears difficult to reconcile from time to time.¹⁰¹

In the US, in *NGC V Lucent*, Linares J admitted the complex nature of Shariah laws but he took a wider outlook to resolve the dispute. Linares J carefully studied the Basic Regulations of the Kingdom of Saudi Arabia,¹⁰² the principles of general legal practice in the Kingdom,¹⁰³ and distinguished the basic concept of 'promise' from conventional contract to Islamic contracts.¹⁰⁴ Linares J then, in light of his exclusive research on the Saudi Arabian legal system, established the intention of parties, i.e., enforcement of Shariah law as applicable in Saudi Arabia.¹⁰⁵ Finally, a comprehensive test of the facts of the case under Saudi laws and legal practices was conducted which led to a fair decision.¹⁰⁶

In *SABIC v Mobil Yanbu*, the court found that, while deciding a dispute under Islamic laws, the first problem a court encounters is that the Islamic legal system does not recognize precedent, and therefore, most often in Islamic jurisdictions, court decisions are not systematically published.¹⁰⁷ For instance, the Delaware Superior Court realized that instead of precedent, Saudi judges rely on *ijtihad* to conclude a dispute.¹⁰⁸ They use '... the Hanbali school's authoritative works' to find out a 'spectrum of possibilities on any given question, rather than a single "correct" answer'.¹⁰⁹ Following the Saudi judges' practice, the trial judge performed *ijtihad* to define Saudi tort law on usurpation.¹¹⁰

Nonetheless, the appellant challenged the trial judge's eligibility to perform *ijtihad*.¹¹¹ The court rejected the argument asking if no US judge is eligible to conduct *ijtihad* '... then why did SABIC choose to file this dispute in a United States Court?'¹¹² The US court did not refrain from performing *ijtihad*; the court sanctioned the provision of the contract, which required the disputes be resolved under Islamic laws. The US judges approach points to positive possibilities for the IF industry in the secular jurisdiction.

Under the doctrine of incorporation, the enforcement of Shariah principles is hindered by the complicated nature of the IF instruments. An explanation of the structure of IF instruments suggests two causes of the complication, i.e., emphasis on form over the substance of financing contract structures

causing Shariah arbitrage and lack of standardization in the global IF industry. It is recommended that until these issues are resolved within the global IF, Irish courts can rely on the IF precedent developing in the US courts.

Development of Islamic Transnational Law

In large measures, the present state of precedent in English court can be attributed to the structure of Islamic finance instruments. The instruments apply Islamic principles to conventional contracts, which create Shariah arbitrage, the current outcome in English courts is a logical result of this practice.¹¹³ As Mufti Muhammad Taqi Usmani explained,

... [murabahah] should neither be taken as an ideal Islamic mode of financing, nor a universal instrument for all sorts of financing. It should be taken as a transitory step towards the ideal Islamic system of financing based on musharakah or mudarabah. Otherwise, its use should be restricted to areas where musharakah or mudarabah cannot work.¹¹⁴

There is a clear absence of profit and loss sharing element in the current murabaha transaction.¹¹⁵ There is an evident gap between the substance of Islamic law and the form it takes in the IF products and services.¹¹⁶

Nonetheless, Islamic finance law is developing under ‘modern *Shari’a*’ whereby current practices in the IF industry is further developed by examining Islamic legal literature, deducing rules out of the literature and applying the rules to the current financial market demands.¹¹⁷ This legal aspect of IF can be truly defined as ‘Islamic finance law’.¹¹⁸ Islamic finance law comprises Islamic transnational contract laws, which rely on the Islamic principles rather than a national legal system.¹¹⁹

Moreover, Islamic transnational contract laws are emerging as a branch of a transnational contract law in international trade and commerce. The underlying principles of the transnational contract law are ‘... the common sense of the business and legal community rather than government intervention, contract rather than statute and professional standardization rather than parliamentary legislation’.¹²⁰ Similarly, the transnational law of IF operates independently of national legal orders.¹²¹

The notion that Islamic Law is itself unpredictable and unstable is often erroneously stated by many¹²² While it may be true that Islamic Law as used today ... in contrast with the classical or medieval periods—in the practice of contemporary Islamic Finance and banking has made Islamic law seem unpredictable and unstable, to blame solely Islamic law and its jurists of yesterday and today would be a shallow understanding of the matter.¹²³

The Islamic transnational contract law forms a part of the Islamic finance transnational legal system, which is leading to standardization and harmonization of the Islamic finance market, as discussed in [Chapter 4](#).¹²⁴

The Islamic transnational contract law is a subject of discussion in *Shamil Bank v Beximco Pharmaceuticals* when Potter J states that the parties failed to specify the aspects of Islamic laws which ‘... are intended to be incorporated into the contract’.¹²⁵ In the field of ‘Islamic finance law’, there is an evident lack of literature on Islamic finance by lawyers.¹²⁶ Potter J identified that: [i]t is insufficient for the defendants to contend that the basic rules of the sharia applicable in this case are not controversial. Such basic rules are neither referred to nor identified. Thus, the reference to the ‘principles of ... sharia’ stand unqualified as a reference to the body of sharia law.

This analysis attempts to describe the existence of the Islamic transnational legal system and the Islamic transnational contract law. Although the laws are underdeveloped on account of a lack of harmonized efforts to address the legal uncertainty in the global IF industry. However, the development of the law will help standardize the industry practices.

Central Shariah Advisory Board

There is a need for proper enforcement of the Shariah principles to the IF products and transactions during the supervisory process of SSB. In this respect, prospects of the central Shariah board are explored. According to Zulkifli Hasan and Mehmet Asutay, ‘[i]t would have been manifestly unjust for the customers of Islamic banks to avoid their liability by raising the Shari’ah defense whereas having previously agreed in the form of the agreements and Shari’ah validity’.¹²⁷

The Islamic finance institutions’ constant attempt to defend their defaults under Shariah arbitrage shows the exploitation of the unstructured nature of the IF principles by IFIs. However, this research suggests that the establishment of a central Shariah board with the objective of the provision of advisory services to courts will facilitate legal certainty. The central Shariah board can play a positive role to ensure the IF disputes are reasonably pleaded and fairly decided.¹²⁸

Central Shariah Advisory Board in Ireland can be comprised members from different professional backgrounds; for instance, in Malaysia, the Shariah Advisory Board comprises a former chief justice, religious scholars, Law professors and researchers.¹²⁹ The Council is appointed by Minister. Shariah Advisory Council (SAC) and can be an appropriate example for secular jurisdictions like Ireland to develop a standard and uniform practice regarding the IF disputes.¹³⁰ The notion of central SSB has further been explored in [Chapter 6](#).

Notes

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5. Number 5 of 2010, Finance Act 2010.
6. Finance Act 2010, s 39.
7. Department of Finance, 'Islamic Finance in Ireland: An Information Note' (2010) 5–6.
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9. Ashraf U. Kazi and Abdel K. Halabi, 'The Influence of Quran and Islamic Financial Transactions and Banking' (2006) 20 Arab LQ 321, 323.
10. Hans Visser, *Islamic Finance: Principles and Practice* (Cheltenham: Edward Elgar Publishing Ltd, 2009) 78.
11. Hans Visser, *Islamic Finance: Principles and Practice* (Cheltenham: Edward Elgar Publishing Ltd, 2009) 78.
12. The Holy Quran, 'Those who charge usury are in the same position as those controlled by the devil's influence. This is because they claim that usury is the same as commerce. However, God permits commerce and prohibits usury', Al Baqarah ii, 275; 'O you who believe shall not take usury, compounded over and over. Observe God that you may succeed', Al Imran iii, 130.
13. Muhammad Taqi Usmani, *An Introduction to Islamic Finance* (London: Kluwer Law International, 2002) xiv.
'Interest, gambling, speculative transactions tend to concentrate wealth in the hands of a few'.
14. Natalie Schoon, *Islamic Banking and Finance* (London: Spiramus Press Ltd, 2009) 23.
15. Natalie Schoon, *Islamic Banking and Finance* (London: Spiramus Press Ltd, 2009) 137.
16. Muhammad Taqi Usmani, *An Introduction to Islamic Finance* (London: Kluwer Law International, 2002) xv.
17. The Holy Quran, 'The usury that is practised to increase some people's wealth, does not gain anything at God. But if people give to charity, seeking God's pleasure, these are the ones who receive their reward many fold'. Al Rum XXX, 39.
18. Nicholas Jessop, 'The Taxation of Islamic Finance in the UK: An Introduction' (2009) 8(2) *Journal of Taxation of Financial Products* 17, 19.
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22. Joseph A. DiVanna and Antoine Sreih, *A New Financial Dawn: The Rise of Islamic Finance* (United Kingdom: Leonardo & Francis Press Ltd, 2009) 150.
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26. Natalie Schoon, *Islamic Banking and Finance* (London: Spiramus Press Ltd, 2009) 137.
27. Ioannis Akkizidis and Sunil Kumar Khandelwal, *Financial Risk Management of Islamic Banking and Finance* (Basingstoke: Palgrave Macmillan, 2008) 2.
'A common thread running across all these tenets is protection of the poor and weak from exploitation by the rich and powerful'.

28. Tax and Duty Manual, 'Tax Treatment of Islamic Financial Transactions' (October 2020) 5.
29. Natalie Schoon, *Islamic Banking and Finance* (London: Spiramus Press Ltd, 2009) 153–154.
30. Natalie Schoon, *Islamic Banking and Finance* (London: Spiramus Press Ltd, 2009) 160–161.
31. Tax and Duty Manual, 'Tax Treatment of Islamic Financial Transactions' (October 2020) 23.
32. Nicholas Jessop, 'The Taxation of Islamic Finance in the UK: An Introduction' (2009) 8(2) *Journal of Taxation of Financial Products* 17, 22.
'... participation certificates conveying an undivided beneficial ownership share in an underlying asset or interest held by the issuer and particularly to the income generated by those underlying assets, typically achieved by an [sic] SPV issuer declaring a trust over the underlying assets ... Typically, the SPV issuer selects income-generating (and *Shariah*-compliant) assets. The SPV issuer then uses the proceeds it receives from the issuance of the *Sukuk* certificates to purchase the assets. The SPV issuer then declares a trust over the assets for the benefit of the *Sukuk* holders. The *Sukuk* holders receive periodic distributions from the income of the trust. Therefore, the *Sukuk* holders [sic] receipts are linked to the underlying performance of the assets. The SPV issuer will provide management and expertise by selecting which assets to invest in, the *Sukuk* holders will provide the capital and both will then share in the risks and rewards. The fact that the returns are based on income generated by the underlying assets, and not according to a fixed interest rate, means that the *Sukuk* should conform to the principles of *Shariah*'.
33. Tax and Duty Manual, 'Tax Treatment of Islamic Financial Transactions' (October 2020) 34.
34. Accounting and Auditing Organization for Islamic Financial Institutions, 'Shari'ah Standard No. (17) Investment Sukuk' <<http://aaoifi.com/ss-17-investment-sukuk/?lang=en>> accessed 14 January 2022.
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41. Tax and Duty Manual, 'Tax Treatment of Islamic Financial Transactions' (October 2020) 20.
42. Edana Richardson, 'Islamic Finance for Consumers in Ireland: A Comparative Study of the Position of Retail-Level Islamic Finance in Ireland' (2011) 31(4) *Journal of Muslim Minority Affairs* 534, 545.
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46. Natalie Schoon, *Islamic Banking and Finance* (London: Spiramus Press Ltd, 2009) 160–161.

47. Tax and Duty Manual, 'Tax Treatment of Islamic Financial Transactions' (October 2020) 36.
'... for the purposes of the Tax Acts, the certificate owner is not regarded as having a legal or beneficial interest in the assets held by the qualifying company'.
48. Tax and Duty Manual, 'Tax Treatment of Islamic Financial Transactions' (October 2020) 20.
49. Tax and Duty Manual, 'Tax Treatment of Islamic Financial Transactions' (October 2020) 29.
50. Tax and Duty Manual, 'Tax Treatment of Islamic Financial Transactions' (October 2020) 37.
51. 'Convention Between The Kingdom of Saudi Arabia and Ireland for the Avoidance of Double Taxation and the Prevention of Tax Evasion with Respect to Taxes on Income' (2011).
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53. 'Convention Between Ireland and the Government of the State of Kuwait for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains' (2010).
54. 'Convention Between Ireland and the United Arab Emirates for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains' (2010).
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56. Edana Richardson, 'Islamic Finance for Consumers in Ireland: A Comparative Study of the Position of Retail-Level Islamic Finance in Ireland' (2011) 31(4) *Journal of Muslim Minority Affairs* 534, 541.
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67. Edana Richardson, 'The Integration of Islamic Finance into the Irish Legal System: Current Issues and Future Challenges' (PhD thesis, Trinity College Dublin 2012) 176–277.

68. *McGrath and O'Ruairc v Trustees of Maynooth College* (1979) Irish Law Reports Monthly 166
69. *McGrath and O'Ruairc v Trustees of Maynooth College* (1979) Irish Law Reports Monthly 166, 186.
70. *McGrath and O'Ruairc v Trustees of Maynooth College* (1979) Irish Law Reports Monthly 166, 187.
71. *Quinn's Supermarket v Attorney General* (1972) Irish Reports 1.
72. *Re-Article 26 and the Employment Bill 1996* (1997) 2 Irish Reports 321
73. Mark O'Flynn, 'Islamic Finance: Are We Ready?' (2012) 30 Irish Law Times 310, 314.
74. *John Francis Kutchera v. Buckingham International Holdings Ltd* (1988) Irish Law Reports Monthly 501, 504.
75. *John Francis Kutchera v. Buckingham International Holdings Ltd* (1988) Irish Law Reports Monthly 501, 504.
76. *John Francis Kutchera v. Buckingham International Holdings Ltd* (1988) Irish Law Reports Monthly 501, 504.
77. *John Francis Kutchera v. Buckingham International Holdings Ltd* (1988) Irish Law Reports Monthly 501, 504.
78. *John Francis Kutchera v. Buckingham International Holdings Ltd* (1988) Irish Law Reports Monthly 501, 504.
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83. 'Irish Law Reform Commission Report on United Nations (Vienna) Convention on Contracts for the International Sale of Goods 1980' (1992) IELRC 1 (May 1992), 21.
84. 'Irish Law Reform Commission Report on United Nations (Vienna) Convention on Contracts for the International Sale of Goods 1980' (1992) IELRC 1 (May 1992), 21–22.
85. *Simon Fraser and Another v Denis Buckle and Others* (1996) 2 Irish Law Reports Monthly 34, 37.
86. *Simon Fraser and Another v Denis Buckle and Others* (1996) 2 Irish Law Reports Monthly 34, 37.
87. *Simon Fraser and Another v Denis Buckle and Others* (1996) 2 Irish Law Reports Monthly 34, 37.
 'A choice of law will normally be given effect to providing it is *bona fide* and legal and not contrary to public policy'.
88. Raymond Byrne and J Paul McCutcheon, *The Irish Legal System* (Edn 4, Dublin, Butterworth, 2001) 325.
89. Raymond Byrne and J Paul McCutcheon, *The Irish Legal System* (Edn 4, Dublin, Butterworth, 2001) 325.
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92. Rebecca Christie, 'Brexit Banking Exodus Creates a Dilemma for Dublin' *The Irish Times* (2019) <<https://www.irishtimes.com/opinion/brexit-banking-exodus-creates-a-dilemma-for-dublin-1.3951662>> accessed 12 January 2022.

'Dublin has gained a lot of new business from London's exodus, becoming the top choice of firms seeking higher ground post-Brexit'.

93. Brexit, 'Brexit: International Banks' Irish Balance Sheets Rise to More Than €500bn' *BBC* (2022) <<https://www.bbc.com/news/world-europe-60037037>> accessed 5th February 2022.

See also: EY, 'EY financial services Brexit tracker: Financial services firms continue moving staff ahead of Brexit deadline, with total jobs relocating from London to Europe now over 7,500' (Press Release, 2020) <https://www.ey.com/en_uk/news/2020/09/ey-financial-services-brexit-tracker-fs-firms-continue-moving-staff-ahead-of-brexit-deadline> accessed November 2021.

'Dublin remains the most popular destination for staff relocations and new European hubs or offices, with 34 financial services firms saying they are considering or have confirmed relocating operations and/or staff to the city'.

94. EY, 'The Race is On' (2017) <<https://eyfinancialservicesthoughtgallery.ie/post-brexit-consequences/>> accessed 5th February 2022.

See also: Brexit, 'Brexit: International banks' Irish balance sheets rise to more than €500bn' *BBC* (2022) <<https://www.bbc.com/news/world-europe-60037037>> accessed 5th February 2022.

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96. Lucy Burton, 'City urges government to prioritize Islamic finance ahead of possible Brexit boom' *The Telegraph* (2017) <<https://www.telegraph.co.uk/business/2017/09/11/city-urges-government-prioritise-islamic-finance-ahead-possible/>> accessed November 2021.

97. Islamic Finance News, 'The UK and Ireland: Taking the Lead in the West' (2022) 19 *Islamic Finance News* 3.

98. Faiza Ismail, 'A Commentary on Islamic Finance Case Law in the US' (2015) 36(4) *Company Lawyer* 123.

99. Raymond Byrne and J Paul McCutcheon, *The Irish Legal System* (Dubline: Butterworth, 2001), 353.

'Such a statement of principle by the House of Lords inevitably makes even weaker any case for following the decisions of that house whether they are in cases before or after the year 122. There are many other jurisdictions like our own where the corpus juris includes the common law such as the United States, Canada, Australia and New Zealand. These are nations where in addition, there are written and, consequently, rigid constitutions, unlike that of the United Kingdom. Whilst the judgment in cases decided in the English Courts at all levels will, on a great many occasions, provide conveniently and, indeed, convincing statements of principle and attractive arguments in favor of such principles, they are no more than that and must be examined and questioned in the light of jurisprudence whose fundamental law is radically different in its denial of the supremacy of parliament and its holding of three co-equal organs of government, in the Legislature, the Executive and the Judiciary'.

'Raymond Byrne and J Paul McCutcheon also consider it essential for Irish judges to contrast the English courts' decisions with other common law jurisdictions like Canada, Australia, and New Zealand'.

100. Raymond Byrne and J Paul McCutcheon, *The Irish Legal System* (Dubline: Butterworth, 2001), 354.

101. Raymond Byrne and J Paul McCutcheon, *The Irish Legal System* (Dubline: Butterworth, 2001), 354.
102. *National Group for Communications and Computers Ltd. v Lucent Technologies International Inc.* (2004) 331 Federal Supplement, 2nd Series 290, 294.
103. *National Group for Communications and Computers Ltd. v Lucent Technologies International Inc.* (2004) 331 Federal Supplement, 2nd Series 290, 295.
‘Generally speaking, the Saudi Arabian legal structure is highly traditional and judges strictly apply classical Islamic laws’.
104. *National Group for Communications and Computers Ltd. v Lucent Technologies International Inc.* (2004) 331 Federal Supplement, 2nd Series 290, 296.
105. *National Group for Communications and Computers Ltd. v Lucent Technologies International Inc.* (2004) 331 Federal Supplement, 2nd Series 290, 297.
106. *National Group for Communications and Computers Ltd. v Lucent Technologies International Inc.* (2004) 331 Federal Supplement, 2nd Series 290, 298–301.
107. *Saudi Basic Industries Corporation v Mobil Yanbu Petrochemical Company Inc and Exxon Chemical Arabia, Inc* (2005) 866 A2d 6, 30–31.
108. *Saudi Basic Industries Corporation v Mobil Yanbu Petrochemical Company Inc and Exxon Chemical Arabia, Inc* (2005) 866 A2d 6, 30–31.
109. *Saudi Basic Industries Corporation v Mobil Yanbu Petrochemical Company Inc and Exxon Chemical Arabia, Inc* (2005) 866 A2d 6, 31.
‘To state it in different terms, the critical inquiry is whether “the proper analytical procedures are followed in reaching the results”’.
110. *Saudi Basic Industries Corporation v Mobil Yanbu Petrochemical Company Inc and Exxon Chemical Arabia, Inc* (2005) 866 A2d 6, 31–32.
111. *Saudi Basic Industries Corporation v Mobil Yanbu Petrochemical Company Inc and Exxon Chemical Arabia, Inc* (2005) 866 A2d 6, 32.
112. *Saudi Basic Industries Corporation v Mobil Yanbu Petrochemical Company Inc and Exxon Chemical Arabia, Inc* (2005) 866 A2d 6, 32.
‘According to Dr.Vogel, “ijtihad requires for its credibility qualifications which on the very face of things neither Prof Hallaq, myself or, with respect, any US Court possesses”’.
113. Kilian Balz, ‘A Murabaha Transaction in an English Court: The London High Court of 13th February 2002 in Islamic Investment Company of the Gulf (Bahamas) Ltd v Symphony Gems NV & Ors’ (2004) 11 *Islamic Law and Society* 117, 132.
114. Mufti Muhammad Taqi Usmani, *An Introduction to Islamic Finance* (Karachi: Kluwer Law International, 2002), 106.
115. Umar F Moghul and Arshad A Ahmed, ‘Contractual Forms in Islamic Finance Law and Islamic INV co of the Gulf (Bahamas) Ltd v Symphony Gems NV & Ors: The First Impression of Islamic Finance’ (2004) 27 *Fordham International Law Journal* 150, 180–183.
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117. Nicholas H D Foster, ‘Islamic Finance Law as an Emergent Legal System’ (2007) 21 *Arab Law Quarterly* 170, 177–178.
‘The method presently used employs the study of Islamic legal literature (much of which is still unexplored, or at least needs fresh interpretation or a new perspective), the extraction from it of principles by deduction, and the application of those principles using analogy to current issues’.
118. Nicholas H D Foster, ‘Islamic Finance Law as an Emergent Legal System’ (2007) 21 *Arab Law Quarterly* 170, 188.

119. Kilian Balz, 'Islamic Law as Governing Law under the Rome Convention. Universalist Lex Mercatoria v Regional Unification of Law' (2001) 6 Uniform Law Review n.s. 37, 48.
120. Kilian Balz, 'Islamic Law as Governing Law under the Rome Convention. Universalist Lex Mercatoria v Regional Unification of Law' (2001) 6 Uniform Law Review n.s. 37, 47.
121. Kilian Balz, 'Islamic Law as Governing Law under the Rome Convention. Universalist Lex Mercatoria v Regional Unification of Law' (2001) 6 Uniform Law Review n.s. 37, 48.
122. Umar F Moghul and Arshad A Ahmed, 'Contractual Forms in Islamic Finance Law and Islamic INV co of the Gulf (Bahamas) Ltd v Symphony Gems NV & Ors: The First Impression of Islamic Finance' (2003) 27 (1) Fordham International Law Journal 150, 191.
123. Umar F Moghul and Arshad A Ahmed, 'Contractual Forms in Islamic Finance Law and Islamic INV co of the Gulf (Bahamas) Ltd v Symphony Gems NV & Ors: The First Impression of Islamic Finance' (2003) 27 (1) Fordham International Law Journal 150, 192.
124. Nicholas H D Foster, 'Islamic Finance Law as an Emergent Legal System' (2007) 21 Arab Law Quarterly 170, 186.

'The institutional creation of "standards", the collecting of fatwas, the organic forces mentioned above, including such processes as the consensus of scholars, standard documentation, and the search for guiding principles: all are creating certainty and uniformity in legal rules'.
125. *Beximco Pharmaceuticals Ltd, Bangladesh Export Import Co Ltd, Mr. Ahmas Sohail Fazlur Rahman, Mr. Ahmed Salman Fazlur Rahman, Beximco (Holdings) Ltd v Shamil Bank of Bahrain*, E.C. (2004) England and Wales Court of Appeal (Civil Division) 19 2004 WL 62027 (Court of Appeal (Civil Division)) [52].
126. Nicholas H D Foster, 'Islamic Finance Law as an Emergent Legal System' (2007) 21 Arab Law Quarterly 170, 188.

'... the legal aspect of Islamic Finance has not yet been considered to constitute an independent subject. However, with the growth in the importance, maturity, and complexity of the field, and as more and more lawyers specialize in the area, that approach is starting to look outdated'.
127. Zulkifli Hasan and Mehmet Asutay, 'An Analysis of the Court's Decisions on Islamic Finance Disputes' (2011) 2(3) ISRA International Journal of Islamic Finance 41, 67.
128. Ann Black and Kerrie Sadiq, 'Good and Bad Sharia: Australia's Mixed Response to Islamic Law' (2011) 34 University of New South Wales Law Journal 383, 174.
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4 Standardization and Irish Policy Makers

Legal uncertainty and consequent Shariah arbitrage are the outcome of multiple interpretations of Shariah law. A comprehensive standardization project can provide the foundational framework that caters to the problems of legal uncertainty and Shariah arbitrage. The task of standardization is not an easy one. At present, there are several bodies including Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), Islamic Financial Services Board (IFSB), International Islamic Finance Market (IIFM), and International Islamic Center for Reconciliation and Arbitration (IICRA) dedicated to the task of standard-setting in respect of different components of the Islamic finance (IF) industry. These bodies must work in harmony, to bring about a consolidated body of standards for the industry. Examples of organizations such as International Swaps and Derivatives Association (ISDA) operating in the over the counter (OTC) derivatives industry, which has yielded similar projectiles of standardization, are instructive in this respect. AAOIFI being the most reputed of all standard-setting bodies should take the lead in this process. The task of standard setting should be complemented with achieving the universal adoption of AAOIFI standards, creation of a universal regulatory body called the Global Shariah Supervisory Board which can provide a uniform direction to the industry, and major reforms in the international Islamic finance law. Ireland being a favorable destination for IF stakeholders after Brexit, can also play its role in being a proactive contributor to the shape and design that IF industry takes in the future, by becoming a part of these regulatory bodies in different capacities, which will harness its potential as a hub of Islamic finance.

Need for Standardization in the Islamic Finance Industry

The current state of Islamic laws is such that the laws cannot be implemented in a common-law jurisdiction to disputes relevant to financial transactions. A major cause of the under-developed nature of Islamic laws is attributed to diverse interpretations by four schools of thought to a single transaction. Islamic laws are well-developed within the four schools of thought. However,

Islamic financial institutions (IFIs) are not very well segregated according to the schools of thought in their dealings. There does not exist a mechanism to make sure all IF transactions are structured according to a particular school of thought or organized according to different schools of thought. In other words, the IFIs are conducting business without specifying compliance with any one specific school of thought in their transactions. This practice has resulted in Shariah arbitrage which needs to be regulated.¹ Regulation of Shariah arbitrage is possible through standardization of the industry practices.

Particularly, the diversity in fiqh (Islamic jurisprudence), on account of four schools of thought needs to be standardized. Islamic history shows that efforts to eliminate differences of opinion, among the four schools of thought, have been unsuccessful.² It is therefore not possible to eliminate the differences, but it is possible to recognize and standardize the differences.³

English courts found it difficult to pick and choose among interpretations under the four schools of thought. This was a reason the court did not apply Shariah law even under the doctrine of incorporation.⁴ However, it will be possible for courts to apply Shariah law which is established into well-recognized standards. Standardization of IF principles therefore will overcome the legal uncertainty arising out of the current IF precedents in English courts.

Finally, standardization is also crucial for regulators to understand the operations of Islamic financing techniques to promote and accommodate the industry within a regulatory framework.⁵ Indeed, standardization is essential to convince regulators in non-Islamic jurisdictions that IF ‘... is amenable to the same standards as applied to the conventional financial industry’.⁶

Challenges to Standardization

Diversity in Fiqh

The first challenge, toward standardization, is diversity in fiqh. The basic contours of this challenge are that under the doctrine of Ijtihad that is crucial to the interpretation of Shariah and devising Shariah rulings, it is unanimously agreed that Shariah envisages and appreciates diverse interpretations, all being equally legitimate. Producing a standard version of Shariah rulings that take precedence over all others, and are considered an indisputable authority, is anathema to this traditional understanding of Shariah.⁷ Until this argument is rebutted with sufficient authority, every effort toward standardization would essentially grind to a halt even if initiated. In theory, this diversity entailing disagreement is seen as valid and fruitful to the growth of Shariah, whereas in practice, the implications of this have been quite detrimental if not disastrous for the industry. This difference of opinion has led to some products deemed permissible within the Malaysian jurisdiction, being labeled as non-permissible by the AAOIFI which is influenced by Middle

Eastern scholars.⁸ For example, in Malaysia, Bay Al Dayn, which involves the sale of Islamic bonds at a lower price to third parties is permissible, but many scholars hold that selling of debt to third parties is unIslamic and thus not permissible. This impermissibility has also been unanimously approved by the Islamic Fiqh Academy of Jeddah.⁹ Similarly, in the case of Bay al Inah transactions, Malaysian scholars are in conflict with the more conservative scholars originating from the Saudi-based scholars who treat such transactions as non-Shariah compliant.¹⁰ Hence, though this difference of opinion has been a classic feature of Islamic jurisprudence, and the different schools of thought in Islam even branching out from different sects represent the diversity, but the same difference of opinion is hampering efforts toward standardization¹¹ because bringing scholar on the same page on one issue is one arduous task.

Fatwa Shopping

Fatwa shopping is a phenomenon that relies on the room for diversity in Shariah and is performed by desperate financial institutions trying to seek a fatwa or legal ruling that best suits their needs and interests.¹² In that their attempt is not to find a reliable ruling of Shariah, but instead any ruling that would provide a Shariah-compliant status to their products. There have been various covert orchestrations of fatwa shopping practices, where conventional products are presented in the shroud of Shariah-compliant transactions, and legitimacy is sought through favorable fatwas.¹³ Hence, fatwa shopping and its benefits for financial institutions seeking to legitimize their products, is one major barrier standing in the face of standardization since these financial institutions would end up losing their ground to maneuver if standardization takes place, and thus oppose the same. Since the above practice seeks legitimacy from Shariah itself, the opposition becomes more formidable.

Form over Substance

One subsidiary challenge, which is a corollary to the diversity of fiqh, is the objective with which scholars devise Shariah rulings. Most classical scholars, in their endeavor, to arrive at Shariah rulings, opt for a strictly literal interpretation of Shariah law. As a result, they fail to take account of the spirit of Shariah law which can even better serve the realities of commercial and financial activities. Hence standard rulings, which make room for market realities based on the spirit of Shariah law, which is essentially the main purpose of standardization, may face opposition from the scholars who believe in the literal interpretation of fiqh as they prohibit the rulings based on substantial interpretation of Shariah law thus causing further discord.¹⁴

Since the spirit of the law is ignored, the maslaha approach is rarely applied. The application of maslaha will bring IF transactions closer to practicalities

of commercial needs. Maslaha approach will also help overcome the criticism that current IF practices are but a replica of conventional banking practices.

Legal Argument

A criticism toward standardization is that the standardization project is impracticable as uniform standards cannot be transplanted to meet the needs of various jurisdictions. Legal rules must develop in a jurisdiction in consonance with the peculiar socio-economic realities of such jurisdiction, and mere transplantation of uniform standards will not yield the desired results but will create more chaos.¹⁵ Thus, transplanting standardized practices will deprive the Islamic finance industry of the ability to grow organically and compete well globally.¹⁶

For example, certain countries may be receptive to the Islamic finance industry while others are not, thus, having rigid standard procedures for the certain transaction may deprive the industry of the adaptability it requires to survive in a non-receptive jurisdiction. An example is that countries based on civil law and common law would have different treatment of various Islamic finance products and uniform standards cannot apply to both.

In common law jurisdictions, there is a distinction between beneficial ownership and legal ownership, but civil law does not recognize the same. How this would cause problems become prominent from the example of sukuk issuance, where a Special Purpose Vehicle (SPV) is created to hold ownership of the underlying asset to protect becomes investors in case of bankruptcy of the originator in a common-law jurisdiction. Such a structure cannot be permitted in a civil law jurisdiction since there is no legal basis to create the same.¹⁷ Thus, having uniform standards to apply to both jurisdictions would create inherent difficulties, and even impossibilities in the case of some Islamic finance products which have to adapt according to the regulatory structure of the host countries, and standardization would be a barricade to this.

Incorporation of Standards into a Legal System

Another derivative of the same argument is that the standardization project cannot work in isolation. It must be supplemented with a reform agenda within the municipal law of the jurisdiction where it is applied, for it to be effective. However, such efforts are very rarely seen, since most countries that have adopted Islamic finance have civil or common law regimes whose legal infrastructure cannot adequately absorb and regulate the Islamic finance industry, and this leads to regulatory gaps even in countries that are ostensibly Shariah-based, like Saudi Arabia.¹⁸ Thus, the standardization effort must be accompanied by a considerable legal and regulatory reform in the countries of various legal traditions for it to be effective. To understand this, one could look at the example of UAE, where after the notorious Dana Gas sukuk

case, it was mandated that all Islamic banks must follow AAOIFI Shariah standards, but it was ineffectual since it was not accompanied by requisite legislation.¹⁹ Contrasting this is the case of Malaysia, where the standardization efforts have been corresponded by the state in the form of developing a specialized legal and regulatory system for Islamic finance, which has resulted in the standardization efforts reaping the desired result, at least within the Malaysian jurisdiction.²⁰

Moreover, there is a high degree of variance in terms of development of the industry in various jurisdictions, Malaysia and Bahrain for example have a well-developed industry, but countries like Indonesia and Brunei are still in the earlier stages of developing the market. Thus, implementation of uniform standards to both would cause imbalance and discrepancies within the market.²¹

Finally, another issue is that even if the standards are there, they have not been properly developed, and are also not updated and revised with the rapid development of the markets which sometimes discourages voluntary adoption as well.²²

Status of AAOIFI Standards in a Court of Law

The above represents the more conceptual and theoretical challenges that can stymie the path toward standardization. However, there are other more practical and specific challenges that standardization efforts have already, especially the efforts undertaken by AAOIFI, faced. The main issue that AAOIFI encountered is that, though many countries have adopted AAOIFI standards, this adoption is not on basis of strict enforceability but is only piecemeal and is stimulated by guidance purposes and not lawmaking. Unlike model law legislation, AAOIFI's standards take the form of recommendations addressed to its members, and this type of standardization can be referred to as the 'Lowest common denominator approach to standardization'.²³

This partial enforcement or adoption can lead to disputes, such as the one that occurred in the case of Blom Bank and the Investment Dar of Kuwait, where Blom Bank gave money for investment to Investment Dar, on basis of a fixed return and the full return of the invested amount at a future date. Investment Dar ended up losing the investment substantially, and Blom Bank filed for repayment of the original amount and the fixed return. In response, Investment Dar argued for non-Shariah compliance of the agreement and claimed that it was essentially an interest-based agreement. Although it was a case of Shariah arbitration by Investment Dar, the important point is that such an agreement is categorically proscribed under Standard Number 23 of AAOIFI, but due to partial adoption of the standard the dispute occurred.²⁴

Finally, several subsidiary challenges also undermine standardization efforts. These include the fragmentation of the markets on the basis of countries, currencies, legal and regulatory regimes, and framework, the divergence on the application of certain Shariah standards and also the validity and invalidity of certain transactions, etc.²⁵ They also include the different levels of development of the capital markets in different jurisdictions, and also

the fact that the industry is not old enough to be able to shoulder the process of standardization. This is because the jurisdictions which are considered to be the point of origin for the industry, and which have given it the required stimulus, do not even have a sophisticated conventional market, and thus no concomitant regulatory structure. They are already in the process of updating their archaic laws, but the poor regulatory structure prevalent in these countries does not portend well for a parallel industry which is much more complicated than the conventional industry.²⁶

Further on, if we take the example of sukuk, which is crucial for the development of Islamic capital market, one of the challenges is that the countries considered to be sukuk hubs often work in isolation and are detached from each other, and one of the reasons is disagreement on the principles comprising it. Hence, the sukuk structure permitted in Malaysia are seen with suspicion or are sometimes outrightly rejected by the GCC countries.²⁷ The cracks have widened further over a period of time, as now the difference in rulings between middle eastern countries are also becoming visible, and it can be expected that a transaction in UAE may not be accepted in Saudi Arabia.²⁸

Global Islamic Finance Standard-setting Bodies

In order to overcome the challenges to standardization, there is a crucial need for an international IF standard-setting body which should take up the task of standardization and harmonization. Following is an analysis of current global IF standard-setting bodies which are successfully operating in the global IF markets.

The need for an internationally recognized IF organization to lead the global IF industry into standardization has been significantly identified in literature.²⁹ This will serve two purposes, first, the IF industry will begin to harmonize. Second, the organization's position will be recognized as a leading and credible IF organization that will regulate the global IF industry in the long term. Presently, many organizations are working to standardize IF practices, below is an overview of the most prominent IF organizations.

IFSB comprises central banks of countries promoting IF. IFSB specifically undertakes to develop standards for 'risk management, capital adequacy, corporate governance [and] disclosures'.³⁰ IFSB was established in 2002, since its inception the board has drafted 36 guiding principles.³¹ These standards are specifically drafted to guide Islamic banking, capital market and insurance.³²

Islamic International Rating Agency (IIRA) is the only Islamic rating agency that provides a rating to facilitate all the stakeholders in the global Islamic financial industry.³³ Established in 2005, the agency seeks recognition from regulators and provides services to well-reputed IFIs like Islamic Development Bank (IDB).³⁴ IIRA identifies Shariah-compliance risk and also examines the '... investment or credit risk, providing an assessment of the risk profile of entities and instruments' to market participants.³⁵ The agency explores disclosure requirements to ensure standardized practices prevail in the industry.³⁶

IIFM is focused on standardization of Islamic capital and money market.³⁷ The organization's vision is 'Active and well-regulated trading and capital

flow across the full spectrum of Shari'ah-compliant financial instruments internationally' through the development of Islamic capital and money market.³⁸ There are numerous types of sukuk being issued every year globally. IIFM seeks to define the various types of sukuk. IFM is working over the standardization of this definition.

IFM has endorsed five significant sukuk issues that not only provide a standard format for issuing sukuk, but also introduce international standards for the application of Shariah in developing Shariah-compatible instruments for trading in secondary markets.³⁹

IICRA was established by the United Arab Emirates, Islamic Development Bank, and General Counsel of Islamic Banks and Financial Institutions.⁴⁰ The agreement among parties was signed in 2004 but it took three years for the center to begin operation in 2007. IICRA is working to introduce standards to resolve disputes in the IF industry by way of arbitration.⁴¹

AAOIFI was established in 1991.⁴² AAOIFI aims to standardize accounting, auditing, and governance practices in IF industry.⁴³ AAOIFI operates to promote '[s]tandardization and harmonization of international Islamic finance practices and financial reporting in accordance to Shari'ah'.⁴⁴ Since its inception AAOIFI has drafted 84 standards in accounting, auditing and governance practices in IF industry. Currently, AAOIFI is working to develop standards for *takaful* (Islamic insurance), *waqf* (Islamic endowments), and *zakat* (Islamic charity).⁴⁵

This author suggests that the IF industry needs a single well-reputed organization that can harmonize the standards introduced by AAOIFI, IFSB, IIFM, IIRA, and IICRCA.⁴⁶ This will structure the IF industry on a strong foundation. Ideally, one of the existing organizations should take up this responsibility. As discussed above, many organizations are working to standardize the global IF industry. Some form part of public bodies and others are privately run organizations.

Among them, AAOIFI is the most influential private body in global IF industry.⁴⁷ AAOIFI is considered to be responsible '... to lead a collective mandate for the industry to bring to bear an effective lobby to the regulatory authorities ... [to bring about] change specific to Islamic finance but also for universal benefit'.⁴⁸

AAOIFI as a Global Standard-setting Body Addressing Challenges to Standardization

AAOIFI's vision is '[t]o provide IF markets with standards and guidelines that can support the growth of the industry'.⁴⁹ The organization's mission is the '[s]tandardization and harmonization of international Islamic finance practices and financial reporting in accordance to Shariah'.⁵⁰ Currently AAOIFI is working on standardization of accounting, auditing, governance, ethics and Shariah related practices in the IFIs.

AAOIFI's current position in the global IF industry is further strengthened by research conducted to evaluate IFIs' compliance with AAOIF's standards.

For the purpose of this study AAOIFI's accounting standards were tested. This is independent research that shows a high level of compliance with AAOIFI's accounting guidelines. It is noteworthy that the AAOIFI's accounting standards which address disclosure issues are ranked at '... a high level of compliance'.⁵¹ According to the research on the benefits of IFIs' compliance with AAOIFI accounting standards '... adopting or complying with the AAOIFI accounting standards can attract more investments, make financial statements more practical as well as relevant and enhances comparability'.⁵² This reflects market participants' needs and regard to long term credible stability.

AAOIFI's credibility is widely recognized to perform a regulatory function in the global IF industry. AAOIFI standards are the most largely recognized standards among IFIs.⁵³ The fact is that '[t]he acceptability and understanding of the role of the Islamic accounting standards (AAOIFI) can be of high significance for policy implications, regulators and standard setters'.⁵⁴ It is important to note that AAOIFI standards are complied with voluntarily and this adds to the credibility of the organization.⁵⁵

AAOIFI's Shariah board chairman Mufti Taqi Usmani's fatwa over *sukuk* had a far-reaching impact on the *sukuk* market.⁵⁶ Under this ruling, Mufti Usmani declared around 85% of some specific types of *sukuk* in the world to be a non-Shariah complaint. Consequently, AAOIFI revised its *sukuk* guidelines to prohibit to guarantee interest-free loans to purchasers and 'repurchase agreements in cases of missed payments or default'.⁵⁷ AAOIFI's confirmation of Usmani's fatwa brought a decline in the issuance of controversial *sukuk*.⁵⁸ This decline proved the regulatory authority the AAOIFI has acquired among other IF organizations.

Thus, the need for organizations to regulate the global IF industry cannot be overemphasized. Being the oldest organization in the industry, AAOIFI has acquired international recognition among global IF market participants. Moreover, AAOIFI's services bring it into a leading position in IF industry. This position is very well understood and recognized among market participants.⁵⁹ Therefore, this author suggests AAOIFI expressly reflect on its position and accept the responsibility which arises thereof.

AAOIFI aims to harmonize and unify the IF industry practices through standardization. This is evident from the fact that the organization has produced standards on accounting, auditing, governance, and Shariah. AAOIFI's emphasis on ethical principles of IF reflects in its 'Code of Ethics' for IFIs.⁶⁰ AAOIFI aims to ensure the correct interpretation of its standards. In this regard the organization plans

[t]o approach the concerned regulatory bodies, Islamic financial institutions, other financial institutions that offer Islamic financial services, and accounting and auditing firms in order to implement the standards, as well as the statements and guidelines that are published by AAOIFI.

Professional development programs offered by the organization are directed toward producing professionals well versed in Islamic accounting and

auditing; for instance, the Certified Shari'a Adviser and Auditor (CSAA), and Certified Islamic Professional Accountant (CIPA).⁶¹ Moreover, the Contract Compliance Certification Program aims to certify IFIs for Shariah compliance in their dealings. This, in turn, facilitates the IF institutions in marketing their products and assures investors to boost their confidence in their investment.⁶²

AAOIFI's Shariah board provides opinions to IFIs' SSBs over their queries relevant to Shariah compliance.⁶³ The organization's Shariah board comprises 20 members who have prominent standings and international credibility. These religious scholars are selected from the AAOIFI member IFIs. The Board of Trustees is responsible to appoint the Shariah board members.⁶⁴ AAOIFI Shariah board is constantly working over developing innovative Islamic financing products, and keeping its entire standard under review to keep pace with the innovations in the market.⁶⁵

SSBs generally encounter the issues of conflict of laws, conflict of interest among SSBs and Board of Directors (BoD), implementation of the board's advice and SSB's place/position in relation to BoD regarding the management of the institutions.⁶⁶ AAOIFI Governance standards authorize the shareholders to appoint the SSB member in a Shariah complaint entity to overcome the conflict of interest problem.⁶⁷ According to AAOIFI's standards every IFI will have at least three members on their SSB.⁶⁸ AAOIFI provides guidelines for Shariah review to be issued by every IFI.⁶⁹

While anticipating needs for Shariah scholars to understand the conventional finance, AAOIFI guidelines allow IF institutions to appoint a non-scholar as a member of their SSB.⁷⁰ AAOIFI standards provide for the enforceability of Shariah board's rulings, i.e., 'The fatwas, and rulings of the Shari'a supervisory board shall be binding on the Islamic financial institution'.⁷¹

The objective of standardization is to achieve an appropriate regulatory framework for the global IF industry. Furthermore, it is equally important that the regulatory framework, which is an outcome of standardization, must be enforced according to the objectives of standardization.

Standardization and Financial Services Industry

In general, the English courts are facing considerable challenges regarding the regulation of the financial services market. The financial services industry lacks regulations resulting in controversial judgments in the event of disputes among parties. The current situation in the financial services industry reveals the IF is not the only industry that encounters problems in English court. OTC derivative markets face a similar situation on account of complex product structure.⁷²

OTC derivative and IF industry are examples of the international financial industry which do not possess a well-defined regulatory framework on account of the complexity of product as well as lack of consensus among

participants.⁷³ However, the global OTC derivative market has overcome the problem of consensus and is therefore well-regulated sector of the international financial industry. This has been done through standardization, an effective regulatory framework, and a functional amicus program that ISDA has been successfully able to provide to the global OTC derivatives market. A brief analysis of these efforts by ISDA would allow us to chart a viable comparison of how AAOIFI can step up to provide similar services to the global IF industry.

AAOIFI has been working toward having standard documentation, but the problem arises from a lack of enforcement powers, which lead to partial or piecemeal adoption only. To address challenges to standardization, the AAOIFI would have to take charge, working groups would have to be made comprising of scholars from across the globe who would then devise a unanimous mechanism in consultation with the market.

International Swaps and Derivative Association (ISDA)

OTC derivative market is led by ISDA. By virtue of its membership, ISDA is the largest international financial trade association. The association is joined by international financial market players as well as professional services providing firms.⁷⁴

In 1980, Salomon Brothers bank made a group of interested parties in derivatives in New York. ISDA was formed by the group after consultation with a US law firm in 1985. The objective of the association was to standardize the contracts and documentations prevailing in the derivatives market.⁷⁵ However it has been recognized that the process for amplification of key norms of the ISDA Master Agreement and regulatory regime more generally put ISDA's activities somewhat beyond the mere setting of technical standards. In the case of the International Standards Organisation (ISO) and numerous more specialized bodies across a variety of technical and professional areas of activity, standards are set for others to use as they see fit. ISDA's involvement in the implementation of key norms of the Master Agreement goes beyond this.⁷⁶

Initially, ISDA drafted definitions for the derivative products which were recognized by the group members. At the initial stages, there were differences of opinion among members in the adoption of the structures and forms of doing business. Over time the differences of opinion have been overcome and currently, all the members work toward the successful operation of the derivative markets.⁷⁷

ISDA's leading membership comprises of financial institutions dealing with swaps and derivatives and industrial companies having sophisticated financial units. Overall membership includes law firms, accounting firms, derivative consultancy firms, and various types of derivative buyers.⁷⁸ ISDA's presence in prominent international financial services centers ensures the association preserves global character. ISDA has offices in all the international financial

centers such as London, Washington DC, Tokyo, Singapore, and Brussels. These locations are hubs of prominent financial institutions and therefore connect them to ISDA.⁷⁹

The association largely deals with three major issues which ensure legal certainty within the derivative sector. Standardization through Master agreement, a regulatory framework through Model Netting Act (MNA) and Model Netting Law (MNL) and amicus program.⁸⁰

Contribution of ISDA to the Global Derivatives Market

ISDA, through its Master agreement, standardized the OTC derivatives market. Standardization of the OTC derivatives market developed into the regulatory framework through ISDA's MNA and MNL. Finally, through its amicus, brief service ISDA now ensures that the standards are interpreted in courts of law as intended by the ISDA.

ISDA Master Agreement led to the ultimate standardization of OTC derivatives market transactions. The innovation in product development combined with technology trading is facilitated by regulatory framework supportive of '... the swift migration of product and technology innovations between both segments'.⁸¹ Thus, the derivatives market has achieved price efficiency as well as risk mechanism which makes the trading highly attractive for investment.⁸²

In order to ensure that the current regulatory framework for derivatives and the regulations enshrined therein should stabilize the market instead of hindering the market's growth, ISDA provides legal and documentation services. An important component of this service is ISDA's amicus brief service.

Let us first look at these specific efforts in brief detail, and then move to establish that the complicated nature of IF laws are not unusual in international finance law. Similar problems have been effectively settled in the past regarding securities and at present, the ISDA is still managing these problems well.⁸³ AAOIFI, therefore, has a model in ISDA to promote standardization for current IF practices. ISDA will also serve as a model for AAOIFI to develop a regulatory framework and provide amicus brief service for the implementation and enforcement of standardized IF practices in the future.

Standardization through a Master Agreement

ISDA Master Agreement was drafted in 1992, the goal was to standardize and document the market practices. The agreement defines transactions as they operate between the parties and also the resulting relationship between the parties. The agreement underlies numerous derivative products. This is utilized by ISDA members to ensure legal certainty and credit relationship among the participants.⁸⁴

The master agreement is drafted to provide for termination procedure, netting to facilitate termination, and address legal issues throughout the transactions between the counterparties.⁸⁵ The master agreement also provides for tax arrangements to be settled within the structure of the transaction. Tax, payable outside the structure of a product, ‘... would clearly distort the pricing structure of the derivative product’.⁸⁶ This ensures the counterparties are aware of their tax obligations in their jurisdictions.⁸⁷

Regulatory Framework

The regulatory framework is promoted by way of rule-making and effective communication. Following is an explanation of the rule-making and effective communication managed by ISDA to provide an appropriate regulatory framework to the global derivatives market.

Rulemaking is performed by committees. These committees can be categorized into two types. There are regional interest focused committees that look after market-related issues in Asia-Pacific, Canada, Europe, Japan, and Latin America. There is another type of committee that deals with technical issues like:

Accounting, Collateral (with three sub-groups), Credit Derivatives Market Practice, Derivative Users Committee, Documentation, Energy, Commodities and Developing Products Committee, Equity Derivatives, Operation (with five working groups), Regulatory (which lists 22 formal responses to US regulatory issues), Risk Management, Tax (with five working groups), and Trading Practice (four main issues currently under review).⁸⁸

MNA is an example of ISDA’s rule-making service to global derivatives markets. It was first drafted in 1996. The Act has been updated in 2002 and finally, in 2006.⁸⁹ The Act is drafted to facilitate common as well as civil law jurisdiction.⁹⁰ The Act brings legal certainty into the global derivatives markets. Moreover, ISDA provides guidelines that identify the areas of local laws which can be affected by the enactment of MNA. These include insolvency laws, gaming laws, and contract laws.⁹¹

MNA provides for ‘close-out netting upon the occurrence of any termination event or event of default’ before or during the procedure of insolvency.⁹² MNA can be adopted to address specific issues identified in a jurisdiction. It is equally useful to adopt the model to regulate ‘the closeout netting process in its various phrases’.⁹³

MNA reduces the systemic risk associated with close-out netting as systemic risk reduction will be beneficial for every stakeholder, i.e., ‘... corporations, insurance, companies, special purpose vehicles used for structured financings, governmental authorities, charitable organizations hedging in the market, private individuals, and so on’.⁹⁴

Amicus Brief

Legal and documentation services provided by ISDA to the global derivatives market include the provision of opinions, setting up determination committees, drafting standard terms, and acting as *amicus curiae*.

ISDA's service as *amicus curiae* is an innovative step toward ensuring that the implementation and enforcement of its standards do not deviate from its original objectives. 'ISDA's *amicus* program continues to actively monitor litigations that may impact the OTC derivatives market or market participants...'.⁹⁵ In other words, under its legal and documentation services, ISDA submits *amicus* brief to courts and, where necessary, the association obtains the court's permission to sit as an expert during the pleadings. Through the *amicus* brief and sitting as *amicus curiae*, ISDA ensures legal stability in the global derivatives market.

Financial Law Reform

ISDA provides the 'Financial Law Reform' under its public policy services. The Financial Law Reform led to the regulatory changes in the form of the EU Collateral Directive in June 2002 (Directive 2002/47/EC of 6 June 2002 on financial collateral arrangement) in the EU.⁹⁶ The EU Collateral directive addresses many issues relevant to collateral which caused uncertainty and unpredictability regarding the collateral protection available in the derivatives market.⁹⁷

Recommendations

ISDA mechanism is an appropriate example of standardization, i.e., provision of regulatory framework through ISDA Master Agreement and enforcement of ISDA Master Agreement through ISDA's legal documentation service. This author suggests the possibilities of AAOIFI leading the global IF industry to standardization by taking a similar approach. Master Agreement will lead to regulating the global IF industry. Global Shariah Supervisory board is crucial to provide the *amicus* program to global IF industry participants. International Islamic finance law will ensure AAOIFI standards are implemented and enacted in the industry.

Adoption of the AAOIFI Standards

AAOIFI Shariah, accounting, auditing, and governance standards are voluntarily adopted among the global IF market participants. AAOIFI standards have been enacted into the legal system of Bahrain, Pakistan, Malaysia, Sudan, and Syria.⁹⁸ Moreover in numerous jurisdictions the Shariah standards are adopted as guidelines on a voluntary basis.⁹⁹ It is suggested that although AAOIFI aims and also attempts to promote its standards, yet there is a need to

establish an appropriate mechanism to ensure all the standards take the status of mandatory regulatory requirement in every member state.

Master Agreement for Islamic Finance Instruments

Master agreements standardize systemic risk, facilitate repetition of high-volume complex transactions and overcome legal uncertainty, it is therefore suggested that AAOIFI works to develop a master agreement for the global IF transactions. ISDA Master Agreement can be defined as, [A] ‘boilerplate’ contract containing standard legal obligations arising out of the transactional relationship. Provisions include, inter alia, general day-to-day obligations owed by each party to the transaction, as well as provisions addressing events of default, termination events, immunity issues, basic representations, and so forth.¹⁰⁰

The Master Agreement will ultimately standardize the industry by providing for legal provisions applicable to all transactions particularly *mudarabah*, *musharakah*, *murabahah*, and *sukuk* in the global IF industry as has been achieved by the ISDA Master Agreement.

Currently, AAOIFI standards extensively address the accounting-related treatment of IF instruments. However, the drafting of the master agreement will include all the relevant standards in the agreement. The master agreement will essentially include provisions relevant to the choice of law, mode of dispute resolution, i.e., litigation or arbitration, templates for *musharakah*, *mudarabah*, *murabahah*, and *sukuk* agreements, provisions relevant to capital guarantees, and ownership rights in underlying assets in case of *sukuk* transaction. The master agreement will also address all the controversial practices of IFIs which are leading the IF industry into formal compliance.

With regard to a master agreement, AAOIFI will encounter a similar situation as was evident in the initial years of the formation of ISDA.¹⁰¹ Most IFIs have drafted their documentation and their preference is to follow their specific course of doing business.¹⁰² This happened in the early days of ISDA when every member institution wanted their method of doing business to be followed. Nonetheless, ISDA was able to overcome the differences and succeeded in drafting uniform documentation with consensus.¹⁰³ There is no doubt with AAOIFI at the forefront IF industry participants will overcome the differences and resolve all the controversial matters.

Global Shariah Supervisory Board

Consensus issues over Shariah-related matters can be overcome through setting up a global Shariah supervisory board. This board will comprise representative scholars from among the AAOIFI members. AAOIFI currently has the Shariah standards board which can be upgraded into the global Shariah supervisory board.

In addition, to resolve the matters of consensus, the global Shariah supervisory board will provide the amicus program for the global IF industry. It is suggested that AAOIFI provides for the amicus program to ensure enforcement of its potential standards and regulatory framework.

The global Shariah supervisory board will be run by Shariah Scholars with multiple qualifications which will essentially include Shariah and conventional qualifications. Shariah scholars specializing in finance and law will be able to effectively write the amicus brief and represent AAOIFI as amicus curiae in courts of law. The need for the multiple qualifications for Shariah scholars, in general, is extensively explored in a later chapter.

International Islamic Finance Law Reforms

'It is apparent that many of the critical factors influencing the growth of the Islamic capital markets are firmly within the field of law'.¹⁰⁴ Therefore, it is suggested that the Islamic transnational law which has been mentioned in [chapter 3](#) should be reformed. The reform will address key issues hindering the IF progress in the world as is the case with financial law reforms provided by ISDA. Particularly the choice of law and Shariah arbitration are causing legal uncertainty in the global IF market. This author suggests international Islamic finance law will address both issues.

The international Islamic finance law regime will be comprised of the laws or 'model acts' drafted for the four areas of Islamic financial services, i.e., banking, securities, pension, and insurance.¹⁰⁵ An example of this lawmaking is the ISDA's MNA. This rule-making will particularly address the choice of law and Shariah arbitration in the global IF industry.

Generally, the risk assessment mechanism addresses the 'certainty, predictability and transparency' that exists with respect 'to each element of the transaction'.¹⁰⁶ Legal risk, therefore, can be mitigated if contractual enforceability is predictable and certain. This is possible through inserting proper governing law clauses in the transactions.¹⁰⁷

These matters are a primary focus in examining enforceability issues: whether, when, and under what circumstances will the principles and precepts of the Shariah be legally enforced in any given circumstance, with respect to any given structure, product, or transaction in any given jurisdiction.¹⁰⁸

Choice of governing law in the contract will largely define how Shariah is incorporated into the transaction. If explicit reference to Shariah is made, the enforceability of the contract according to Shariah is highly unlikely as evident in IF case law in the UK.¹⁰⁹ However, if Shariah principles are incorporated into the contract without express reference to Shariah law, the possibility of enforcement will be higher. This can be achieved by making sure that the transactions are globally standardized by AAOIFI. However, until an appropriate level of standardization is achieved, AAOIFI can develop the Islamic finance law regime to promote research on current IF transactions.

The international Islamic finance law reform may be acceptable under Rome Convention if structured into a well-standardized code; specifically, if the regime specifies various Shariah principles applicable to four sectors of the financial services industry.¹¹⁰

Applicable legal principles, as affirmed in this case, would seem to allow express incorporation of the Shariah into a contract governed by the national law of a secular Jurisdiction if the incorporation is sufficiently specific and is structured as the incorporation of contractual terms rather than as a general governing law provision.¹¹¹

AAOIFI can establish a committee to examine current market practices and suggest reforms. These reforms then can be drafted into regulations into the member states' regulatory framework as ISDA's suggestions are enacted into EU Collateral Directive, i.e., Directive 2002/47/EC.¹¹²

Standardization and Irish Regulators

Until AAOIFI takes up the task of standardization and harmonization of IF industry practices, Irish regulators can become part of AAOIFI as a member of the organization. AAOIFI has five categories of membership which include founding members, associate members, members representing regulatory and supervisory authorities, observer members, and supporting members.

Ireland can join AAOIFI as a common member under the three of the latter categories, including as a member representing regulatory and supervisory authorities, observer member, and supporting member. To join under the first category of the three listed in the preceding sentence, Ireland must setup a regulatory authority that deals exclusively with the Islamic financial industry, and this would allow Ireland to not only participate but also vote in the General assembly meetings of the AAOIFI.

If not, Ireland can still simply join as an observer member or a supporting member, which would earn it a right to participate in the General assembly meetings, but not vote. However, again, even such participating would allow it to receive a lot of technical knowledge about the developments in the industry, which would help sufficiently to set local regulatory paradigms in accordance with those developments.

Conclusion

Undoubtedly, standardization of the IF practices will resolve the problems of legal uncertainty and Shariah arbitrage. However, the route to standardization is mired with several hurdles and challenges. These include the huge diversity that characterizes Islamic fiqh which materializes in contradictory rulings coming from different jurisdictions and schools of thoughts on similar issues, absolute reliance of scholars on classical teachings while choosing to remain aloof from the market pressures and demands, hurdles in transplanting uniform rules across various jurisdiction which have very different

socio-politico-economic dynamics and currents, lack of will of host countries to contribute to the standardization project, the unequal growth of the Islamic finance industry in different jurisdictions where some jurisdictions are only in the early stages of growth like Indonesia and Brunei while others have faced astronomical levels of growth like Malaysia and Bahrain, and phenomenon like fatwa shopping which insinuate toward different vested interests for whom standardization would be anathema.

Despite these challenges, significant headways toward standardization of the industry could be made, if major standard-setting bodies work together, with AAOIFI preferably taking the lead, to come up with standards that are agreeable to all stakeholders. ISDA's regulation of the OTC derivatives industry which is an industry as complex as the IF industry provides a blueprint. Standard-setting bodies should follow ISDA, to come up with a master agreement similar to that introduced by ISDA. This master agreement should have some boilerplate clauses, which shall act as common denominators to all Islamic finance agreements and transactions. Secondly, there is a need for the establishment of a Global Shariah Supervisory Board which shall have representation of all stakeholders of the industry and shall act as a trans-national body accepted by all jurisdictions as the final arbiter in all disputes related to Islamic finance.

Lastly, international Islamic finance law should be reformed to ensure that fundamental Shariah precepts are applied across jurisdictions as a uniform code. This would allow Islamic finance law to become a coherent body of law applicable by English courts under the Rome convention, curtail phenomena such as Shariah arbitrage and fatwa shopping, and create an institutional memory for the industry. Ireland can play a vital role in making the above proposals a possibility and can attune itself to the IF Industry by becoming part of the regulatory bodies, including AAOIFI and IFSB. Such a relationship would encourage a two-way adaptation, both by the IF Industry and Ireland as its host, which would pave the way for Ireland to become the logical destination for the IF Industry in the wake of Brexit.

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3. M. Fahim Khan, 'Setting Standards for *Shariah* Application in the Islamic Financial Industry' (2007) 49 (3) *Thunderbird International Business Review* 285–307, 293.
'Failing to unify the fiqh opinions, the need was felt to at least codify the fiqh opinion so as to standardize the difference and avoid any confusion that may arise in the application of Shariah in any place at any point in time'.
4. Explained in [Chapter 3](#).
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5 Islamic Finance in International Commercial Arbitration and International Investment Arbitration

Arbitration is well-established within the Islamic tradition if the practices of the prophet and his companions are any indicator. However, for an arbitration award to be valid under Islamic law, it must be firmly rooted within Shariah precepts. In today's world, International Commercial Arbitration (ICA) has been on the rise as a means to amicably resolve commercial disputes. There is both the use of ad-hoc arbitration where parties can adopt any set of rules such as UNCITRAL to govern the process and that of institutional arbitration where a recognized institute assumes the responsibility to carry out arbitration. However, commercial arbitration in reference to Islamic arbitration reveals certain disconnects. Islamic arbitration awards may not be enforced in secular countries and vice versa due to several public policy-related concerns, on both sides of the aisle. Thus, there is a need for collaboration between ICA organizations and Islamic countries, to achieve unison and harmony in arbitration principles and to resolve this conundrum. Substantial efforts in this direction have been made by several Islamic jurisdictions, which have attempted to incorporate arbitration within their legal frameworks. However, for these efforts to come to fruition, they must be complemented with the principles and practices of ICA. Additionally, in order to promote the Islamic capital market via sukuk, international investment arbitration (IIA) is examined. IIA provides protection to foreign investors in state-investor disputes. International investment agreements, both Bilateral Investment Treaties (BITs) and Multi-lateral Investment Treaties (MITs) almost always provide an arbitration clause. Islamic countries should work with organizations like International Centre for Settlement of Investment Disputes (ICSID) to incorporate IIA within their framework as well.

Islamic Arbitration

Arbitration as a tool of a solution finds its roots in a pre-Islamic era, and some of these practices were transformed into Islamic concepts of arbitration. The first treaty entered into by Muslims under the leadership of the Holy Prophet in 622 AD, the Treaty of Madina, had an arbitration clause incorporated in it as a method to resolve any disputes arising out of the treaty. Similarly, the

dispute with the Banu Qurayza tribe was resolved by the Holy Prophet by resorting to arbitration.¹ The Holy Prophet did not only advise his companions to adopt arbitration as the means to resolve disputes but also accepted the decisions of the arbitrators.²

Companions of the Holy Prophet continued promoting arbitration to amicably resolve the disputes. Agreement between Hazrat Ali and Hazrat Ameer Muawiyah for the caliphate is a prominent example of recognition of arbitration as a dispute resolution mechanism under Islamic law.³ All four Sunni schools of thought accept arbitration as a legitimate source to resolve disputes. The binding nature of arbitration has been established by the majority including Majella.⁴

Enforceability of Foreign Arbitral Award

Public policy in the muslim states is recognized in accordance with the local laws which are evolved from the principles of Shariah. For instance, public policy in Saudi Arabia is determined in the light of Shariah⁵ and the Saudi courts review the merits of the arbitral to ensure compliance with the Shariah.⁶ The courts in Islamic states have not enforced arbitral awards because they go against the canons of Islamic laws.⁷ Islamic public policy can be divided into two sets: procedural and substantial. The procedural principles emerge from the different rules of Islamic judicial law and are not explicitly prescribed in the Quran or Sunnah.

Award in Conflict with Islamic Substantive Law

The substantive Islamic public policy principles are the prohibition of riba and gharar and they are derived from the Holy Quran and Sunnah.⁸ Prohibition of riba is strictly enforced in countries like Saudi Arabia, Qatar, Oman, Yemen, where Islamic laws are present; an arbitral award which provides interest as compensation for damages can be struck down for being against public policy.⁹ Similarly, 'the question of the existence of a future dispute involves speculation and uncertainty',¹⁰ i.e., gharar is also prohibited in Islam. This is because Shariah prohibits any agreement to arbitrate any future issue or dispute which is not yet in existence.

Arbitration rules of World Intellectual Property Organization (WIPO), London Court of International Arbitration (LCIA), American Arbitration Association (AAA), and United Nations Conventions on Contracts for the International Sale of Goods (UNCCISG) entitle parties to deal in interest-based transactions, however, the domestic law of many muslim countries ban interest-based transactions.¹¹ Moreover, speculation and uncertainty (gharar) are also prohibited under Shariah. Gharar exists in an agreement that contains a speculative clause which is dependent on the occurrence of any uncertain events.¹² A prominent example of this is the insurance contracts, which is commonly used in the conventional finance system.¹³

Award in Conflict with Islamic Arbitration Procedural Law

Arbitrator's capacity is affected by the criteria Islamic laws provide for a person to be eligible to arbitrate. In this regard, two issues have gained enormous focus. First, is the incapacity of a female to become an arbitrator.¹⁴ Second, only a Muslim can arbitrate under Islamic laws. In other words, a Muslim male will be an arbitrator to resolve Islamic finance (IF) disputes.¹⁵

Some jurists argue that under Shariah law only a male Muslim can be appointed as arbitrator since women cannot be appointed as judges, so they should not be appointed as arbitrators too. However, in history, there are instances when women were appointed as judges.¹⁶ Therefore this belief lacks substantial credibility. Similarly, the restriction that only Muslims can be appointed as arbitrators stem from the classical understanding that a dispute between two muslims can only be judged by a muslim by applying the Shariah.¹⁷ However, there is a difference of opinion between scholars on this as well, as those who oppose this restriction point out that there is no express prohibition of non-muslim arbitrators in the primary sources of the Shariah.¹⁸ Although, countries like Oman and Saudi Arabia strictly apply these restrictions in their jurisdictions, UAE, does not make such requirement.¹⁹

International Commercial Arbitration

ICA law can be divided into two broad categories: Ad-hoc rules and institutional rules.²⁰ The parties to a dispute who choose to use ad-hoc arbitration can adopt any set of procedural rules such as the UNCITRAL to govern their arbitration. Since no institution is involved in overseeing the arbitration proceedings, the parties have complete autonomy over the arbitration proceedings. In contrast to ad-hoc arbitration, institutional arbitration is one in which an institution has assumed the responsibility of arbitration. The most prominent institutional arbitration centers are the International Chamber of Commerce and the London Court of International Arbitration. International arbitration provides a certain set of rules to assist arbitration proceedings.²¹

The arbitral institutes have the primary role to enable and provide support to the arbitrators who are appointed by the parties; the institute itself does not arbitrate the dispute. Providing support to the arbitrators could include resolving any challenges to arbitrators, providing a designation for arbitration and schedule for the arbitration.²² Lastly, there are also subject-specific arbitration institutes, such as ICSID which offers a platform for arbitration of investment disputes.²³

Challenges

The arbitral awards rendered under various institutions as well as rules like UNCITRAL, explicitly state that the parties to the arbitration shall recognize that the arbitral awards are binding and enforceable. Judicial review is

available to the parties against the enforcement of an arbitral award, but the judicial review is available on procedural grounds, like the appointment of an arbitrator, or the power of the arbitrator to adjudicate the issues. An ICA award cannot be reviewed. Most recognition and enforcement of an arbitration award is unhindered except for public policy concerns under the New York Convention and UNCITRAL. Enforcement of an arbitral award can be refused when the award is in conflict with the public policy of enforcing state. The most commonly applied public policy relates to the national legal system of a state. For instance, in the US, the equal protection clause forms an essential part of its public policy.

Public policy

In *Jivraj v Hashwani*, the court conducted a review of the arbitration agreement to examine if the agreement was in conflict with the national law of the country. Mr. Jivraj entered into a joint venture agreement with Mr. Hashwani in 1981. The agreement contained a clause that any dispute arising out of the agreement shall be decided through arbitration and the arbitration panel shall consist of three people who should belong to the Ismaili community. Jivraj and Hashwani also belong to the Ismaili community.²⁴ A dispute arose between the parties and Hashwani objected to the arbitration clause which required the arbitrator to be a person from the Ismaili community. He contended that the clause for three Ismaili arbitrators was violative of the UK Employment Equality (Religion or Belief) Regulations 2003 (SI 2003/1660) ('the Regulations'). The issue was whether the requirement that only Ismaili community members were eligible to act as arbitrators violated the Regulation because their requirement promoted discrimination on the basis of religion.²⁵

Article 1 of the directive under which the regulations were made, stated that the discrimination should be combated on the grounds of religion²⁶ Regulation 2(3) which defines 'employment' as 'employment under a contract of service or of apprenticeship or a contract personally to do any work'.²⁷ Thus, keeping in view these rules, the tribunal found that the role of an arbitrator under the agreement did not fall in the definition of the employment as provided by the regulations. The tribunal made the distinction between 'employment' and 'independent service providers of services who are not in the relationship of subordination to whom they are offering the services'.²⁸ The role of the arbitrator under the agreement between the parties fall under the latter because although they are providing personal services to the parties which they cannot delegate, but at the same time they are not in subordination to the parties because they do not perform those services or get their fees under the direction of the parties.²⁹

Furthermore, the tribunal also noted that even though if the arbitrator fulfilled the classification of employment as defined in the regulations, the parties had the autonomy to choose Ismaili as their arbitrators. Applying

Regulation 7(3), the court observed that when the employer has an ethos based on certain religion-specific and it is sufficient for them to employ a person of the specific religion particularly when it is a 'genuine occupational requirement of the job'.³⁰ Thus, the arbitration clause did not violate the UK's national law and therefore, exceptions made under public policy concern were not applicable.

There are instances where national laws have broad implications for international laws. For instance, the Equal Protection Clause of the US constitution. Article V(1)(d) of the NY Convention provides an exception to the enforcement of the arbitral award on the ground that the law used during the arbitral proceedings was not in accordance with the agreement of the parties.³¹ This will be problematic for an award in which Islamic law was applicable. On account of multiple interpretations of Islamic law, one of the parties can object that the interpretation or version of Islamic law applied by the arbitrator is not in line with the law the parties intended to choose. The US court will hold such award invalid on the ground that the arbitral version of Islamic law was not the one chosen by the parties and hence not in accordance with the agreement of the parties.

Under the Equal Protection clause, discrimination based on religion, and gender is unacceptable. Application of Islamic principles such as a person qualified to be a judge is qualified to be an arbitrator, which for some schools of thought means that non-muslims and women cannot serve as arbitrators,³² will render an award unenforceable in the US.

The application of such rules will be violative of the Equal Protection Clause in the United States.³³ Article V(1)(B) requires an arbitrator to ensure parties should get equal opportunities to present their case and all the material witnesses. If a material witness testimony is not accepted under Islamic laws because a witness has any sort of interest in it, then this will conflict with Article V(I)(b), because the arbitrator has not allowed the party any material witness and in effect denied the party the opportunity to present their case.³⁴ Similarly, if the parties chose Islamic law and the arbitrator applies the interpretation which holds a woman's testimony to be equal to half of a man's testimony in financial disputes,³⁵ the United States court would constitute it as a violation of Equal Protection clause, and enforcement and recognition of this arbitral award would be against U.S. public policy.

Enforcement of an arbitral award remains a challenge regardless of secular or Islamic state. Non-compliance with substantive principles of Islamic finance such as a prohibition on interest will always render enforcement of an arbitral award uncertain in an Islamic state. In such cases, the Islamic state would be inclined to refuse enforcement of an arbitral award on state public policy. Similarly, in secular states like the US, an arbitral award based on religious laws such as Islamic laws, enforcement of such award will be subject to Equal Protection clause.

Therefore, this author makes two suggestions to overcome the public policy concerns. First, there is a need to promote delocalized arbitration.

Second, a collaboration between Muslim and secular arbitration institutions. Both of these suggestions are discussed below.

Recommendations

Collaboration between ICA Organizations and Islamic Arbitration Centers

There is a lack of consensus on specific Islamic rules regarding arbitration within the context of resolving modern international commercial disputes.³⁶ The current practice of the Islamic arbitration centers has been focused to harmonize the procedures and rules of Islamic finance arbitration with the international standards like UNCITRAL rules and Model law. For instance, Saudi Arabia issued the Saudi Arbitration Law 2012, which substituted the Saudi Arbitration Law 1983, intending to make the arbitration proceedings Shariah-compliant. Unlike the Arbitration Law 1983, which allowed the Saudi courts authority to approve enforcement of foreign judgments and arbitral awards, the Arbitration Law 2012 abandoned such authority and created a forum within which judgments and awards can be enforced without the Saudi court's approval.³⁷ At the same time, the newly enacted law is also consistent with the UNCITRAL Model Law.³⁸ Currently, the Board of Grievances has the jurisdiction to hear arbitration matters, enforce foreign judgments, and arbitral awards.³⁹

In Malaysia, the cases of Islamic banking at first were decided under classical common law, which emphasized the common law approach, instead of Shariah compliance.⁴⁰ In *Arab-Malaysia v Taman Ihsan Jaya & Onor* (2009), the appeals court of Malaysia overturned the decision of the High Court and declared the contract of sale void on the ground of non-compliance with Shariah. The appeals court believed that Shariah principles were to be decided by judges who were experts in Islamic law.⁴¹ This led to the formation of the Shariah Advisory Council in Malaysia.

Malaysia enacted the Central Bank of Malaysia Act No. 701 in 2009 which established the central bank Shariah Advisory Council and made it mandatory that the arbitration tribunals shall refer to the SAC before passing any award concerning Shariah matters.⁴² Moreover, the Kuala Lumpur Regional Centre of Arbitration (renamed in 2018 as Asian International Arbitration Centre (AIAC)) adopted the arbitration rules for Islamic arbitration in 2012 called i-Arbitration rules. The law grants autonomy to the parties to choose their applicable laws as they wish. Shariah related issues are sent to Shariah experts or advisory council as agreed between the parties.⁴³ The parties after delivery of the report by the Shariah expert can question the expert.⁴⁴ According to Article 29(5) of the i-Arbitration rules; the expert after the delivery of the report can be heard at a hearing where the parties shall have the opportunity to be present and interrogate the expert. The i-Arbitration rules can be used for any dispute arising out of an

agreement that is premised on the principles of Shariah. The Rules of 2012 are based on the UNCITRAL Rules 2010.⁴⁵

Furthermore, Indonesia established a specialized tribunal called Basyarnas/National Shariah Arbitration Body which shall hear IF disputes in Indonesia.⁴⁶ The National Shariah Arbitration Body or Basyarnas was setup to hear disputes related to IF. The disputes are resolved through the mix of both civil and Shariah laws.⁴⁷

Moreover, the International Islamic Centre for Reconciliation and Arbitration (IICRA), established in 2004 in UAE, makes arrangements (including reconciliation, arbitration, and appointment of an arbitrator) to settle any commercial or financial disputes related to Shariah.⁴⁸ The IICRA has also issued arbitration and reconciliation procedures, derived from UNCITRAL arbitration rules, allowing parties the autonomy to choose arbitration law and process.⁴⁹ The arbitration rules of IICRA give freedom to the parties to choose any law governing a contract but the arbitration tribunal shall abide by that governing law to the extent that it is compliant with Shariah. The arbitration tribunal excludes any such stipulation of the governing law which is not Shariah-compliant.⁵⁰ Both, IIRCA and AIAC i-Arbitration rules also provide model arbitration clauses. Moreover, specialized boards are setup for the approval of financial transactions, and these boards act as arbitration bodies. These boards adjudicate the disputes through the mixture of national law and the Shariah principles.⁵¹

In the Cairo Regional Centre for International Commercial Arbitration (CRCICA) Case No. 577 of 2008, the claimants submitted a request for arbitration before CRCICIA because the respondent company failed to fulfill its obligation, and hence the claimant company wanted the principal amount in addition to the interest due and statutory interest for late payment.⁵² The governing law was the Egyptian law as long as it was not in conflict with the rules of Islamic law. The arbitration tribunal rejected the claim for interests sought by the claimant company. Although, Egyptian law allowed the charging of interest on a loan, but Islamic law does not, and hence the tribunal ruled it unlawful based on their findings on the verses of the Quran. Interestingly, the tribunal allowed the claimant company the statutory interest for late payment as compensation for the delay and justified it on the provisions of Islamic law.⁵³

Moreover, in *the International Investor Kcsc (Kuwait) (IIK) v Sanghi Polyesters Limited (India) (SPL)* the parties entered into an Islamic contract wherein the IIK financed the SPL to produce and export polyesters yarn. In 1997, the SPL defaulted and IIK commenced proceedings at ICC.⁵⁴ The law applicable to the contract was English law to the extent that it does not conflict with Islamic law. The arbitrator awarded the claimant the principal amount and profits claimed but disallowed the additional damages on the ground of its non-compliance with the Shariah.⁵⁵ SPL challenged the award in English Court, but the court dismissed the appeal on the ground that all the issues of law SPL raised were questions of Shariah law and not the law of England, and hence, for an appeal to succeed in the English Court the question must be of English law.⁵⁶

Moreover, in an Ad-hoc Arbitration case, the claimant company requested arbitration as the issue was of the amount due by the respondent bank.⁵⁷ The parties were engaged in Mudarabah contracts, and the governing law was the Egyptian law and the Islamic law. The arbitration tribunal nullified five clauses related to predetermined profit, share in bearing the loss, the claimant to bear losses without negligence or misconduct, etc., because they violated the Islamic law. The tribunal prevailed the Islamic law over the Egyptian law, however, the governing law clause does not state so.⁵⁸

Bahrain in collaboration with American Arbitration Association (AAA) launched the Bahrain Chamber for Dispute Resolution (BCDR-AAA), the center for mediation and arbitration of commercial cases. The BCDR-AAA has an International Centre for Dispute Resolution (ICDR), an international division of AAA, that addresses international commercial disputes.⁵⁹ The domestic office, the BCDR has made its own rules, including some aspects of Shariah but the ICDR applies its own set of rules based on International Dispute Resolution Procedures, which does not incorporate any aspect of Shariah.⁶⁰ The center established Arbitration and Mediation rules which came into force in 2017 and 2019, respectively, intending to make arbitration and mediation more time and cost-effective and introduced new model clauses.⁶¹ BCDR till date has administered around 350 cases through BCDR courts, and its international arbitration and mediation wing.⁶² The center has also launched series of publications on topics ranging from recognition and enforcement of foreign arbitral awards in the Arab states of the Gulf to the women's voices in the international arbitration. BCDR has also been effectively holding workshops for judges on international arbitration and national courts and was recently awarded the 2021 Global Arbitration Review Award for Regional Institution that impressed.⁶³

On account of the under-developed nature of the legal system in various Middle East countries, the international arbitration center like the BCDR-AAA can play an important role to ensure enforcement of the foreign arbitral awards in the Middle East countries.⁶⁴ Middle East countries are accommodating the ICA by establishing international arbitration centers in collaboration with internationally recognized arbitration centers.⁶⁵ The establishment of Bahrain-AAA is, therefore, a crucial step toward implementing 'the recognition and enforcement of foreign arbitral awards in the Middle East'.⁶⁶

Delocalized Arbitration

A-national arbitration ensures the highest level of party autonomy. 'Advantages of this type of arbitration includes limited interference from national courts, increased inter-state commercial relationship with the least legal barriers from the host state and above all a-national arbitration facilitates parties to avail of the "solutions and remedies to be created which fit parties" disputes and objectives'.⁶⁷

Delocalized arbitration facilitates the parties to choose rules applicable to their arbitration agreement whether by procedures provided by a legal

system other than those available in the seat of arbitration or institutional or ad-hoc arbitration rules which do not require the involvement of local laws.⁶⁸ *TOPCO* and *Aramco* are the examples where delocalized arbitration was recognized.⁶⁹ Additionally delocalized arbitration ensures minimum judicial control over arbitration award.⁷⁰

In the UK, until the 15th century, the ‘arbitration proceedings remained subordinate to English civil courts’.⁷¹ The Arbitration Act 1698 first introduced the concept of enforcement of arbitration award by courts. Over time the recognition of arbitration as an alternative to court grew. By the time the 1979 Arbitration Act was enacted, the judicial control in the form of review of arbitration proceedings and the award was considerably reduced. The 1996 Arbitration Act liberalizes the arbitration practice to a great deal; so much so that the 1996 Arbitration Act is considered to promote delocalized arbitration in the country.⁷²

It is argued that an a-national or delocalized arbitration can be a perceived challenge to the sovereignty of a state. Even though delocalized arbitration operates on the standard that ‘[delocalization] does not, by virtue of intention, deride or override sovereignty’.⁷³ Indeed the public interest and state sovereignty will require an answer to the question ‘what is the relationship between delocalized arbitration and mandatory norms of the place of arbitration?’⁷⁴ Public policy concerns always exist in the ICA. Therefore, it is not surprising that whenever a-national arbitration will be recognized, this will be possible if the award does not conflict with public policy.

More importantly, a-national award lacks legal protection available to the general arbitration award.⁷⁵ *Republic of Argentine v BG Group PLC (BG Group)*⁷⁶ is considered to be a recognition of party autonomy.⁷⁷ Regarding delocalized arbitration, the question is to what extent is it true that delocalized arbitration is ‘... vested with the inherent power of sovereign coercion’.⁷⁸

An important argument against delocalized arbitration is the right of a third party. Once an award is made in delocalized arbitration it cannot be challenged because delocalized arbitration claims immunity from domestic court’s intervention. This raises concerns for the third party ‘who never have consented to arbitration at all’.⁷⁹ The fact is that ‘[u]nder a system of complete arbitral autonomy, such as now prevails concerning foreigners in Belgium, the victim of arbitrator fraud or other procedural irregularity would have no opportunity to challenge the arbitrator’s decision where rendered’.⁸⁰

Delocalized arbitration facilitates parties to draft a body of procedures to run the arbitration proceedings. This ensures the dispute is not bound by a national legal system of a country, i.e., the highest level of party autonomy with no state scrutiny.⁸¹ Recognition of the delocalized arbitration award by states in their national legal system will resolve this problem.

A model procedural law may be drafted by the institutional arbitration centers to facilitate the delocalization of international arbitration. Without institutional arbitration centers’ model law or recognition of the de-localized

arbitration by state courts, enforcement of a foreign delocalized award will be doubtful.⁸²

Delocalized arbitration grants unsupervised and uncontrolled powers to arbitrators.⁸³ Arbitrator's jurisdiction and supervision over his power will remain outside government public domain. This will also raise public policy concerns.

International Investment Arbitration (IIA)

International investment laws facilitate regulations of foreign investment activities. Foreign investment activities include the benefits that foreign investment generates for the foreign investors as well as the host state.⁸⁴

International investment law serves two important purposes. First, International Investment Law (IIL) regulates foreign investment for the benefit of foreign investors. Second, IIL regulates foreign investment to ensure economic development for the host state.⁸⁵ In other words IIL aims to achieve a dual objective of protection to foreign investors from host states 'political strategies and immunity of state sovereignty from the challenges arising out of the foreign investors' claims.⁸⁶

Bilateral Investment Treaties (BITs)

BITs are agreements made between two countries with the purpose to protect investments made by investors of one contracting state in the territory of the other contracting state. In 1959, the first BIT was signed between Germany and Pakistan. The year 2001 proved to be the year when BITs peaked, around 97 countries were at least involved in the signing of one treaty.⁸⁷ A MIT is an international investment agreement which is entered into between several states, with the reciprocal protection of investments made by individuals and companies in signatory countries' territories.⁸⁸

BITs and MITs provide protection to foreign investors from contracting states' enormous power. Although every BIT is different from each other but there is some common structure to each BIT. The BITs cover four main areas:

- the promotion of foreign investment,
- the treatment of the investment in case of dispute,
- general protection and guarantee offered to the investments and
- the method to resolve host state-investor state and host-state and foreign investor disputes.⁸⁹

BITs form the basis of the claims by an individual, company, or state against the other contracting state. Under BITs, two main types of disputes arise. First, are investor-state disputes. Since the BITs are signed between states, the obligation is of one contracting state to the other state investors. Hence,

an aggrieved investor, when it considers an action taken by the host state to violate BIT, investor-state disputes arise. Second, are inter-state disputes, as the BITs are agreements between the states and the BITs also provide a mechanism for inter-state dispute resolution.

BITs almost in all cases provide for an arbitration clause, and most of the time this dispute resolution is covered under the ICSID or ad hoc tribunals.⁹⁰ Four conditions need to be met for arbitration to fall under the jurisdiction of the ICSID. ‘The parties should submit their dispute to ICSID, the dispute must be between a contracting party to the ICSID and a national of another Contracting State, must be a legal dispute and dispute arise directly out of an investment made in contracting state’.⁹¹

There are implicit obligations that arise when two states enter into a BIT. These obligations include fair and equitable treatment and full protection and security to the investment of foreign countries. Fair and equitable treatment requires that there should not be ‘arbitrary, discriminatory and abusive’ treatment by the contracting states. Similarly, the full protection and security requirements that the host states will not nationalize or expropriate investments from the other contracting state unless such measure is taken in the public interest and is non-discriminatory. Similarly, BITs allow unhindered, free, and protected transfer of funds related to investments by foreign investors which also includes protection against foreign exchange restrictions.⁹²

Moreover, some obligations are explicitly enunciated in the BITs which include the national treatment and most favored nation treatment obligations. The national treatment requires that the contracting states offer the same protection to the foreigners which is available to the domestic investors. The goal is to prevent any sort of discrimination in the treatment of domestic and foreign investors. Similarly, BITs often include a most favored nation clause. This clause embodies that the host states must provide the investors of the other contracting state with treatment that is no less favorable than the treatment which is provided to the investors investing under other investment treaties.⁹³

Investor Protection under IIA

There are two types of arbitration available to international investment agreements. First is institutional arbitration which is governed by the ICSID. The second is ad-hoc arbitration based on the UNCITRAL rules.⁹⁴

The ICSID convention was introduced in 1965, with the purpose of settlement of investment disputes between the host states and the foreign investors or states. Accession to ICSID by states is a sign of their dedication to protecting foreign investors. If two states are parties to the ICSID convention, and they do not have a BIT or MIT between them, the ICSID convention rules still allow the investor of one of the member countries to bring a claim against the host member state.⁹⁵

Moreover, the ICSID convention in the form of the ICSID arbitration tribunal provides a platform to resolve state-state or investor-state disputes resulting under the BITs between the contracting parties. The jurisdiction of the ICSID arbitration tribunal to entertain disputes resulting from the relevant BITs stem from Article 25 of the convention. Article 25(1) states:

The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally.⁹⁶

ICSID requires three conditions to be fulfilled by the parties, for them to avail of the center's services. These include

- 1 The state, which is a party to the dispute should be ICSID members,
- 2 The dispute has to relate to investment as defined by the Centre, and
- 3 The dispute must be an investor-state dispute.⁹⁷

ICSID convention does not provide an explicit definition of investment. The jurisprudence that the arbitration tribunals have developed over the years has helped describe investment for ICSID's jurisdiction.

The ICSID arbitration tribunal in the *Salini Costruttori v Kingdom of Morocco* established fundamental elements of investment. The facts of the case are that a dispute arose regarding payment for compensation for unforeseen events.⁹⁸ Salini filed for arbitration to claim compensation for the expenses they incurred during the construction of the highway joining Rabat to Fes. The government of Morocco objected to the jurisdiction of ICSID regarding the nature of the dispute. The government of Morocco alleged that a national court (Moroccan) had the jurisdiction to hear the dispute as it was concerned with services instead of investment.⁹⁹

The tribunal held that as per BIT Art 1(c), (e), and (g) construction contract between Salini and the Moroccan government-created economic value and economic right as a fundamental object of the contract.¹⁰⁰ The construction contract falls within the definition of investment as provided by BITs Article 1.¹⁰¹ Washington convention which governs the ICSID does not provide a definition of investment to allow contracting parties to define investment as they choose to.¹⁰² Nonetheless, ICSID case law has developed a doctrine which suggests four attributes of investment, i.e., contribution, a certain duration of performance of the contract, risk involved and economic development of the host state.¹⁰³

The tribunal held that contribution was made by Salini in terms of finance and employment of workforce.¹⁰⁴ Duration of performance was 36 months.¹⁰⁵

Appropriate risk was taken during the completion of the highway.¹⁰⁶ Finally, construction of the highway added into the economic development of the state (Morocco).¹⁰⁷

Definition of investment was further expanded to include the provision of services as a type of investment. In *Patrick Mitchell v DRC*, US citizen Patrick Mitchell was operating a law firm in the DRC. The authorities in DRC on suspecting illegal activity seized Mitchell's law firm and arrested two lawyers. Later on, the charges were dropped but Mitchell brought an action for compensation for damages against the DRC.

DRC objected to the tribunal's jurisdiction on the ground that law firm's services do not constitute investment. The tribunal referred to the BIT between the US and DRC, Article 1(c) which included a definition of investment. According to Article 1(c), the law firms' services formed investment. Moreover, tangible property such as firms' documents, knowledge and reputation, and firms' license to operate created rights, which should be treated as investment protected under the BIT.¹⁰⁸

Moreover, the ICSID arbitration tribunal has jurisdiction for two types of investor-state disputes. First, are those disputes which arise due to the breach of the BIT, as mentioned above in the *Patrick Mitchell and the Salini* case. In such an instance, since the state or investor has violated the terms of the BIT agreement, the other party can approach the ICSID arbitration tribunal. However, another instance, in which an investor-state dispute can be filed in the ICSID is when a contractual claim between the two turns into a treaty claim. A contractual claim in investor-state arises when there is a breach of a contract by any one of them. In *Abaclat and others v The Argentine Republic*, the tribunal observed that a contractual claim is one where a host state breaches an obligation arising under the investor-state contract. However, this contractual claim takes the shape of a treaty claim when the state along with the breach of the obligation under the contract has also breached its obligations provided under the BIT. The treaty breach occurs when: the act which breached the contractual obligation was a result of the exercise of the sovereign power by the state and the act is outlandish to the essence of the contract.¹⁰⁹ ISID has jurisdiction when the dispute relates to 'investment' and there is a breach of a treaty claim. In the case of a contract claim between a foreign investor and the host state, ICSID does not have necessarily jurisdiction.

The tribunal described the treaty claim in ABACLAT. Argentina (Respondent) issued a series of a bond to ABACLAT. Under the bond, ABACLAT acted as a creditor to Argentina which was a debtor. Argentina failed to fulfill its obligations to pay the principal amount and interest to ABACLAT. This failure was a breach of the bond and hence a contractual claim arose.¹¹⁰ Argentina did not trigger a bankruptcy regime or adopt contractual provision to relieve itself of its obligation under the bond toward ABACLAT.¹¹¹ Instead, emergency law was passed which allowed Argentina to liberate itself from its obligations to ABACLAT.¹¹² Argentina's reluctance

to employ contractual provision or legal bankruptcy and its preference for making a law to get out of its obligation was held to be a clear exercise of sovereign power.¹¹³

The tribunal held that Argentina's action (Emergency law) constituted an exercise of sovereign powers by a host state. It, therefore, was a treaty claim which activated the question of protection for a foreign investor under the BIT which existed between Italy and Argentina. Thus, ICISID's tribunals' jurisdiction was established.

State Immunity

BITs over the years have faced multiple challenges from countries across the world. The countries like Bolivia, Ecuador, Venezuela have terminated their BITs due to the fear that the BITs were benefitting and the foreign investors at the expense of the host state. Similarly, a systematic bias is noticed by the states that the arbitration tribunals prefer developed state investors over developing states. This systematic bias is also seen in the choice of arbitrators. Some arbitrators are perceived as state-friendly while others are seen as investor-friendly.

Nonetheless, the international community has adopted various strategies to overcome these challenges. First, some states have started renegotiating their treaties with the aim to strike balance between protection to foreign investors and sovereign power of host states. The second strategy is to look for alternatives for investor-state disputes. These states are hesitant to allow the investor-state claims to be submitted to the arbitration tribunals which are prone to systemic bias. For instance, the United States and the EU are devising a strategy to form an 'investment court system' for investor-state disputes in which judges will be appointed by the mutual consent of the contracting states. Lastly, transparency in investor-state disputes is being promoted by the UN Commission. The UN Commission on International Trade Law Rules on Transparency in Treaty-based Investor-State arbitration allows public access to arbitral proceedings. This eliminates the possibility of arbitrators being biased in favor of developing states as the public can access the documents filed by the parties and attend arbitral hearings.¹¹⁴ Thus international investment law which includes BITs, MITs, and IIA has been successfully promoting international trade and efficiently protecting foreign investors from states' unfettered powers.

UK Sovereign Sukuk

In the context of protection available to foreign investors under international investment law, an examination of dispute settlement mechanisms available to sukukholders in the UK is conducted in the preceding part of the chapter.

United Kingdom (UK) is the first European sovereign state which has issued sukuk. It is an attempt by the UK to make its financial market more

favorable for Shariah-compliant investments. The first sovereign sukuk was issued by the UK government in July 2014 with its maturity period expiring in 2019. The total worth of the first sukuk was £200 million, with a profit rate of 2.036% per annum. The first sukuk have been successfully redeemed without any dispute.¹¹⁵ After the success of the first sukuk, the UK government issued its second sovereign sukuk worth £500 million in 2021. The scheduled dissolution date for the second sukuk is 22 July 2026 at a rate of 0.333 percent annum.¹¹⁶

Dispute Settlement Mechanism Included in the Sukuk Certificates

UK sovereign sukuk is a contract between the UK government and private investors. Like any other contract, the sukuk provides a mechanism for dispute settlement between the parties. As per the second Sovereign sukuk, the law and jurisdiction clause maintain that the disputes will be governed by the English law and the Courts of England will have exclusive jurisdiction to resolve disputes between the parties.¹¹⁷ Unlike the first Sovereign sukuk, which only stated that for the dispute arising out of the transaction documents the English law will be applicable but there was no mention as to which court had the jurisdiction.¹¹⁸ Since, there has not been any dispute regarding the first Sovereign sukuk, the issue as to which court will have the jurisdiction to apply the English law, did not arise. However, the second Sovereign sukuk explicitly mentions the exclusive jurisdiction of UK courts and law, to discard any uncertainty.

Additional Protection to Sukuk Holders under International Investment Law (IIL)

The second sovereign sukuk has been fully subscribed by the different foreign investors in the UK. Like foreign investments, the sukuk holders of those countries which have signed BIT with the UK government, have added protection along with the contractual dispute settlement provided under the sukuk. BITs offer protection to the foreign investors making investments in the other contracting party. In *Abaclat and others v the Argentine Republic*, the tribunal distinguished between a contractual claim and a treaty claim and held that where a sovereign act of a state disturbs the equilibrium of the contract, it forms a treaty claim and the investors can approach the arbitration tribunal provided under the relevant BIT for the settlement.¹¹⁹ However, an important point to note is that, in a treaty claim, there will be a breach of the contractual claim between the parties first.

The sukukholders as foreign investors have acquired protection under the BITs signed between the UK and the states of those investors. The second sukuk has been mostly purchased by the financial hubs of the Middle East and Asia.¹²⁰ The financial hub of the Middle East is UAE and a BIT between

UK and UAE has been enforceable since 1993. In the UK/UAE BIT, investment has been defined as ‘liquid assets, deposits and claims to money or any performance under contract having a financial value’.¹²¹ As sukuk are alternative to conventional bonds, which are Shariah-compliant, and trading is done through specific and identifiable assets,¹²² they can be said to be covered under the definition of investment provided in the BIT. The second sovereign sukuk are covered under the investment definition provided in the UK-UAE BIT, any sovereign act of the UK government which changes their obligation to repay the initial amount and profit under the sukuk contract would count as a treaty claim and the UAE investors will acquire protection provided by the tribunal of ICSID.

Similarly, the financial hub of Asia is Malaysia, and the UK-Malaysia BIT has been in force since 1988. Investment between these countries is defined as ‘claims to money or to any performance under contract having a financial value’.¹²³ Sukuk will be covered under this definition of the investment as they oblige the UK to perform their obligation under the sukuk which has a financial value. Any imbalance in the performance of the sukuk contract which changes the obligations of the UK government due to their sovereign act will allow the Malaysian investors which are holding UK Sovereign sukuk to approach the ICSID under the breach of a treaty claim.

UK’s Concerns about Protection to Foreign Investors under the IIL

UK legislature like many other states has been critical of investor-state dispute claims which arise under their BIT obligations. This could become a challenge for the foreign investors who have subscribed to the second sovereign sukuk if the UK changes its obligations toward the investor-state disputes. The UK Parliament in a report named ‘Investment Liberalization and Investment Protection’ heavily criticized the UK government for the investor-state dispute claims under the BIT and asked for their policy on the investor-state disputes post-Brexit.¹²⁴ However, as of yet there has not been any official communication by the UK government in reply to the report.

Conclusion

Islamic arbitration requires an arbitrator to be a male and a muslim, which may contravene the equal protection clause of the US thus may not be enforceable in the US. A US award may uphold interest-based transactions which are proscribed in Shariah thus may not be enforceable in an Islamic jurisdiction. This example illustrates the very obvious, yet complicated nature of divergence between the Islamic and secular streams of arbitration. Islamic jurisdictions have taken several steps to overcome this divergence. Saudi Arabia promulgated the Saudi Arbitration Act 2012 to make arbitration proceedings Shariah-compliant, and arbitral awards to be enforced without

court intervention. Malaysia, through the Central Bank of Malaysia Act 2009 made it mandatory for an arbitration tribunal to refer to the Shariah Advisory council before passing an award. Indonesia established a specialized tribunal called Basyarnas/National Shariah Arbitration Body to hear IF disputes. Bahrain in collaboration with AAA launched the BCDR-AAA.

Despite the importance of these steps, they posit only an insular framework, which remains to a great extent, aloof from the demands of both the ICA and the IIA. There is a need for Islamic countries to not only work in collaboration with ICA organizations but at the same time to also explore new and unconventional methods of arbitration, to allow for a dynamic development of the Islamic arbitration regime. In that, De-localized/a-national arbitration offers good prospects. It reduces uncertainty since it ensures that arbitration awards being not amenable to review by states are not struck down on public policy grounds. There is limited interference of national courts, increased inter-state commercial relationships with the least legal barriers from the host state, granting the highest level of party autonomy and enforceability. However, it has its demerits as well, such as being taken as a challenge to the host country's sovereignty, and no accountability toward arbitrator's bias or procedural irregularities in the passing of an award.

Apart from ICA, IIA also provides a huge playing field to Islamic arbitration. ICSID is the primary organization that carries out arbitration in relation to a dispute arising out of the IIA, and over time it has added a lot of depth to the arbitration regime pertaining to IIA. ICSID assumes jurisdiction in IIA, both when there is a breach of treaty obligation or a contractual obligation that in turn triggers a treaty obligation. It is by this route that the sukuku issued by the UK government, carry dual protection for investors both under the BITs regime and the contractual breaches.

Notes

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4. Faisal Kutty, 'The Shari'a Factor in International Commercial Arbitration' (2006) 28 *Loyola of Los Angeles International and Comparative Law Review* 565, 597-598.
5. Faisal Kutty, 'The Shari'a Factor in International Commercial Arbitration' (2006) 28 *Loyola of Los Angeles International and Comparative Law Review* 565, 603.
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18. Faisal Kutty, 'The Shari'a Factor in International Commercial Arbitration' (2006) 28 *Loyola of Los Angeles International and Comparative Law Review* 565, 608.
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20. Faisal Kutty, 'The Shari'a Factor in International Commercial Arbitration' (2006) 28 *Loyola of Los Angeles International and Comparative Law Review* 565, 571.
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23. Faisal Kutty, 'The Shari'a Factor in International Commercial Arbitration' (2006) 28 *Loyola of Los Angeles International and Comparative Law Review* 565, 575.
24. *Jivraj v Hashwani* (2011) UKSC 40 [1].
25. *Jivraj v Hashwani* (2011) UKSC 40 [1].
26. Article 1 states, 'a general framework for combating discrimination on the grounds of religion or belief, disability, age or sexual orientation as regards employment and occupation, with a view to putting into effect in the member states the principle of equal treatment'. *Jivraj v Hashwani* (2011) UKSC 40 [6].
27. Regulation 2(3) states that '... references to "employer", in their application to a person at any time seeking to employ another, include a person who has no employees at that time; "employment" means employment under a contract of service or of apprenticeship or a contract personally to do any work, and related expressions shall be construed accordingly'. *Jivraj v Hashwani* (2011) UKSC 40 [7].
28. *Jivraj v Hashwani* (2011) UKSC 40 [27].
29. *Jivraj v Hashwani* (2011) UKSC 40 [40].
30. 'There are four relevant requirements under regulation 7(3). The issue between the parties centers upon whether the second requirement is satisfied. The requirements are (1) that the employer should have an ethos based on religion or belief; (2) that, having regard to that ethos and to the nature of the employment or the context in which it is carried out, being of a particular religion or belief is a genuine requirement for the job; (3) that, having regard to that ethos and to the nature of the employment or the context in which it is carried out, it is proportionate to apply

that requirement on the facts; and (4) that the person to whom the requirement is applied, does not meet the requirement'. *Jivraj v Hashwani* (2011) UKSC 40 [55].

31. United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (adopted 10 June 1958) 21 UST 2517.
32. Saad U. Rizwan, 'Foreseeable Issues and Hard Questions: The Implications of U.S. Courts Recognizing and Enforcing Foreign Arbitral Awards Applying Islamic Law under the New York Convention' (2013) 98 *Cornell Law Review* 493, 498.
33. 14th amendment of the US constitution: Requires the United States government to practice equal protection:

'No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any state deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws'. U.S. Const. amend. XIV, s 2.

5th amendment of the US constitution: Requires states to practice equal protection:

'No person shall be held to answer for a capital, or otherwise, infamous crime, unless on a presentment or indictment of a grand jury, except in cases arising in the land or naval forces, or in the militia, when in actual service in time of war or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation'. U.S. Const. amend V, s 2.

See also: 'The state's discrimination on the basis of religion, without a compelling government interest, amounts to an equal protection violation'. See *Powers v. Ohio* 499 U.S. 400 (1991), 434–435.

34. Article V(1)(b), United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (adopted 10 June 1958) 21 UST 2517:

'1. Recognition and enforcement of the award may be refused, at the request of the party against whom it is invoked, only if that party furnishes to the competent authority where the recognition and enforcement is sought, proof that:

(b) The party against whom the award is invoked was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case'.

See also: Saad U Rizwan, 'Foreseeable Issues and Hard Questions: The Implications of U.S. Courts Recognizing and Enforcing Foreign Arbitral Awards Applying Islamic Law under the New York Convention' (2013) 98 *Cornell Law Review* 493, 499.

35. 'In cases involving financial disputes, Islamic law requires the testimony of two men to establish a fact as proven'. Saad U Rizwan, 'Foreseeable Issues and Hard Questions: The Implications of U.S. Courts Recognizing and Enforcing Foreign Arbitral Awards Applying Islamic Law under the New York Convention' (2013) 98 *Cornell Law Review* 493, 499.
36. Aida Maita, 'Arbitration of Islamic Financial Disputes' (2014) 20 *Annual Survey of International & Comparative Law* 35, 54.
37. Maria Bhatti, 'The Role of Shari'a in International Commercial Arbitrations' (2018) 36 *Wisconsin International Law Journal* 46, 67.
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42. Section 56, Central Bank of Malaysia Act No. 701, 2009.
43. Rule N. 8, KLRCA i-Arbitration rules: Procedure for Reference to Shari'ah Advisory Council or Shari'ah Expert 2012. 'The Shariah expert or the advisory council is selected from the Malaysian National Shariah Advisory Council established by the Central bank Act of 2009'.
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46. Aida Maita, 'Arbitration of Islamic Financial Disputes' (2014) 20 *Annual Survey of International & Comparative Law* 35, 44.
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56. Mohamed A. Hassan, 'The Ex Officio Power of the Arbitrator to Raise New Issues of Law in Islamic Finance Disputes' (2020) 7 *Indonesian Journal of International & Comparative Law* 477, 531.
57. Only the reasoning of the award is published.
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6 Irish Financial Regulators Regulating Shariah Supervisory Boards

The realm of Shariah governance has remained a theatre for the manifestation of several problems such as Shariah risk and Shariah arbitrage. Reputed standard-setting bodies which have taken up the task of devising the trajectory that Islamic financial institutions should follow have posited several detailed standards catering to a myriad of risks and obstacles which Islamic finance (IF) industry encounters. In this chapter, we have identified the most recurrent and discernible of these obstacles which encapsulate the crux of the problems that IFIs and regulators face, in implementing effective Shariah governance. These include lack of transparency and disclosure, lack of competency, conflict of interest, and an absence of liability. This chapter includes an extensive examination of the standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and Islamic Financial Services Board (IFSB) regarding the above-mentioned challenges. It is interesting to know that there are standards that cater more or less to all these categories.

Where does the problem lie then? It lies in the insular framework that these standards put forward and their tendency to create Shariah as a point of fixation which prevents them from catering to the larger picture. It is a framework that fails to cater to the fault lines effectively since it detaches itself from a conventional framework of corporate governance and this has turned these fault lines into a deep impasse. A lot of material has been added to the redundant structure of Shariah governance, but no one has felt the need to reassess the 'first principles'. The first principle in the case of Shariah governance is to understand that IFIs are also corporate bodies at the end of the day and thus they have to be rooted in the paradigm of corporate governance as well, though with an added layer of Shariah governance.

It is with this understanding that this chapter lays down compartmentalization of the problems faced by the Shariah governance project, looks at the standards that cater to these problems, and provides a critique of how these standards remain uncomplemented with the conventional corporate requirements. The chapter then veers toward determining the contents of an alternative program, about which the author suggests that Shariah scholars should

be placed in a position of directors of IFIs and should not merely remain advisors. This will lead to the incorporation of Shariah corporate governance into the conventional corporate governance system.

Shariah Risk and Shariah Arbitrage

Shariah risk is an additional layer of risk facing the Shariah corporate governance system of IFIs. Shariah risk is also referred to as the risk of non-compliance. It is the risk that an IFI may not adhere, in carrying out its functions, to the rulings and precepts of Shariah. Owing to the recurrent nature of this phenomenon, both the AAOIFI and IFSB standards address this risk in detail. IFSB standards require that IFIs should ensure compliance with Shariah particularly while accepting deposits and investment funds, providing finance, or carrying out investment services for its clients.¹ Similarly, the AAOIFI Governance standard requires that IFIs shall objectively monitor the material risks relating to Shariah non-compliance, as part of its operational risk management.²

The existence of Shariah risk encourages the practice of Shariah arbitrage. Shariah arbitrage refers to the arbitrary exploitation of Shariah risks for the short-term benefits of individual IFIs. Shariah arbitrage has become recurrent, defendant's argument in *Shamil Bank v Beximco Pharmaceuticals* is an apt example of the use of Shariah arbitrage.³ Shariah risk must be mitigated to eliminate Shariah arbitrage. There are different categories of Shariah risk that give rise to Shariah arbitrage. Four types of most commonly prevalent Shariah risks are: validity of Islamic finance transactions, suspicious nature of instruments for lack of transparency, investment in non-Islamic ventures and scholars sitting on multiple Shariah supervisory boards (SSBs).⁴

SSB is responsible for ensuring the IFIs comply with the principles of IF law.⁵ Practically speaking, there are two types of functions performed by SSBs in the current corporate governance structure of IFIs, i.e., supervisory and advisory.⁶ Supervisory functions include the issuance of fatwas, auditing financial statements, approving the Shariah compliant features of products and approval of income distribution.⁷ Advisory functions include zakat calculation, distribution of non-compliant income, and training managers and clients on Shariah law finance.⁸

AAOIFI GS 2 (5) defines the Shariah scholars' role as advisors and makes the directors responsible for the management of Shariah risk.⁹ Under AAOIFI standards, the directors are responsible to manage the overall risk mechanism of an Islamic financial institution.¹⁰ Shariah risk management remains an essential domain of SSBs as per AAOIFI standards. SSBs are responsible to ensure Shariah's aspects of corporate governance are well managed.

Management of the bank is conducted by the Board of Director (BoD) whereas the SSB ensures that all the matters of the bank remain Shariah-compliant.¹¹ Since the advisory role is confined to the supervision of banking

products and related matters, it does not extend to major decision-making tasks such as product development processes and documentation of the transaction. As a result, IFIs are free to disregard their SSB-approved transactions in the court of law. This also means that IFIs can go fatwa shopping or pressure their SSB to produce fatwas favorable to their business needs, allowing them to make investments in the non-Shariah compliant business. Moreover, Shariah scholars as advisors remain outside the domain of regulations, as a result of which, they do not incur any liability for their actions that may lead to Shariah risk.

In order to manage Shariah risk and overcome consequent Shariah arbitrage, this author suggests that it is the right time for Shariah scholars to take up executive positions in IFIs. If Shariah scholars act as directors, they will have increased authority over product development processes and documentation of transactions. Scholars in executive positions will have the authority to ensure transparency and full disclosure, eliminate Shariah arbitrage and this would also prevent these scholars from sitting on multiple SSBs. At the same time, the scholars will be subject to regulatory requirements/scrutiny applicable to directors such as the conventional qualification requirements and fit and proper test which directors must pass before being eligible to run a company. Problems arising out of lack of disclosure, scholar's competence, presence of conflict of interest, absence of liability are discussed below in detail.

Transparency and Disclosure

To ensure transparency in the functioning of an IFI, it is imperative to draft proper guidelines regarding disclosure. AAOIFI GS 4 calls for the establishment of an Audit and Governance committee to ensure greater transparency and disclosure in financial reporting, which would enhance the confidence and trust of the general public in the functions of an IFI.¹² Similarly, IFSB standard No. 19 also states that there shall be full disclosure of information which would be helpful to an investor in his decision to invest,¹³ and further that this disclosure should be made in a timely manner so as to not lose its worth in guiding investment decisions.¹⁴

The two most important aspects of the disclosure, pertaining to Fatwas/rulings issued by the SSB and investment strategies of an IFI.

- 1 Disclosure regarding the fatwas (opinions that grant legitimacy to a transaction as being Shariah-compliant), and the reasoning that underlie the issuance of these fatwas are crucial for ensuring transparency. In [Chapter 4](#), we have identified how fatwa shopping is becoming a recurrent practice in IFIs and has injected Shariah-based transactions with uncertainty and suspicion. Having disclosure requirements that make it mandatory for scholars to mention the methodology used to arrive at a particular conclusion regarding a specific transaction, would curb this phenomenon to a great extent because if the reasoning is flawed and lacks coherence, instant feedback can be obtained from the other scholars and Islamic circles.

- 2 The second aspect of disclosure pertains to the operations of the IFI, and this further culminates into two issues.
 - a The first issue relates to the investment decisions made by an IFI. IFIs should be required to disclose the venture in which they invest their depositor's money. Such disclosure requirements would prevent dubious arrangements. Several IFIs had deposited huge sums of money with BCCI on the assumption that they would be invested in commodity-based transactions. However, after BCCI's collapse, the auditor's report suggested that there was no evidence that BCCI had ever entered into any commodity-based transaction. This came as a shock, as one of the IFIs had invested around 25% of its total assets with BCCI and it turned out that there was no Shariah compliance in those transactions.¹⁵ Thus, investment strategies of IFIs should be made publicly available to all stakeholders, so that IFIs are discouraged to operate in dubious waters.
 - b The second issue relates to the beneficiaries of finance advanced by the IFIs to its customers. Criterion to assess the creditworthiness of its customers is an important part of the disclosure. For Instance, Ihlas Finance House (IFH) of Turkey was liquidated by the Turkish Banking Regulations and Supervision Agency for having appropriated \$1 billion out of its deposits and having them advanced to its shareholders on very low profit. This was kept hidden by rising amounts of deposits, which came from the high reputation that the IFI enjoyed. Thus, lack of transparency allowed this system to establish in favor of shareholders at the expense of depositors, and when the bank was liquidated, it could not pay 200,000 of its depositors as the IFI was not covered by deposit insurance. As soon as this scandal came out, IF industry in turkey witnessed a 63% reduction in their total deposits as people lost trust and withdrew their deposits.¹⁶ A public disclosure of the reasoning behind fatwas is crucial because public disclosure of fatwas' reasoning will place the Shariah review report under public scrutiny and consequently controversial fatwas can be scrutinized. In this regard, AAOIFI GS 1 (9) to (24) layout the complete mechanism to produce fatwas¹⁷, and GS 1 (25) and (26) mention that these fatwas should be published by the IFI, along with an annual report of the SSB.¹⁸ IFSB standard 3, Principle 3.2 states that IFIs shall comply with the rulings of Shariah Scholars, and the rulings should be accessible to the general public as well.¹⁹ Apart from the fatwas, in order to avoid the situations resulting from non-compliance with Shariah precepts in terms of deposits and investments, as happened in the case of BCCI, AAOIFI GS 1 (20) (21) state that the report of the SSB should scrutinize the contracts and documentation for Shariah compliance, and any violations thereof should be stated as well.²⁰ Moreover, AAOIFI and IFSB have produced an enormous number of standards related to disclosure to prevent manipulation as witnessed in the case study of IFH.²¹

Not only do these standards provide directors, but in order to ensure that there is a proper internal review of whether they are followed or not, the AAOIFI GS 3 (9) states that '[t]he staff of the internal Shari'a review shall be proficient and shall have appropriate educational background and training relevant to internal Shari'a review. The head of the internal Shari'a review shall establish suitable criteria to meet the above'.²²

Shariah risk can be managed by observing the requirements put forth by AAOIFI and IFSB regarding disclosure. However, compliance with AAOIFI and IFSB standards is voluntary which makes the standards ineffective to a great extent. This problem is further examined in the latter part of this chapter.

Further, disclosure requirements as per IFSB and AAOIFI are sufficient to overcome fatwa shopping and fraudulent practices among IFIs. Implementation of AAOIFI and IFSB standards is carried out on a voluntary basis. Code of conduct will include all the disclosure requirements related to Shariah as well as conventional corporate governance to mitigate Shariah risk.

Competence

In case of dispute, there is a possibility that the validity of Islamic finance transactions may be challenged on the basis of their (purported) non-compliance with Shariah.²³ This risk materializes when one party opts out of its obligations by claiming that the agreement they signed was not compliant with principles of Shariah.²⁴ *Shamil Bank v Beximco Pharmaceuticals* is a classic example of this type of Shariah risk. In *Shamil bank vs Beximco*, the court found that the transactions that were contended as non-Shariah compliant were authorized and approved by the SSBs of the respective IFI. Shariah arbitration questions the status and competence of Shariah scholars sitting on the SSB of the IFI.²⁵

Competency is simply finding the right person to do the job, but in the area of corporate governance with a further Islamic angle to it, ensuring the same will help overcome Shariah arbitration. AAOIFI GS 1 (2) lays out that a member of SSB should be an expert in the field of Fiqh al Muamlat.²⁶ Furthermore, AAOIFI provides for fit and proper criteria for a head of SSBs which includes the detailed list of Shariah qualification and experience for the head of Shariah compliance.²⁷ IFSB standard no. 10 lays down detailed and descriptive requirements for assessing the competence of persons mandated with the task of Shariah governance. This includes fit and proper criteria, which comprises of assessment of good character, diligence, capability, and soundness of judgment, having no bad antecedents on past record, being fair, truthful and forthcoming in dealings, having sound knowledge of the responsibilities of his position and being physically and emotionally fit to perform duties.²⁸ Some further competency requirements have also been mentioned in Appendix 4 of the same standard, though from a more academic perspective. Here, the standards require that a person appointed on Shariah

board must hold a degree from a recognized Islamic University, must be able to demonstrate a good understanding of Islamic finance and strong skills in the philosophy of Islamic finance.²⁹

AAOIFI and IFSB put forth extensive criteria for qualification and expertise of scholars regarding knowledge of Shariah. However, no requirement to obtain conventional qualification is mentioned in AAOIFI and IFSB standards which is a loophole. The absence of conventional qualification amongst Shariah scholars results in Shariah arbitrage. IFIs take advantage of the lack of knowledge and authority of scholars to refute the validity of contracts that were approved by their own SSBs. Scholars need to have conventional as well as Shariah qualifications to deal with Shariah arbitrage and this is only possible when scholars work as directors.

Competence under UK Regulations

The FSA considered that the operations of the SSBs should be supervised for two reasons. Firstly, if members of SSBs are actively participating in the management of the firm as directors then they should meet the criteria for FSA's standard on 'Fit and Proper Test on Approved Persons'. Secondly, if the criteria are met and the members act as executive directors then this will give rise to a restriction; i.e., the SSB member cannot hold similar positions in multiple SSBs.³⁰

Previously, the FSA was an independent and single regulator for the financial services sector in the UK which has now been converted into FCA and PRA. A combined handbook of the PRA and FCA describes the criteria for fit and proper tests for approved persons authorized by the PRA and FCA. However, supervision procedures differ according to the body of authorization.³¹ According to the PRA and FCA, an authorized person is

[A]n individual who has been approved by the Prudential Regulation Authority (PRA) and/or the Financial Conduct Authority (FCA) to perform one or more Controlled Functions on behalf of an authorized firm. Approval must be obtained before an individual can perform a Controlled Function.³²

The criteria to test 'fitness and propriety' include an assessment of

'(1) honesty, integrity and reputation; (2) competence and compatibility; and (3) financial soundness' of the person seeking approval to carry out PRA and/or FCA controlled activities in the UK.³³ In the Banking Reform Act 2013, the UK further emphasizes on competency criteria as specified by the FCA and PRA.³⁴

This study is based on FSA guidelines on IF which is not an official guideline but is the only document that provides regulators' perspective on SSBs in the

UK. This discussion examines the FSA rules as applicable to SSBs for two reasons: firstly, the FCA or PRA has not produced their policy on IF, therefore, this analysis examines FSA guidelines on IF. Secondly, the FSA was established under the FSMA 2000. FSMA 2000 has been replaced by the FSA 2012 and the FSA is replaced by the FCA and PRA. Nonetheless, the firms authorized by the FCA and PRA are still subject to the FSMA 2000 rule on authorization for approved persons.³⁵ Moreover, the firms authorized by the FCA and PRA are required to comply with ‘fit and proper test for approved person’.³⁶ Therefore, the Shariah scholars are also subject to the FSMA 2000 regulations.

In *Ghanshyam Batra v the Financial Conduct Authority*, Greg Sinfield J explained that the FSMA 2000, section 59 authorizes the FCA and PRA to grant approval to an authorized person to perform regulated activities.³⁷ Section 63 authorizes the FCA to withdraw approval for an authorized person who does not meet these criteria.³⁸ The FCA is entitled to issue an order prohibiting an approved person from performance of regulated activity authorized according to section 59. The order of prohibition is issued under section 56 as endorsed by Roger Berner J in *David Hobbs v the Financial Conduct Authority (Hobbs v FCA)*.³⁹ The order is issued when the FCA finds that an approved person failed to comply with the fit and proper criteria.⁴⁰

Competence of the managers and staff is emphasized by Roger Berner J in *Michael Lee Thommes v The Financial Services Authority*.⁴¹ In *Michael Lee Thommes v The Financial Services Authority*, the court examined the experience and prospects of a person to assess their fitness and propriety.⁴² Moreover, in order to strengthen the risk management mechanisms of financial institutions, the FCA requires that the approved person has specific skills and expertise to manage risk in the firm.⁴³

Fit and Proper Tests for the Approved Person as Specified in Ireland

The Corporate Governance Code for Credit Institutions and Insurance Undertakings 2013 regulate the corporate governance structure of financial institutions in Ireland.⁴⁴ Under this code, the corporate governance structure of non-EEA credit institutions and insurance undertakings are governed in the country. Corporate governance structures of an IFI authorized to operate in Ireland will be governed under this code.⁴⁵

Fit and proper tests for approved persons are specified by the Central Bank of Ireland.⁴⁶ The European Banking Authority (EBA) is responsible for laying down the assessment criteria for the fit and proper tests.⁴⁷ 2006/48/EC, Article 12 provides the criteria for authorization of the financial institutions.⁴⁸ The EBA provides guidelines for the implementation of 2006/48/EC directives.⁴⁹ According to the guidelines, the managers (as well as ‘key function holders’) will be assessed for their competence. ‘Key function holder’ refers to the staff who do not form part of management, but their role has a considerable impact on the decisions of the financial institutions. These include ‘heads of significant business lines, EEA branches, third-country subsidiaries,

support, and internal control functions'.⁵⁰ SSB members are part of internal controls when they perform Shariah reviews. Therefore, the guidelines apply to them.

Furthermore, the EBA guidelines explain in detail the criteria for competency. Clause 14.3 on the assessment of competency is particularly essential to note in the context of competency of SSB members. This clause states:

The assessment should not be limited to the educational degree or proof of a certain period of service in a credit institution or other firm. A more thorough analysis of the members' practical experience should be conducted as the knowledge gained from previous occupations depends on the nature, scale, and complexity of the business as well as the function performed within it.⁵¹

The Central Bank of Ireland, Fitness and Probity Standard 2 provides guidance for the standard governing fitness and probity test.⁵² Standard 3 then explains the competency and capability requirement for the managers of financial institutions.⁵³ An IFI operating in Ireland will be required to comply with the Fitness and Probity Standards for the qualification of board members. Standard 3 is of specific relevance for members of SSB as the following:

- 3 (1) A person shall have the qualifications, experience, competence, and capacity appropriate to the relevant function.
- 3.2 (d) has a sound knowledge of the business of the regulated financial service provider as a whole and the specific responsibilities that are to be undertaken in the relevant function;
- 3.2 (e) has a clear and comprehensive understanding of the regulatory and legal environment appropriate to the relevant function.⁵⁴

Being part of the BoD implies that the fit and proper test for BoD members and management staff applies to the members of SSBs operating in the UK and Ireland.

Currently, the qualifications of SSB members are unregulated in the global IF market on account of Scholars' limited role as advisors.⁵⁵ However, if SSB members act as directors, they will have to comply with competency criteria applicable to the members of BoD. The FSA's approach toward SSBs' regulations is in conformity with the AAOIFI governance structure. The FSA requires full disclosure of scholars' role whether as advisors or as members of BoD in an IFI.⁵⁶

Competence is an essential requirement that impacts the appointment of Shariah scholars to become members of SSB who in the future are expected to be a part of the Board of Director (BoD) in the UK.⁵⁷ Shariah scholars are required to be well versed in conventional finance.⁵⁸ If this criterion is made applicable to the SSB, Shariah risk can be included in the FCA's policy to regulate the risk management system of IFIs. This will overcome the Shariah arbitrage and legal uncertainty in the IF industry.

AAOIFI and IFSB standards describe qualification and experience requirements in terms of Shariah law for scholars. These extensively drafted requirements include a description of good character, experience, and integrity. FCA and IFSC require directors to hold a conventional qualification in addition to considerable experience and expertise in conventional finance. Hence, the code of conduct applicable to scholar directors of IFIs should include a combined requirement of competency as mentioned in AAOIFI and IFSB standards as well as FCA/IFSC regulations. This will ensure scholar directors will have complete understanding and authority over operations of IFIs.

Conflict of Interest

Conflict of Interest, especially, when a person owes a huge responsibility to an organization, is anathema to the effective and efficient execution of those responsibilities. Conflict of interest, in the case of Shariah governance, arises from the prevalent practice of Shariah scholars sitting on the SSBs of multiple IFIs. Despite the fact that this practice has become a legitimate part of Shariah governance, it is pertinent that regulators look into the tangible impacts of this practice.⁵⁹

AAOIFI governance standards emphasize that scholars should be independent and objective and should not yield to the pressures of conflict of interest.⁶⁰ Similarly, Shariah scholars sitting on SSBs must avoid any potential or actual situations that could put them in a position where their ability to make objective and professional judgment is compromised.⁶¹ IFSB standard No. 24 Principle 14 lays emphasis on the provision of effective policies and procedures to identify and eliminate actual and potential conflicts of interest, or at least disclose them to the public.⁶² However, these standards fail to address the crux of the matter. It is invariably conspicuous that to solve this conundrum, conflict of interest is to be eliminated from its roots. This can only happen when scholars are prohibited from sitting on multiple SSBs. On this, unfortunately, the AAOIFI standards are silent.

Conflict of interest remains unaddressed to a great extent in AAOIFI and IFSB standards. There is some reference to avoid conflict of interest which is generic in nature. The prevalent practice of Shariah scholars holding advisory positions in multiple IFIs shows the existence of a significant conflict of interest that remains unaddressed. Scholars acting as directors will again be instrumental in solving this problem, as they would be required to avoid conflict of interest under the conventional regulatory requirement. A combined code of conduct will sufficiently address this problem too.

Liability

Shariah risk multiplies when an Islamic financial transaction is approved against the standardized practice. For instance, Goldman Sachs listed a \$2 billion sukuk in the Irish stock exchange in 2011. Sukuk was structured on

Murabaha agreement that was an unsecured loan.⁶³ It was an asset-based sukuk but the instrument became controversial before it could be issued.⁶⁴ The structure of the sukuk was a reverse *tawarruq* which has been declared to be non-compliant by the International Islamic Fiqh Academy of OIC.⁶⁵ Goldman Sachs insisted that the sukuk structure was certified by Shariah scholars. However, the sukuk has not been issued and, therefore, it is not possible to examine Shariah scholar's reasons for approval of the *tawarruq* arrangement. The issuance was postponed on account of doubts among investors over the Shariah-compliant nature of the instrument.⁶⁶

There is a need for minimum deterrence, in terms of personal accountability, to ensure that Shariah scholars do not trespass in dubious terrain. AAOIFI GS 4 (8) can be seen to be a founding stone. Although it does not specifically create explicit liability for Shariah scholars but it calls for the establishment of an Audit and Governance Committee, which shall assess the reports issued by the SSBs to see if proper Shariah compliance procedures have been followed.⁶⁷ This is a committee that examines IFI's operations and checks the performance of the SSB. This creates an implicit check and consequent liability for the SSBs in case they have not carried out proper Shariah review of the operations of the IFI and have not ensured adherence to Shariah precepts.

Apart from the accountability of the SSBs, AAOIFI also sets out standards for the accountability of the management of an IFI. In this regard, AAOIFI GS 2 (3) defines how Shariah review should be carried out, and calls for the examination of contracts, agreements, policies, products, transactions, financial statements, reports, etc. to check compliance with Shariah.⁶⁸ Although the review is to be carried out by the SSB, but the management has a corresponding responsibility under GS 2 (5) to ensure compliance⁶⁹ and under GS 2 (6) to not hinder access to such records as are necessary for the carrying out of a proper review. If any such barrier is created, the same is to be communicated in SSB's report to the shareholders.⁷⁰

But there still remains a possibility of collusion because the whole process highlighted above is institutionally entangled and there is no neutral arbiter to unknot the same and find discrepancies. In order to address this possibility, the AAOIFI standards put forth the requirement of an external review. According to AAOIFI GS 7 (Appendix C), an external review is to be carried out by an independent body which ensures that there is actual compliance by the IFI.⁷¹ Similar requirement for an external review can also be found in IFSB-10, Clause 3 (d) of which, states that there shall be an annual review that should be carried out by an external auditor or external Shariah firm, in order to confirm whether the internal audit or compliance review has been carried out properly. Furthermore, the standard envisages that the external review should be reported in two manners, one being a general statement regarding the status of compliance, and the other being a report for supervisory authorities.⁷² Both of these standards regarding an external review create an extra layer of check on the SSB as well because if they fail to report

a discrepancy, it may come to fore in external review and the SSB would be held to account for non-reporting.

Liability is an area of corporate governance that is sensitive for both scholars as well as directors. AAOIFI and IFSB require scholars to be independent of IFIs' pressures but since scholars are acting as advisors, therefore, they are immune to any liability arising out of their actions. A combined code of conduct will also address this problem.

Collaboration between Islamic and Conventional Standard-setting Bodies

A country promoting IF will consider the establishment of Shariah Supreme Councils (SSCs) within its financial services industry.⁷³ SSCs are established to supervise the SSBs at a macro level. SSCs generally operate under the control of the central bank of the country.⁷⁴ In other words, the Irish government can authorize the Central Bank of Ireland to setup a team to supervise SSBs (as suggested in [Chapter 3](#)). With the growth of the IF industry in the country, this team may be called SSC.

In the 90s, the supervision of IFIs was uncertain in the UK on account of their performance and scale at which these institutions were operating.⁷⁵ However, the growth of the IF industry along with a regulatory change in the country made the supervision of IFIs by the FSA possible.⁷⁶ Regarding Ireland, there exists a similar situation. There is no IFI operating in the country at the moment, however, in the future if Ireland plans to accommodate and adequately supervise the IFIs, that will be done in a European context (given the Central bank of Ireland supervises the banking industry in collaboration with the ECB).

In order to manage Shariah risk in the IF industry, the FSA favors the efforts of standardization as carried out by the AAOIF and IFSB.⁷⁷ Until standardization is undertaken completely and successfully at an international level by global IF organizations, a concept of European Shariah Supervisory Council (ESSC) will be beneficial to centralize the SSBs' supervision in Europe. This board can be entrusted with the task of collaboration with AAOIFI to promote standardization of the IF principles. This will reduce legal uncertainty in the IF markets in Europe. The ESSC will manage Shariah risk in global IF markets by providing the regulatory framework and consequently, EU member states will benefit from the investments of oil-producing nations in the Middle East.

Central Shariah Advisory Board in Ireland can comprise members from different professional backgrounds; for instance, in Malaysia, the Shariah Advisory board comprises a former chief justice, religious scholars, law professors, and researchers.⁷⁸ The Council is appointed by Minister. Shariah Advisory Council (SAC) can be an appropriate example for secular jurisdictions like Ireland to develop a standard and uniform practice regarding the IF disputes.⁷⁹

Conclusion

One of the very important instruments to gauge the success of the Shariah governance framework is to look at the trust that investors and customers are willing to repose in an IFI. The practices that create a dent in this trust and rapport can prove to be detrimental to the long-term success of the industry. Phenomena, such as Shariah risk and Shariah arbitrage, and case studies such as that of BCCI and the Ihlas Finance House of Turkey, pose serious questions to the legitimacy and credibility of the industry practices as a whole, and after every such event, the jury goes out on the above question, and the verdict returned is mostly against the industry. Practical fallouts of such verdicts are invariably conspicuous and are no longer so insignificant so as to be unquantifiable. Only after the Ihlas Finance House scandal, IF industry in Turkey had faced a 63% reduction in their total deposits which speaks to the fact.

In order to cater to these issues, this chapter has highlighted four main areas of engagement. These include transparency and disclosure, competency, conflict of interest, and liability. Transparency and disclosure pertain to the disclosure of the fatwas and the thought process that went into bringing about such fatwas, and transparency in the avenues of investment and advancement of loans by IFIs. Competency pertains to ensuring that the Shariah scholars are well equipped with Shariah as well as conventional qualifications. Conflict of interest pertains to eliminating the practice of Shariah scholars sitting in the boards of multiple IFIs and liability pertains to ensuring that Shariah scholars are held accountable in cases of deviation from the standard practices.

In respect of all four categories, we looked at the requirements laid down in the AAOIFI and IFSB standards. Despite the presence of these standards, these standards remain aloof from the conventional framework for corporate governance and that is one reason that they fail to holistically address the challenges faced by the Shariah governance project. In this respect, the author recommends that the first step toward achieving this matrimony between Islamic and conventional governance is to place Shariah scholars as directors in IFIs. This would automatically attract, the conventional requirements that a director must fulfill to be eligible for the position, to Shariah scholars and would prove to be a great leap forward. Further, it is recommended that standards issued by AAOIFI and IFSB should be intertwined with those issued by regulatory bodies such as FSA and IFSC, in order to arrive at a comprehensive Shariah governance framework that accommodates conventional as well as Shariah regulatory requirements and effectively caters to the problems highlighted through the chapter.

Notes

1. Islamic Financial Services Board, 'Guiding Principles of Risk Management for Institutions (Other than Insurance Institutions) Offering Only Islamic Financial Services' (Principle 7.1, Cls 127, 128, 129, 130, 2005).

2. Accounting and Auditing Organisation for Islamic Financial Institutions, 'Governance Standards for Islamic Financial Institutions', Governance Standard No. 9, para 25.
3. *Shamil Bank of Bahrain v. Beximco Pharmaceuticals Limited and Others* (2003) England and Wales High Court 2118 (Comm) [20].
4. Samy Nathan Garas and Chris Pierce, 'Shari'a Supervision of Islamic Financial Institutions' (2010) 18 *Journal of Financial Regulation and Compliance* 397, 396.
5. '... revising the articles of associations and all internal policies; issuing of religious decisions (fatwas) before the release of products to the public to ensure their compliance with Shari'a; reviewing new products and contracts during their execution to ensure their compliance with Shari'a; and reporting Shari'a opinion to relevant parties'. Samy Nathan Garas and Chris Pierce, 'Shari'a supervision of Islamic financial institutions' (2010) 18 *Journal of Financial Regulation and Compliance* 397, 396.
6. Samy Nathan Garas and Chris Pierce, 'Shari'a Supervision of Islamic Financial Institutions' (2010) 18 *Journal of Financial Regulation and Compliance* 397, 395.
7. Samy Nathan Garas and Chris Pierce, 'Shari'a Supervision of Islamic Financial Institutions' (2010) 18 *Journal of Financial Regulation and Compliance* 397, 395.
8. Samy Nathan Garas and Chris Pierce, 'Shari'a Supervision of Islamic Financial Institutions' (2010) 18 *Journal of Financial Regulation and Compliance* 397, 395.
9. 'While the SSB is responsible for forming and expressing an opinion on the extent of an IFI's compliance with the Shari'a, the responsibility for compliance therewith rests with the management of an IFI'. Accounting and Auditing Organisation for Islamic Financial Institutions, 'Governance Standards for Islamic Financial Institutions', Governance Standard No. 2, para 5.
10. Accounting and Auditing Organisation for Islamic Financial Institutions, 'Governance Standards for Islamic Financial Institutions', Governance Standard No. 6, para 5 and 7.
11. Humayon A. Dar and John R. Presley, 'Lack of Profit Loss Sharing in Islamic Banking: Management and Control Imbalances' (2000) 2(2) *International Journal of Islamic Financial Services* 3.
12. Accounting and Auditing Organisation for Islamic Financial Institutions, 'Governance Standards for Islamic Financial Institutions', Governance Standard No. 4, para 2.
13. Islamic Financial Services Board, 'Guiding Principles for Disclosure Requirements of for Islamic Capital Market Products (Sukuk and Islamic Collective Investment Schemes)' (IFSB 19 Sec 2.1.2 Principle G.2, 2017).
14. Islamic Financial Services Board, 'Guiding Principles for Disclosure Requirements of for Islamic Capital Market Products (Sukuk and Islamic Collective Investment Schemes)' (Sec 2.1.2 Principle G.3, 2017).
15. Abdurrahman Raden Aji Haqqi, 'Shariah Governance in Islamic Financial Institution: An Appraisal' (2014) 11 *US-China Law Review* 112, 122.
16. Abdurrahman Raden Aji Haqqi, 'Shariah Governance in Islamic Financial Institution: An Appraisal' (2014) 11 *US-China Law Review* 112, 123.
17. Accounting and Auditing Organisation for Islamic Financial Institutions, 'Governance Standards for Islamic Financial Institutions', Governance Standard No. 1, para 9–24.
18. Accounting and Auditing Organisation for Islamic Financial Institutions, 'Governance Standards for Islamic Financial Institutions', Governance Standard No. 1, para 25 and 26.
19. Islamic Financial Services Board, 'Guiding Principles on Corporate Governance for Institutions offering Only Islamic Financial Services (Excluding Islamic Insurance (Takaful) Institutions and Islamic Mutual Funds)' (IFSB-3 Principle 3.2, 2006).

20. Accounting and Auditing Organization for Islamic Financial Institutions, 'Governance Standards for Islamic Financial Institutions', Governance Standard No. 1, para 20 and 21.
21. AAOIFI Governance Standard 6, para 5 and 10 states '[t]he IFI should maintain high standards of transparency and market discipline to build trust with shareholders and other stakeholders'. Moreover, see also standards issued by the IFSB that relate to disclosure requirements which include IFSB-4 issued in December 2007, IFSB-19 issued in April 2017, IFSB-22 issued in December 2018 and IFSB-25 issued in December 2020.
22. Accounting and Auditing Organisation for Islamic Financial Institutions, 'Governance Standards for Islamic Financial Institutions', Governance Standard No. 3, para 9.
23. Maria Bhatti, 'Managing Shariah Non-Compliance Risk via Islamic Dispute Resolution' (2020) 13(1) Journal of Risk and Financial Management 1.
24. Maria Bhatti, 'Managing Shariah Non-Compliance Risk via Islamic Dispute Resolution' (2020) 13(1) Journal of Risk and Financial Management 1, 2.
25. *Shamil Bank of Bahrain v. Beximco Pharmaceuticals Limited and Others* (2003) England and Wales High Court 2118 (Comm).
26. Accounting and Auditing Organisation for Islamic Financial Institutions, 'Governance Standards for Islamic Financial Institutions', Governance Standard No. 1, para 2.
'A Shari'a supervisory board is an independent body of specialized jurists in Fiqh Al-Mua'malat (Islamic commercial jurisprudence). However, the Shari'a supervisory board may include a member other than those specialized in Fiqh Al-Mua'malat, but who should be an expert in the field of Islamic financial institutions and with knowledge of Fiqh Al-Mua'malat'.
27. Accounting and Auditing Organisation for Islamic Financial Institutions, 'Governance Standards for Islamic Financial Institutions', Governance Standard No. 9, Appendix B.
'Appendix B: Specimen fit and proper criteria'
'Head of Shari'ah compliance:

Well-versed in the operations and functions of Islamic banking or finance, the relevant Shari'ah principles and rules, including in particular the principles contained in the hierarchy in line with paragraph 3(i) of this standard, as well as, having an understanding of Fiqh
 - 1 al-Muamalat.
 - 2 Having a university degree in Shari'ah (Fiqh al-Muamalat Usul al Fiqh), Islamic law, Islamic finance or an equivalent academic qualification OR having a university degree or professional qualification suitable for the position with significant additional understanding of (a) above.
 - 3 Preferably 10-years (but in no case less than 5-years, e.g., in case of new markets, if so allowed by the SSB) work experience in the area of Shari'ah compliance, Shari'ah advisory, internal or external Shari'ah audit, internal audit or other relevant areas.
Having been approved by the SSB with regard to the necessary knowledge and skills in Shari'ah principles and rules applicable to the IFI and Fiqh al-Muamalat'.
28. Islamic Financial Services Board, 'Guiding Principles on Shariah Governance Systems for Institutions offering Islamic Financial Services' (IFSB-10 Principle 2.1 Cls 26-30, 2009).
29. Islamic Financial Services Board, 'Guiding Principles on Shariah Governance Systems for Institutions offering Islamic Financial Services' (IFSB-10, Appendix 4, 2009).
30. Michael Ainley and others, 'Islamic Finance in the UK: Regulation and Challenges' (The Financial Services Authority, 2007) 13.

31. Bank of England, Financial Conduct Authority, 'Combined View' <<http://fshandbook.info/FS/html/handbook>> accessed 6 January 2022. 'To support the transition to the FCA and the PRA, this section shows a combined view of all provisions made by both regulators'.
32. Bank of England, Prudential Regulation Authority, 'Approved Person' <<http://www.bankofengland.co.uk/pru/Pages/authorisations/approvedpersons/default.aspx>> accessed 6 January 2022.
33. Bank of England, Financial Conduct Authority, 'FIT 1.3 Assessing Fitness and Propriety' <<http://fshandbook.info/FS/html/handbook/FIT/1/3>> accessed 6 January 2022.
34. Alan Bainbridge and others, 'The Banking Reform Act 2013' (2014) Compliance Officer Bulletin, Legislative Comment, 24 and 27.
35. Bank of England, Prudential Regulation Authority, 'Approved Person' <<http://www.bankofengland.co.uk/pru/Pages/authorisations/approvedpersons/default.aspx>> accessed 6 January 2022.
36. Bank of England, Prudential Regulation Authority, 'Approved Person' <<http://www.bankofengland.co.uk/pru/Pages/authorisations/approvedpersons/default.aspx>> accessed 6 January 2022.
37. *Ghanshyam Batra v The Financial Conduct Authority* (2014) Weekly Law Report 3843413 [7].
38. Financial Services Market Act, s 63.
According to section 63:

'(1) The FCA may withdraw an approval under section 59 given by the FCA or the PRA in relation to the performance by a person of a function if the FCA considers that the person is not a fit and proper person to perform the function.

(1A) The PRA may withdraw an approval under section 59 in relation to the performance by a person ('A') of a function if—
(a) the PRA gave the approval, or the FCA gave the approval and the function is a significant-influence function performed in relation to the carrying on by a PRA-authorised person of a regulated activity, and

the PRA considers that A is not a fit and proper person to perform the function'.

39. *David John Hobbs v The Financial Conduct Authority* (2013) Upper Tribunal, Tax and Chancery Chamber, reference no FS/2010/0024, 37.
40. Financial Services Market Act 2000, s 56.

Section 56 states; '(1) The FCA may make a prohibition order if it appears to it that an individual is not a fit and proper person to perform functions in relation to a regulated activity carried on by—

(a) an authorised person,
(b) a person who is an exempt person in relation to that activity, or
(c) a person to whom, as a result of Part 20, the general prohibition does not apply in relation to that activity.

(1A) The PRA may make a prohibition order if it appears to it that an individual is not a fit and proper person to perform functions in relation to a regulated activity carried on by—

(a) a PRA-authorised person, or
(b) a person who is an exempt person in relation to a PRA regulated activity carried on by the person'.

41. *Michael Lee Thommes v The Financial Services Authority* (2012) Weekly Law Report 7092664 [13].

According to Berner J, 'FIT 1.3.1G provides that the Authority [FCA] will have regard to a number of factors when assessing the fitness and propriety of a person to

perform a particular controlled function. The most important considerations include competence and capability. When assessing fitness and propriety, the Authority will take account of the activities of the firm for which the controlled function is or is not to be performed, the permission held by that firm and the markets in which it operates (FIT 1.3.2G)'.

42. Michael Lee Thommes v The Financial Services Authority (2012) Weekly Law Report 7092664 [14].

As the court said, 'FIT 2.2.1G explains that, in determining a person's competence and capability the Authority will have regard to matters including (but not limited to) whether the person has demonstrated by experience that the person is able to perform the controlled function'.

43. The City Library, 'Corporate Governance in Financial Institutions' (October 2020) Compliance Officer Bulletin, 12.
44. Central Bank of Ireland, 'Corporate Governance Code for Credit Institutions and Insurance Undertakings 2013' (2013) <Corporate Governance Code for Credit Institutions and Insurance Undertakings 2013 (effective January 2015)> accessed 6 January 2022, 5 (Definitions: Institutions).
45. Central Bank of Ireland, 'Corporate Governance Code for Credit Institutions and Insurance Undertakings 2013' (2013) <Corporate Governance Code for Credit Institutions and Insurance Undertakings 2013 (effective January 2015)> accessed 6 January 2022, 5.

The code defines corporate governance as;

'Procedures, processes and attitudes according to which an organisation is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organisation – such as the board, managers, shareholders and other stakeholders – and lays down the rules and procedures for decision-making'.

See also: Central Bank of Ireland, 'Corporate Governance Code for Credit Institutions and Insurance Undertakings 2013 – Frequently Asked Questions' (2014) <Corporate Governance Code for Credit Institutions and Insurance Undertakings 2013 – Frequently Asked Questions> accessed 6 January 2022, 3.

46. Central Bank of Ireland, 'Fitness and Probity for Regulated Financial Service Providers' <<http://www.centralbank.ie/regulation/processes/fandp/Pages/IntroductiontoFitnessandProbity.aspx>> accessed 6 January 2022.
47. European Banking Authority, 'Guidelines on the Assessment of the Suitability of Members of the Management Body and Key Function Holders' (2012) <<https://www.eba.europa.eu/documents/10180/106695/EBA-GL-2012-06-Guidelines-on-the-assessment-of-the-suitability-of-persons-.pdf>> accessed 6 January 2022.
48. Directive 2006/48/EC of the European Parliament and of the Council, 'Relating to the Taking Up and Pursuit of the Business of Credit Institutions' <[http://www.centralbank.ie/regulation/industry-sectors/investment-firms/mifid-firms/documents/2006%2048%20ec%20\(consolidated\).pdf](http://www.centralbank.ie/regulation/industry-sectors/investment-firms/mifid-firms/documents/2006%2048%20ec%20(consolidated).pdf)> accessed 6 January 2022

Article 12 states; 'The competent authorities shall not grant authorisation for the taking-up of the business of credit institutions unless they have been informed of the identities of the shareholders or members, whether direct or indirect, natural or legal persons, that have qualifying holdings, and of the amounts of those holdings'.

49. European Banking Authority, 'Guidelines on the Assessment of the Suitability of Members of the Management Body and Key Function Holders' (2012), 3 <<https://www.eba.europa.eu/documents/10180/106695/EBA-GL-2012-06-Guidelines-on-the-assessment-of-the-suitability-of-persons-.pdf>> accessed 6 January 2022.

50. European Banking Authority, 'Guidelines on the Assessment of the Suitability of Members of the Management Body and Key Function Holders' (2012), 11 <<https://www.eba.europa.eu/documents/10180/106695/EBA-GL-2012-06-Guidelines-on-the-assessment-of-the-suitability-of-persons-.pdf>> accessed 6 January 2022.
51. European Banking Authority, 'Guidelines on the Assessment of the Suitability of Members of the Management Body and Key Function Holders' (2012), 17 <<https://www.eba.europa.eu/documents/10180/106695/EBA-GL-2012-06-Guidelines-on-the-assessment-of-the-suitability-of-persons-.pdf>> accessed 6 January 2022.
52. Central Bank of Ireland, 'Fitness and Probity Standards (Code Issued Under Section 50 of the Central Bank Reform Act 2010)' (s 2, 2014).
53. Central Bank of Ireland, 'Fitness and Probity Standards (Code Issued Under Section 50 of the Central Bank Reform Act 2010)' (s 3, 2014).
54. Central Bank of Ireland, 'Fitness and Probity Standards (Code Issued Under Section 50 of the Central Bank Reform Act 2010)' (s 3 (1), 3 (2) (d) and (e) 2014).
55. Bashra H. Malkawi, 'Shari'ah Board in the Governance Structure of Islamic Financial Institutions' (2013) 61 *The American Journal of Comparative Law* 539, 570.
56. Michael Ainley and others, 'Islamic Finance in the UK: Regulation and Challenges' (The Financial Services Authority, 2007), 13.
57. Financial Conduct Authority, 'TC 2.1 Assessing and Maintaining Competence' (FCA Handbook) <<https://www.handbook.fca.org.uk/handbook/TC/2/1.html>> accessed 6 January 2022.
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59. Todd J Schmid, 'The Real Shariah Risk: Why the United States Cannot Afford to Miss the Islamic Finance Moment' (2013) *University of Illinois Law Review* 1293, 1332.
60. Accounting and Auditing Organization for Islamic Financial Institutions, 'Governance Standards for Islamic Financial Institutions', Governance Standard No. 5, para 2.
61. Accounting and Auditing Organization for Islamic Financial Institutions, 'Governance Standards for Islamic Financial Institutions', Governance Standard No. 5, para 4.
62. Islamic Financial Services Board, 'Guiding Principles on Investor Protection in Islamic Capital Markets' (IFSB-24 s 2.5.5 Principle 14, 2020).
63. Goldman Sachs International, 'Base Prospectus' (18 October 2011) <https://ise-prodnr-eu-west-1-data-integration.s3-eu-west-1.amazonaws.com/legacy/Base+Prospectus_5aedf90a-b1dd-4f91-b743-44b9e2861a66.pdf> accessed 6 January 2022.
64. Archana Narayanan, 'UPDATE 1 – Goldman Sachs Gets Strong Demand for Landmark Sukuk Issue' Reuters (16 September 2014) <<https://www.reuters.com/article/goldman-sukuk-launch-idUSL6N0RH2RH20140916>> accessed 6 January 2022.
65. Siti Faridah, 'The Islamic Financial Services Industry: The Shariah Board's Governance Framework' (2013) *Company Lawyer* 297, 299.
66. Andrew Torchia, 'Goldman Advisor Defends \$2Bn Islamic Bond Scheme' *Reuters* (2 January 2012) <<https://www.reuters.com/article/goldman-sukuk-controversy-idUSL6E7NV08O20120102>> accessed 6 January 2022.
67. Accounting and Auditing Organisation for Islamic Financial Institutions, 'Governance Standards for Islamic Financial Institutions', Governance Standard No. 4, para 8.

68. Accounting and Auditing Organisation for Islamic Financial Institutions, 'Governance Standards for Islamic Financial Institutions', Governance Standard No. 2, para 3.
69. Accounting and Auditing Organisation for Islamic Financial Institutions, 'Governance Standards for Islamic Financial Institutions', Governance Standard No. 2, para 5.
70. Accounting and Auditing Organisation for Islamic Financial Institutions, 'Governance Standards for Islamic Financial Institutions', Governance Standard No. 2, para 6.
71. Accounting and Auditing Organisation for Islamic Financial Institutions, 'Governance Standards for Islamic Financial Institutions', Governance Standard No. 6, Appendix C.
72. Islamic Financial Services Board, 'Guiding Principles on Shariah Governance Systems for Institutions Offering Islamic Financial Services' (IFSB-10 Cls 3(d), 2009).
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75. David Firth, 'International Islamic Finance' (M.A. thesis, University of Durham 1990), 136.
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4. Accounting and Auditing Organisation for Islamic Financial Institutions, 'Governance Standards for Islamic Financial Institutions', Governance Standard No. 3.
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6. Accounting and Auditing Organization for Islamic Financial Institutions, 'Governance Standards for Islamic Financial Institutions', Governance Standard No. 5.
7. Accounting and Auditing Organisation for Islamic Financial Institutions, 'Governance Standards for Islamic Financial Institutions', Governance Standard No. 6.

8. Accounting and Auditing Organisation for Islamic Financial Institutions, 'Governance Standards for Islamic Financial Institutions', Governance Standard No. 9.
9. Ainley M. and others, 'Islamic Finance in the UK: Regulation and Challenges' (The Financial Services Authority, 2007).
10. Bainbridge A. and others, 'The Banking Reform Act 2013' (2014) Compliance Officer Bulletin, Legislative Comment.
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Conclusion

The collapse of the Lehman Brothers triggered the financial crisis of 2008 which shook the global financial system. All four International Financial Centers (IFCs) could not avoid the shocks of the financial crisis in 2008. The crisis questioned de-regulation in the US financial markets. Tokyo, Singapore, and HK dealt with the effects through reforms to their respective financial regulations and supervisions. The UK could survive the bank run on Northern Rock through state guarantee to the bank depositors. UK regulatory framework did not need an extraordinary reform.

Owing to its stable regulatory framework, London developed the Islamic finance (IF) market in the country. There is a huge influx of IF activities which include five Islamic banks, numerous Islamic funds, sukuks including two sovereign sukuk trading in the international capital market, and many educational institutions offering degrees in IF. The British government has been actively engaged in the promotion of London as a hub of IF.

However, the IF industry in the UK is threatened by the current Brexit deal. The deal doesn't specify regulation of financial services between the UK and the EU. This simply means that Brexit deprives the UK from the benefits of a passporting facility that allowed it access to Euro states. In other words, the Euro market is not so conveniently accessible to the IF investors in the UK.

There is an outflux of financial service providers from London to Dublin for obvious reasons, i.e., Dublin is a euro member state which is the most suitable place to operate in Europe while having convenient access to euro member states. Thus, IFSC Dublin has a great opportunity to set up a euro-zone hub of IF in the country. In this regard, IFSC would like to contribute to the growth and development of the global IF market too.

This author suggests that IFSC can help the global IF industry overcome the challenges of standardization by becoming a member of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). AAOIFI has the resources and potential to lead the global IF industry into standardization through the introduction of model laws, international Islamic finance law reforms, and provision of *amicus curiae* which should prevent unfavorable precedent such as set in *Shamil Bank vs Beximco Pharmaceuticals*.

The financial system in Islamic countries comprises of both conventional as well as Islamic finance.¹ Malaysia has advanced the global Islamic financial industry by developing the Islamic legal system to deal with Islamic financial disputes. The UAE is another emerging hub of Islamic finance. Legal and regulatory systems in Malaysia and the UAE are discussed to suggest a regulatory mechanism for Irish court to avoid Shariah complaint risk during proceedings.

Moreover, as an alternate dispute resolution mechanism, International Commercial Arbitration (ICA) and International Investment Arbitration (IIA) serve the global IF industry well. Although exception of public policy has been exercised in multiple occasions by both western countries as well as middle eastern countries to refuse enforcement of arbitral awards. Collaborative centers will help streamline the public policy concerns in the ICA. Interestingly, IIA ensures complete protection to foreign investors in state-investor agreements, which is a positive aspect of sukuk's dispute settlement process.

Finally, the introduction and development of Islamic corporate governance will overcome Shariah risk and Shariah Arbitrage. Scholars employed as executive directors will also promote innovations along with genuine shariah compliance. This is possible as scholars will be required to obtain both conventional as well as shariah qualifications. Scholars will have complete authority over the product development process which will ensure innovation and shariah compliance that will encourage substantial as well as formal compliance. This tendency will revolutionize the global IF industry as it will no longer remain just a replica of conventional finance.

Note

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Index

- AAOIFI Governance Standards 43, 47, 160, 210
- Administration of Muslim Law Act (AMLA) 28
- All Party Parliamentary group 100
- Amanie Advisors 99
- Anzen 39
- Arbitration: American Arbitration Association (AAA) 177, 183; Asian International Arbitration Centre (AIAC) 181; Basyarnas/National Shariah Arbitration Body 182, 192; Cairo Regional Centre for International Commercial Arbitration (CRCICA) 182; i-Arbitration 181–182; International Islamic Centre for Reconciliation and Arbitration (IICRA) 152, 182; London Court of International Arbitration (LCIA) 41, 177–178; The Arbitration Act 1698 184; The Arbitration Act 1979 184; The Arbitration Law 1983 181; The Arbitration Law 2012 181; The Islamic Centre for Reconciliation and Arbitration (IICRA) 182; The Saudi Arbitration Law 2012 181; 2021 Global Arbitration Review Award for Regional Institution 183
- Asia Pacific region 26
- Asian Currency Unit 22
- Asian Dollar Market (ADM) 20–21
- Auditors 6, 7
- Bad debts 6, 34, 38, 40
- BAFIA (Amendment) Act 1996 51
- Bahrain Chamber for Dispute Resolution (BCDR-AAA) 183
- Bailout 9, 13–15, 35, 39
- Bank deposits 9, 26
- Bank Islam Malaysia Berhad (BIMB) 50, 56, 58–59
- Bank Kerjasama Rakyat Malaysia 50
- Bank of America 6, 25
- Bank of Credit and Commerce International (BCCI) 5, 6, 7, 11, 205, 213
- Bank of England 5, 6–7, 10, 34, 100–101, 105
- Bank of Japan 38–39
- Bank Run 5, 9, 11, 104
- Banking Act 1970 21, 28
- Banking Act 1979 5–6
- Banking Act 1987 5–6, 11
- Banking and Financial Institutions Act 1989 (BAFIA) 49, 51, 58
- Banking and Financial Services Act 1989 52
- Banking Law of 1981 37
- Banking Reform Act 2013 207
- Barclays 25, 100
- Barings Brother and Co Ltd. 7
- Barings Crisis 1995 7, 11
- Bay Bithaman Ajil (BBA) 57–59
- Bear Stearns 13
- Bilateral Investment Treaties (BITs) 176, 185
- Bingham Report 7
- Black Monday 4, 30, 32
- Blackstone 17, 92
- Blair 19
- BNP 33
- Bretton Woods 30, 34
- Broad-based eligibility 15–16
- Bubble 4, 12, 35, 39–40
- Business Registration Act 28
- Business Trusts Act 28
- Capital adequacy standards 27
- Capital Market Masterplan 2001 48, 52, 60

- Capital Markets and Services Act 2007 53, 56
- Cathay Pacific Airways Limited 32
- Central Bank 8, 20–21, 30, 48–49, 51–52, 54–56, 59–60, 105, 135, 181, 195, 208–209, 212
- Central Bank of Malaysia Act 1958 52, 54, 56, 181, 192
- Central Bank of Malaysia Act 2009 52, 54, 56, 59
- Charles Proctor 110
- Chris Howard 99
- Citigroup 17, 19, 25
- Collateral Debt Obligations (CDOs) 9
- Companies Act 1965 50, 53
- Computerized Trading 32
- Conflict of interest 11, 160, 202, 204, 210, 213
- Consumer Financial Protection Bureau 15
- Consumption 10, 25, 35–36
- Consumption economy 35
- Court: Admiralty Court 91; Court of Chancery 89; Court of First Instance (CFI) 32–33, 44, 46; Court of Staple 91; Dubai Courts 42, 44, 46, 48; Fair Courts 91, 96; London Court of International Arbitration (LCIA) 41, 177–178; New Zealand High Court 96; Shariat Court 28, 56–57; Singapore International Commercial Court (SICC) 21, 23, 24, 29; Supreme Court of Judicature Act 1969 24; Technology and Construction Court (TCC) 97
- Credit Transaction 6, 131, 134
- Daiwa Securities Ltd 38
- Dana Gas Sukuk 155
- Default 6, 12, 14, 40, 54, 57–58, 106–108, 110, 142
- Deposit Transaction 131, 134
- De-regulation 11, 16, 35, 60
- Devaluation 25, 31
- DIFC Wills and Probate Registry 41
- Disclosure Requirements 7, 11, 31, 37, 53, 157, 204–206
- Dodd-Frank Act 2009 15–19
- Domestic Demand 35, 37
- Dr Morrison 113
- Dubai Courts 42, 44, 46, 48
- Dubai Financial Services Authority (DFSA) 41–44, 46
- Dubai International Finance Center (DIFC) 4, 40, 41, 42, 44–48
- Economic Growth Regulatory Relief and Consumer Protection Act (EGRRCPA) 16
- Emergency Economic Stabilization Act 2008 (EESA) 14–15
- Emergency loans 15–16
- Euro region 131, 139
- European Banking Authority (EBA) 208
- European market 20–21
- European Shariah Supervisory Council (ESSC) 212
- Exchange Control Act 1953 21
- Federal Budget 2004 54
- Federal Reserve 13–17
- Finance Act 2003 101
- Finance Act 2005 101
- Finance Act 2010 131, 133–134, 137
- Finance and Probity Standard 209
- Finance Companies Act 1967 21
- Financial Conduct Authority (FCA) 5, 10–11, 207–208
- Financial Futures Law 37
- Financial Promotion Department 23
- Financial Reconstruction Law 39
- Financial Sector Master Plan (FSMP) 48, 52, 60
- Financial Services Act 2012 (FSA) 5, 8–11, 51
- Financial Services Act 2013 (FSA) 5, 8–11, 51
- Financial Services Reform Law 38
- Fit and Proper Test 113, 207–209
- Flaux J 108
- Foreign Exchange Act 1970 20–21
- Foreign Exchange and Trade Control Act of 1949 37
- Fragmented legal system 16–17
- FSMP 48, 52, 60
- Gen-Saki transactions 35
- Geographical relocation 17
- Glass-Steagall Act 11–12, 14, 16
- Global Crisis 2008 8, 26
- Global Trends in Islamic finance and the UK market 100
- Government of Morocco 187
- Government of Singapore Investment Corporation (GIC) 26, 29
- Great depression 5, 11, 20, 60
- Guidelines on the Offering of Islamic Securities 53
- Guidelines on Unit Trust Funds 53

- Halal Mutual fund 99
 Hang Seng Index 31–32, 34
 House of Commons 8
 Housing prices 12
- Ikeda Hayato 35
 Ilhas Finance House (IFH) 205
 Ilhas Finance House of Turkey 213
 Impact loans 37
 Income Doubling Plan of 1960 35
 Industrial Policy of Japan 35
 Informal Supervision 5, 8, 10
 Initial Public Offering (IPO) 17
 Inter-Bank Money Market 50
 International Centre for Dispute Resolution (ICDR) 183
 International Chamber of Commerce 178
 International Dispute Resolution Procedures (IDRP) 183
 International Financial Center (IFC) 4–5, 11, 20–22, 29, 35, 40
 International Islamic Finance Market (IIFM) 152
 International Islamic Fiqh Academy of OIC 211
 Investment Company 17, 108–109
 Investment Liberalization and Investment Protection 191
 Investment Transaction 131
 Investor's Ordinance 1974 29–30
 Irish Law Reforms Commission 138
 Irish Stock Exchange 134–135, 210
 Islamic Bank of Asia 26–27
 Islamic Bank of Britain (IBB) 102
 Islamic Banking Act 1983 48–49, 52
 Islamic Banking Scheme 1993 52
 Islamic Development Bank (IDB) 98, 157–158
 Islamic Finance Advisory Council 42
 Islamic Finance Advisory Group 100
 Islamic Finance Rules 41–43, 47
 Islamic Financial Business (IFB) 2004 42
 Islamic Financial Services Act 2013 (IFSA) 51–52, 55
 Islamic Financial Services Board (IFSB) 27, 153, 202
 Islamic Instrument Study Group (IISG) 55
 Islamic Insurance Association of London (IIAL) 100
 Islamic International Rating Agency (IIRA) 157
 Islamic Transnational Law 141
 Islamic Window 41–43, 50–51, 99
- J Paul McCutcheon 139
 Japan Offshore Market 35, 37
 Japanese government 36
 John Foster 112
 Johnson Matthey Bank (JMB) 5–6, 11
 Judicial Appointment Commission (JAC) 97
 Jusen Problem 39
 Justice Henchy 137
 Justice Jackson 97
 Justice Linares 140
 Justice Morison 106, 109
 Justice Ramsey 97
- Kelantan Malay Reservation Enactment 1930 (KMRE) 58
- Lebanese company 107
 Legal Profession Act 1966 24
 Lehman Brothers 12–14, 33–34
 Li Ka Shing 33
 Liberalization 35–40, 52
 Limited Liability Partnership Act 28
 Limited Partnership Act 28
 Liquidation 8, 11–13, 15, 33, 35, 39
 Liquidity Coverage Ratio (LCR) 104
 Liquidity crisis 9
 Liquidity risk 9, 104
 London 5–8, 19, 26, 41, 88, 90, 93, 95, 98–101, 112–113, 139, 162, 177–178
 London Stock Exchange 93
 Long-Term Credit Bank of Japan (LTCB) 39
 Lord Chief Justice Mansfield 93
 Lord George 101
 Lord Justice Potter 107, 109
 Lord Sheikh 100
 Lost Decade 4, 40
- Malaysian Code on Corporate Governance 2012 53
 Malaysian Code on Takeovers and Mergers 2010 53
 Manufactured products 25
 Market manipulation 19, 31, 35
 Market Misconduct Tribunal (MMT) 33
 Martin Act 19–20
 MAS Act 1971 20–21
 Mens rea 19–20
 Merrill Lynch 25
 Meydan Group 45–46
 Michael Randall 112
 Middle East and South Asia Banks 98
 Mini Bonds 33–34

- Minimum Capital 5–6, 11, 22
- Model Netting Act (MNA) 162
- Model Netting Law (MNL) 162
- Ministry of Finance 26–27, 37–39
- Monetary Authority of Singapore (MAS), 4, 7, 8, 17, 21–23, 25–29
- Monetary policy 8, 12, 25, 51
- Moral hazards 10, 13–14, 16
- Mortgage 9, 12–14, 100–101
- Mortgage-backed securities 9, 12–13
- Multiple Stamp Duty Land Tax (SDLT) 101, 134
- Muslims Ordinance of 1957 28

- Nakasone Yasuhiro 37
- National Central Cooling Company (Tabreed) 99
- National Steering Committee 48, 49
- Naz Shah 100
- Net Stable Funding Ratio (NSFR) 104
- New York 19, 39, 44, 47, 161, 179
- New Zealand High Court 96
- New Zealand's Reciprocal Enforcement of Judgements Act 1934 95
- Nick Leeson 8
- Nikko Securities Ltd 38
- Nippon Credit Bank (NCB) 39
- Nixon Shock 31
- Nomura Securities Ltd 38
- Non-Performing Loans (NPL) 39
- Northern Rock (NR) 9, 11, 14, 45

- O'Flaherty J 138
- Off-shore Banking Unit (OBU) 38
- Oil crisis 31, 34, 37
- Organization of the Petroleum Exporting Nations (OPEC) 36

- PCCW Limited 33–34
- Personal liability 20, 31–32
- Policy making 4, 11
- Port Folio Insurance 32
- Positive religious discrimination 137
- Precious (HK) Ltd 108–109
- Prevention of Bribery Ordinance 32
- Principle-based approach 10, 16–17, 20
- Protection of Investor's Ordinance 34
- Prudential Regulatory Authority (PRA) 5, 10, 11
- Punitive supervision 16, 19–20
- Purchase Undertaking 45

- Raymond Byrne 139
- Recession 12–13, 25–26, 36, 40, 60
- Referendum 2016 112
- Registration of Shariah Advisors Guidelines 53
- Regulatory arbitrage 16–17
- Regulatory response 5, 20, 34
- Reporting requirements 11
- Risk profile 22, 104, 157
- Risks 8, 11–12, 15, 22, 202–203
- Rome Convention 105–107, 113, 138, 167–168
- Ronald Li Fook Shiu 32
- Royal Mint 99
- Rule-based 16–17, 19–20

- Safe Haven 9
- Sarbanes-Oxley Act 14, 19
- Securities and Exchange Law (SEL) 37
- Securities and Future Commission (SFC) 4, 27, 32–34
- Securities and Future Commission Ordinance 30
- Securities Commission of Malaysia 54–55
- Securities Exchange Commission 15
- Securities Exchange Surveillance Commission (SESC) 38
- Securities Industry Development Center (SIDC) 54
- Securities Ordinance 30–31, 33–34
- Securitization 9
- Self-regulation 4–6, 8, 10
- Shariah Advisory Board 28, 142, 212
- Shariah Supreme Councils (SSCs) 212
- Shariat Court 28, 56–57
- Sheikh Zayed Road 40, 46
- SIMEX 7–8
- Singapore International Commercial Court (SICC) 21, 23, 24, 29
- Skim Perbankan Islam (SPI) scheme 50–52, 56–60
- Skim Perbankan Tanpa Faedah (SPTF) scheme 50, 59
- Small Claims Tribunal 41
- Smithsonian Agreement 31
- Solomon Brothers 161
- Special Purpose Vehicle (SPV) 133, 155
- Specified Financial Transaction 131, 134
- Standard Chartered 25–27, 100
- Star chamber 90–91
- Stimulus package 21, 26, 29
- Stock Market Crash 1973 29, 30, 34, 60
- Stock Market Crash of 1987 4, 30, 32
- Stockbrokers Act 1697 5
- Strategies 8, 11, 22, 52, 104, 131, 185, 189, 204–205

- Strict regulation 11, 15–16, 20, 29, 60
 Structural Development Initiative 35
 Structural Impediments Initiative (SII) 37
 Sumitomo Trust 39
 Supervision 5–11, 16, 19–20, 22, 185, 203, 205, 207, 211
 Supervisory functions 203
 Supreme Court of Judicature Act 1969 24; Admiralty Court 91; Court of Chancery 89; Court of First Instance (CFI) 32–33, 44, 46; Court of Staple 91; Fair Courts 91, 96
 Symphony Gems Nevada 108
 Systemic failure 10, 14
- Taskforce on Economic Challenge (TFEC) 30, 34
 Tax treatment 17, 131–134
 Technology and Construction Court (TCC) 97
 Temasek Investment 25–26, 29, 60
 Teresa May 112
 The Bank of England Alternate Liquidity Facility 105
 The Barnard's Act 1735 93
 The Board of Grievances 181
 The Central Bank Act 1971 135
 The Central Bank of Ireland 135, 208–209, 212
 The Central Bank of Malaysia Act no. 701 in 2009 181
 The Choice of Jurisdiction Clause 95
 The Contract Act 1990 105
 The Corporate Governance Code for Credit Institutions and Insurance Undertakings 2013 208
 The Department of Finance 131–132
 The Equal Protection 179–180, 191
 The European Union 111
 The European Union Collateral Directive 164
 The International Standards Organization (ISO) 161
- The Judicature Act 1873 90
 The London Metal Exchange (LME) 98
 The Maastricht Treaty 111
 The Number and III Practice of Brokers and Stock Jobbers (the Brokers's Act 1969) Act 1696 93
 The Shariah Compliant Facility (SCF) 105
 The Taxes Consolidation Act 1997 133
 The Treaty on the Functioning of the EU 111
 Tiger Asia 32
 Tokyo International Financial Future Exchange (TIFFE) 37
 Tokyo Kyowa 39
 Too-big-to-fail 15
 Treasury 9, 14–15, 100, 107
 Treasury Pool 107
 Treaty of Rome 111
 Treaty on European Union 112
 Troubled Asset Relief Program (TARP) 14–15
 Troubled Assets 14–15
- UK Employment Equity (Religion of Belief) Regulation 2003 179
 UK Islamic Banks (UKIBs) 100
 UNCITRAL model 42, 181
 United Nations Convention on Contracts for the International Sale of Goods (UNCCISG) 177
 Universal Banking 49
- Western Hub 100
 World Gold Council 99
 World Intellectual Property Organization (WIPO) 177
 World Islamic Economic Forum 100
 World War II 111–112
 Yamaichi Securities Ltd 38